

Response to Consultation by

the Single Electricity Market Committee on

Administered Scarcity Pricing Review Consultation

Electricity Association of Ireland

Status: Final

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The Electricity Association of Ireland (EAI) is the representative body for the electricity industry and gas retail sector operating within the Single Electricity Market (SEM) on the Island of Ireland.

Our membership comprises utilities that represent 90% of generation and retail business activities and 100% of distribution within the market. Our members range in size from single plant operators and independent suppliers to international power utilities.

We believe that electricity has a fundamental role in providing energy services in a decarbonised, sustainable future, in particular through the progressive electrification of transport and heating. We believe that this can be achieved, in the overall interest of society, through competitive markets that foster investment and innovation.

We promote this vision through constructive engagement with key policy, regulatory, technology and academic stakeholders both at domestic and EU levels.

We represent the Irish electricity industry in EURELECTRIC, the representative body for the European electricity industry, and help shape the broader European response to developing policy and legislative initiatives.



Introduction

EAI members welcome the opportunity to engage in this public consultation on the Administered Scarcity Pricing Review. We understand that Security of Supply concerns, and a perceived masking of scarcity given lack of ASP events, has prompted the RAs to reflect on the function of administered scarcity pricing in SEM. Specifically, the RAs appear to be considering different options to amend the trigger for the Administrative Scarcity Price (ASP) in an effort to increase the signal for the market to respond to the ongoing tightness in the system; purposely triggering ASP pricing events.

We are of the view that it is flawed to purely consider the lack of triggering of the ASP as a signal that there is a single factor masking scarcity and attributing this to the algebra in an effort to consider whether in isolation, ASP had a better chance historically of being triggered. We appreciate this was the position both in the previous discussion paper on ASP as well as the proposed scope for improvement from the CRM review conducted by Ernst and Young

Industry has been consistent in articulating its view that triggering of ASP more frequently will not lead to long-term investment signals and will not have the desired effect on reliability if the majority of capacity providers are already locked into the Capacity Contracts and associated which already provide the strong reliability incentive of RO difference payments. Our members have also been clear that a purely theoretical exercise in the ASP ignores the market realities, such as the fact that the RO Strike Price helps protect customers from higher prices. There is nothing new in this paper that suggests these fundamental design outcomes have been considered. It still remains unclear to our members what the SEMC is expecting to achieve by this paper and from the 3 options being proposed. For the avoidance of doubt, all our members (suppliers and generators) are unanimously unsupportive of the 3 options proposed due to concerns around unintended consequences and the fact that none of these options consider the market realities, the existing regulatory risks and penalties on units to be reliable and to price at cost in the SEM.

Furthermore, it is the EAI's view that all the ASP proposals contained in this paper, have been considered completely in isolation, and external factors such as connection via Celtic (larger capacity single in-feed and EU market reintegration), revised Value of Loss of Load, and implementation of Electricity Balancing Guidelines have not been considered where all these factors will change the operation of the ASP. In addition, there is no recognition that the SEM is heavily collateralised meaning higher prices mean higher collateral burden for market participants, that this would make the consumer financially worse off from bearing participants' bidding risk premia. Lastly, the potential for sustained higher prices to widen the "hole in the hedge" has also not been considered, especially where the Socialisation Fund is now serving an additional purpose in DSU payments.

EAI Position on Options Presented in Paper

Option 1 is not an acceptable option for our members. ASP is reserved for the Balancing Market, which is a short-term market, therefore, short-term reserve is completely appropriate for this calculation and for this requirement for flexible response. It should be noted that if short term reserve is removed from this calculation entirely, it would effectively kill the market for short term flexible storage in the SEM because currently there are no other markets that these assets can participate in. While we reject all three options, perhaps a suitable solution could be to apply a scalar to this calculation, that does not remove "interruptible load", but is based on duration of reserve load, as a

sliding scale. Responses to the previous ASP discussion paper did signal that rather the focus for incentives should be laid at the TSO to better motivate scenarios where reserve is taken. As we have seen in the past, reserve has been preserved via the use of high-priced interconnector trades instead. Where there are not stronger signals or incentives for the TSO to draw down reserve, there will never be a situation where the market conditions will match true scarcity since Replacement Reserve will continue to look healthy, whilst ASP will only be triggered in isolation and hit generators.

Both 2a and 2b are unacceptable options for our members. These options will lead to hikes in imperfections charges which is a risk for all market participants, and negatively impacts customers. TSOs have perfect knowledge of how their constraints are operated. Therefore, these should not be added into a calculation based on reliability for generation, where generators cannot mitigate this external risk. Constraints are a system issue. Given the recent SEMC decision¹ and subsequent modification, Mod_04_23², which sought to address unfair impacts of external risks on in merit units, these options (2a and 2b) are in complete conflict with that approach of appropriate risk apportionment. This interaction of principles should be reviewed in the context of considering constraints being appropriate to include in the ASP. Particularly, in the case of the North South Tie Line (option 2a) where it was shown in 2018 that it was inappropriate for this system constraint to affect cash out, it should then be treated like interconnectors are in Mod_02_21. On the basis that the North South Tie Line is effectively a landlocked interconnector, and its operation would be a system action, its effects should be flagged out of cash out in the same way as in Mod_02_21.

It is important to point out that options 2a and 2b will also make scarcity more locational if targeted as part of the RSP. RSP is an all-island market signal and therefore should not be set in a way that could create locational effects. If looking at all-island system alerts alone, only a handful have in fact occurred and many of them on the basis of system actions or otherwise benign events, rather than always on the basis of an early signal of stress prices. This has not been considered as in itself a signal as to why ASP has not been triggered, namely that there still remain issues that can still trigger the RO Strike Price at times when there is not a system issue and clearly not an all-island event to warrant its triggering. The approach for options 2a and 2b appears to be dangerously shoehorning how RSP would align to past system alerts that are based on system issues and less about capacity adequacy. This paper confuses again, constraints versus energy actions. These are not interchangeable and have very different effects.

Adequate Incentives for Reliability

The paper references unit unreliability in a negative light, inferring that units are not acting responsibly. This is viewed as an unfair characterisation given the significant and various mechanisms in place to incentivise unit reliability: RO strike price and difference payments, trip charges, no load costs, Grid Code obligations around timely return from outages - none of which are inconsequential or immaterial. As responsible generators and as per Grid Code, units are obliged to be available in a timely manner

¹ <u>Applicability of RO NPDC to Available In-merit Units - Decision Paper 0.pdf (semcommittee.com)</u>

² https://www.sem-o.com/documents/market-modifications/Mod 04 23/Mod 04 23DecisionLetter.pdf

that is also appropriate for the safe operation of the unit, after an outage or trip. Units should not be considered somehow wilfully withholding generation intentionally.

An important factor in wishing for higher prices in the market, is that the SEM is a heavily collateralised market. Higher scarcity prices in the market mean higher collateral needing to be posted to support the risk of heavier losses in the market. This would affect price takers like wind assets the most. This symmetric factor and impact to a business has not been considered at all in this theoretical review of ASP but goes hand-in-hand with triggering of scarcity prices.

Units at all times are acting commercially to be able to actively get remunerated for their generation, and therefore would rather be on load than not on load (where profitable). This very fact is why the view of unreliability somehow needing yet another penalty through ASP, is viewed unfairly by our members. It must also be realised from EirGrid modelling that there is a significant amount of generation on the system that is over 20 years old. Older plant require more maintenance to keep them operational and this will increase as SNSP increases which will increase the variability of dispatch of conventional generating units and increase wear and tear. There has never been any acknowledgement of these facts when SEMO, EirGrid or the SEMC are pointing out unit unavailability. Market signals and increntives for entry (or for the refurbishment of existing units) have yet to be strong enough to replace all these units that we expect should be net zero. Therefore, any perceived challenges with unavailability will not be remedied by further penalty and could rather produce an exit signal, without sufficient strong signals and process around repowering or refurbishment.

Limitation of exposure

Stop loss limits are mentioned as a suitable check to limit exposure for generators, and the socialisation fund for suppliers. However, the socialisation fund is not solely a protection for suppliers any longer as it is being utilised as a mechanism for DSU payments. Stop Loss Limits at 1.5 times is not immaterial since this market is also heavily collateralised (as above), and there is no well operating secondary trading market. If these measures did adequately protect from undue exposure, it remains an unsuitable defence for creating a change that would cause more frequent high prices at a time where cost of living is of critical importance to customers. Higher prices in the market, where we see that even amber alerts can happen due to benign reasons, would create undue distress.

Lastly, with respect to exposure, the SEMC has never acknowledged the regulatory risks and uncertainty associated with pricing at scarcity. Market outturn data shows very few units are taken on the "buy" side at prices higher than the RO Strike Price. In addition, the bidding principles in this market (BCOP) focus on pricing at cost (Short-Run Marginal Cost), which is an overarching requirement (for complex bids). SRMC and scarcity cannot exist within the same boundaries, and the expectation that scarcity could be priced in this market is not provided for within bidding principles. Therefore, parties to this market face likely regulatory scrutiny of extreme pricing (as has been demonstrated since SEM go-live with either modifications to reduce impacts in cash out, or modifications to limit extreme (negative) pricing as this was impacting price takers). This regulatory jeopardy does not appear to have been considered in the analysis of why scarcity pricing is not triggered.

Secondary Trading

Secondary trading is still insufficiently robust to assist generators to reasonably hedge their exposure to RO strike price even before scarcity can be considered. There are modifications in the TSC relating to secondary trading, which are still awaiting completion since 2021. It is unconscionable to implement such exposure to scarcity when there are insufficient mechanisms for hedging of this risk.

Scarcity Pricing as a Business Case for Non-RO Holders

The paper talks about the intention of the ASP as an investment signal for non-RO holders. There are no businesses that could make an investment case purely on the basis of temporary scarcity pricing, to enter the market. Investment in generation has a time horizon of 15-20 years at minimum. ASP is a Balancing Market signal only, and is a temporary, short-notice signal in a short-notice market. It could therefore never realistically be considered the long-term signal to encourage sustainable investment.

The SEMC needs to acknowledge that the commercial investor case in SEM is currently lacking confidence due to piecemeal, uncoordinated changes and isolated, theoretical, principle-based decision-making. All generation in the market would prefer to expand their offerings and provide support to the system for system services, capacity, reserves, future net zero needs—but at present, these ASP pricing proposals lack any holistic consideration, and are simply an example of what our members view as a disjointed approach to market design purely on the basis of cost minimisation and blunt regulatory signals in what should be a fully open and competitive market.

General Comments on ASP Proposals

The premise on which the proposals are based, that the ASP is not working as expected, is flawed. The ASP is a trigger to mitigate against significant system issues and is triggered when we are close to exhausting our reserve requirements (or when load shedding becomes necessary). ASP is logically linked to a possible Red Alert scenario currently, which is prudent. It is also a scenario that is by its construction, designed to be rare.

System alerts in the SEM have not been related to supply scarcity and have therefore not triggered a scarcity price response. It should be recognised that the capacity market is intended to meet an 8-hour security standard, not to prevent Amber Alerts, and that the SEM is an unconstrained energy market designed to efficiently allocate risk and provide the necessary price signals to invest in grid and system operations where required.

In this paper again, there is a view advocating for higher prices more frequently and that this will protect customers. At no point has the SEMC ever evidenced the expected benefits of more frequent scarcity pricing. The EY report where this was recommended repeatedly, never provided the analysis to demonstrate that their isolated analysis of the CRM market and the signals it should have for entry, translated to a full SEM market understanding of the impacts and benefits of more frequent scarcity.

This consultation completely disregards other related triggers and design features that would affect scarcity such as single largest in-feed changes and design of VOLL and EBGL. There is no future proofing aspect and benefit considered in this consultation, only a view that an older mechanism installed in the market has not been triggered. Capacity is not delivering; emergency generation has

been required for the system to be supported—this should be a sufficient indication that there are more pressing deficiencies in the capacity arrangements designed to ensure security of supply.

Problems with correlation of DSR and ASP

Considering the other aspect of the paper, it is clear that an intended outcome in adjusting the trigger for RSP, is greater demand side response during times of scarcity. We consider that this is not a guaranteed, substantiated or certain outcome. Historic high (or negative) prices have not been matched with changing behaviour from some DSR. It is unlikely therefore that this alternative measure will encourage DSU availability to improve significantly, especially by sharpening the penalty for being unavailable after contracts with customers have been struck. Furthermore, the impacts to all capacity contract holders (including DSR) of this change, as discussed above, is a disproportionate effect of this proposal.

It is an important factor in this discussion that DSU contracts would likely have been struck ahead of time and therefore sharpening of penalties makes no difference if DSU contracts provide extremely strong protection against demand customers actually being called to be interrupted. This factor does not appear to be considered by the SEMC. It further strengthens our members' argument that a blunt approach in the ASP will not have the desired effect if better DSR responsiveness is the intention.

SEMC has never been fully clear on what is hoped to be achieved with this fixation on ASP. Where ASP may be seen as yet another reliability signal, this completely undermines other aspects of the SEMC's market design which our members are adamant are material to their business viability, i.e., RO payments, other system charges, higher collateral etc and are absolute obligations in this market. Where higher prices are seen as an investment signal, this is misguided since it has been forgotten that the ASP exists purely in a short-term market and the effect of higher prices will hit price takers like wind extremely negatively.

Conclusion

The main intent of this paper seems to be to increase scarcity events in order to ensure better responsiveness during times of perceived scarcity. The proposed changes seem to have been decided upon by aligning RSP with past system alerts and disregard that these system alerts were caused mainly by system issues rather than by capacity adequacy issues. There has been no consideration of future looking events and changes that could change how sensitive RSP might be without any amendments. Above we have addressed why we do not believe any of the options proposed would result in the outcomes envisioned by SEMC. In brief, EAI believes that the proposed changes would have a knock-on negative impact on investor confidence by increasing the potential regulatory risk at a time when, in our tight security of supply situation, we need a large amount of new investment in SEM to meet the security of supply challenge (which the CRM is still not delivering) and to meet net zero targets.

EAI would like to highlight that we believe that availability performance is already effectively incentivised and penalised for the majority of market participants, however if the RA's have evidence of a lack of responsiveness from specific units or unit types that they believe should be responding, other measures should be considered within existing performance metrics.