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L I M I T E D

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Ref: TEL/CJD/19/120

12th July 2019

RE: Response to SEM-19-024

Dear Karen, Thomas,

Tynagh Energy Limited (TEL) welcome the opportunity to respond to the Balancing Market and Capacity Market Options Consultation (the Consultation).

This response will be in two parts firstly giving TEL's high level views on the Consultation (Part A) and secondly answering the specific questions raised in the consultation (Part B).

Part A

There are five key points that TEL would like to raise:

- 1) Timing of Simple NIV tagging proposal
- 2) Balance responsibility
- 3) Unintended consequences of Simple NIV tagging
- 4) Investment uncertainty in Northern Ireland
- 5) Market Design conflict

1. Timing of Simple NIV tagging proposal

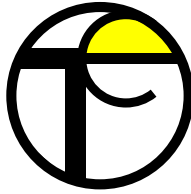
We appreciate that this consultation is as a result of the events of October 9th and January 24th but believe that a Market Design consultation that is based on prices analysis is not appropriate at this time.

The evidence provided for this change is dubious. It is based on incorrect prices and at this stage out of date pricing methodology:

- 1) Mod-09-19 has recently been approved and implemented. His modification will address the key issues that Option 1 of this consultation seeks to address. The local market power that units in the Northern Ireland were able to exercise is no longer available with the removal of the North South tie line from the pricing mechanism.
- 2) There will be repricing for virtually every day of the first nine months of I-SEM. This is due to start in M+13, after that data is published it may be appropriate to explore a pricing consultation.
- 3) The prices that are used in the consultation are from participants' bidding behaviour from the start of the market, when participants were (as expected) learning. Participants have significantly changed their bidding behaviour over the first nine months of this

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market and consequently the drivers for the high prices on October 9th and January 24th are no longer present in the market.

There are issues with the balancing market and the integration of each of the pillars of the wider design, but as a whole the market works. It is not prudent to change one pillar of the market without looking at the implications for each of the other pillars.

These are real issues in the market but to address one, without considering the impact on ex-ante liquidity and potentially the CRM could destabilise an effective market.

2. Balance Responsibility

Balance responsibility was considered as one of the six tenets of the philosophy in the High Level Design (HLD) – SEM-14-085a:

v. Balance responsibility for all participants to ensure that their notifications of generation or demand best reflect their actual expectations.

The philosophy did not discuss marginal pricing, but to include balance responsibility as a tenet, showed the importance that was accorded to it in the HLD.

The HLD further emphasised that all participants would be balance responsible under section 4.6, and stated:

All market participants in I-SEM will be balance responsible. This means that they are financially responsible for differences in volumes between their actual metered generation or load, and the volumes traded in the DAM and IDM, adjusted for any instructed non-energy. This illustrates the importance of a liquid intraday market to allow market participants to manage their contracted positions in responses to changes after the DAM – e.g. change in forecast demand or generation.

Unfortunately, this consultation is reducing the importance of the intraday market and is likely to make it less liquid.

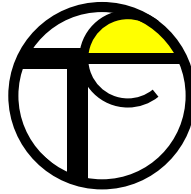
SEM-15-026 (the ETA Markets Consultation Paper) states *'If the imbalance price were overly dampened there could be a knock-on impact for the DAM and IDM by reducing liquidity in these ex-ante markets which is very important. For example, it could be that a participant that is expecting to be short would not act in the IDM in the expectation that the price will be lower in the BM...'*

Again, this shows the importance that the RA's placed on having spiky prices in the Balancing Market, in 2015, they appreciated the importance of the ex-ante markets as the central branch of the I-SEM.

This principle was emphasised in the detailed design, SEM-15-065 states *'The SEM Committee considers that the principle of balance responsibility is central to the I-SEM approach, and the creation of ex-ante liquidity'*.

If the pricing is dampened then this principle is diluted, it is no longer central to I-SEM. This will see a reduction in ex-ante liquidity at a detriment to the entire market design.

In conclusion, the potential volatility of the BM induced by generators over or under generating from their ex-ante position incentivises generators to deliver power aligned with their market position. However, this proposed overhaul in BM pricing will dampen positive and negative prices, thus eliminating this incentive. For example, (1) Generators will have less incentive to prevent trips, (2) To avoid both market and physicals starts, generators may submit Final



Physical Notifications (FPN's) across large gaps in their ex-ante schedule without incurring undesirable financial outcomes.

3. Unintended consequences

I-SEM is an intricate web of regulations which are either closely related to the Balancing Market, such as the Ex Ante Markets and CRM, or more tangentially related e.g. DS3. It is a balancing act between each of these revenue streams and markets. A significant change in one market may have considerable impacts on other markets.

Ex Ante Markets

If simple NIV Tagging is introduced, then as described in section 2.3 of the Consultation the prices in the balancing market will be smoothed. This may see more participants (particularly supply) spill into the Balancing Market, as there will be less risk in this market. This would lead to reduced prices in the ex-ante markets. This could subsequently drive less efficient flows on the interconnectors.

This was to an extent foreseen by the RA's in the HLD consultation when they stated: *'If the imbalance price were overly dampened there could be a knock on impact for the DAM and IDM by reducing liquidity in these ex-ante markets which is very important. For example, it could be that a participant that is expecting to be short would not act in the IDM in the expectation that the price will be lower in the BM...'*

This is genuine risk that was shared in the past by the RA's and has only been mentioned briefly in the introduction of this consultation.

CRM

If there are less spiky prices in the BM, then there will be less risks attached to a RO holding. This will lead to lower prices in the CRM auctions, making it harder to attract necessary new investment, and equally potentially threatening existing generator viability. This has the potential to lead to uncontrolled exits from the market.

4. Investment Certainty in Northern Ireland

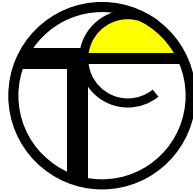
The new SEM is a complex system, with a single energy market (with effectively seven timeframes), combined with both an integrated Capacity and Ancillary Services Market all covering two distinct power systems.

But this combination of Energy Market, Integrated Capacity and Ancillary Services has to act as a source of investment on both sides of the border. The capacity market is one aspect, but just as important is that at times of scarcity there must be a return for participants in that location. As described in section three the introduction of Simple NIV tagging could have implications for the auction clearing price. But similarly, it could considerably reduce generators IMR in the energy markets.

On July 8th there was an amber alert in Northern Ireland from 5:30pm to 7pm. The BM prices were somewhat reflective of this scarcity. However, if Simple NIV tagging was present then the price would have dropped to an average of just €23.

Time	NIV 30 (MW)	DAM Price (€)	BM Price (€)	Simple NIV (€)
17:30	10.45	98	178.9	23.8
18:00	12.39	80.1	Back Up price: 58.9	23.2
18:30	9.83	80.1	29.7	22.1

From July 3rd to July 11th, the market as a whole was predominantly long. However, there were high price spikes, with peaks of €150-€280 every night (bar July 4th). This is reasonable as



Northern Ireland was very short, there have been 4 significant plants on an outage in Northern Ireland over this period. Northern Ireland had very little ex ante power sales, and there was a requirement for a number of plants in the North to be brought on for reserve. If simple NIV tagging was in place the prices would have been in the region of €20-€40 for each of these periods. This would not provide a signal to generators of the scarcity in the Northern Ireland system. This would have significant implications for investment in Northern Ireland.

A secondary concern for investment certainty, is regulatory change. This is a fundamental change being proposed with very little involvement from industry, if an investor was minded to invest hundreds of millions in a plant to operate in the SEM, they would gain little confidence that there would not be further fundamental regulatory change with insufficient stakeholder involvement.

5. Market Design Conflict

The RA's state in the consultation that Simple NIV tagging is in line with the HLD as *'it defines the "marginal unit for energy balancing actions" as that unit which produced the last MWh of energy which met the NIV'*.

But section 4.5.14 HLD states: *'The I-SEM will employ a marginal pricing mechanism for energy balancing actions taken through the BM. The marginal price reflects the cost for generating one more or one fewer MWh of electricity within the BM timeframe. This means that, if aggregate load on the system is higher in the BM than DAM, the incremental bid of the next most expensive resource (generation or DSU) used to meet demand (i.e., provide balancing energy) will set the balancing energy.'*

This means that the marginal price would reflect the cost of generating one more or one less MWh of electricity, this is very different to *'the cost of the last MWh of electricity which meets the NIV'*. The unit that produced the last MWh which met the NIV is highly unlikely to be the unit that can generate one more or one less MWh of electricity. This is because on the Irish system, there is usually only one unit that is marginal and able to produce one more or one less MWh of electricity. For example, if the system is short, cheaper units that would be setting the price under simple NIV tagging are likely to be at baseload and will not be able to provide an additional MWh.

Simple NIV tagging breaches section 4.5.14 of the HLD.

This proposal does not comply with the HLD.

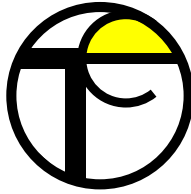
Summary

There is no evidence to support this consultation at this time, furthermore what is apparently the reason for the change – the impact of the North-South tie-line constraint is solved by MOD 09-19.

In this consultation the RA's seem to have moved significantly from the importance that they had placed on balance responsibility (and liquidity in the ex-ante markets) in both the HLD and detailed design decisions. This is a backward step regarding the wider market design.

There will be unintended consequences in the ex-ante and CRM markets if this option is followed through. These consequences were foreseen by the RA's in consultations for the HLD and the detailed design.

If option 1 is implemented, then it is likely that there will be a significant signal provided to investors not to invest in an area of considerable scarcity, i.e. Northern Ireland.



Finally, Simple NIV tagging does not align with the HLD description of marginal energy pricing and therefore should not be implemented.

Part B

Answers to specific questions asked in the Consultation

Option 1:

1) Do you support this Simple NIV tagging option and its implementation in the SEM?

TEL do not support a move to Simple NIV tagging. At this stage we do not know the implications of the existing methodology, as (i) we do not know what the correct prices are over the last nine months, (ii) do not know the implications of the changes in bidding behaviour to pricing and (iii) have not seen the impact of MOD 9-19 in practice.

To move away from where we are, without knowing where that is would just introduce further risk to participants for no gain.

This proposal does not comply with the HLD. The pricing mechanism does not look for the marginal MW movement, but rather looks for the marginal unit. It is very likely (most units in the system are non-marginal) that that unit will be constrained in the system and would not be able to provide a marginal MW.

2) Do you have any concerns regarding moving to Simple NIV tagging in the Balancing Market, including the risk of unintended consequences?

Yes, there are many possible unintended consequences, it will certainly have an impact on balance responsibility, as the SEMC stated in SEM-15-026 that a participant who expects to be short may not act in the IDM if they expect the price to be lower in the BM –(if the price is dampened).

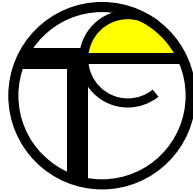
This could lead to further adverse consequences to the CRM, Ex-Ante markets and potentially requiring the introduction of the Information Imbalance Charge.

3) Do you agree or disagree that Simple NIV tagging meets the I-SEM High Level Design, the I-SEM Detailed Design and the I-SEM market power mitigation decision? If you disagree, please explain why.

TEL disagree that the introduction of Simple NIV tagging meets the I-SEM design documents. It reduces the importance of balance responsibility, which was described in the High Level Design decision (section 3.1) as one of the tenets of the philosophy of I-SEM. If spikier prices are dampened, which they will be under this method, then participants will be more encouraged to go straight to the BM.

Equally the HLD was clear and unambiguous regarding the Marginal Pricing Mechanism:

The marginal price reflects the cost for generating one more or one fewer MWh of electricity within the BM timeframe. This means that, if aggregate load on the system is higher in the BM than DAM, the incremental bid of the next most expensive resource (generation or DSU) used to meet demand (i.e., provide balancing energy) will set the balancing energy.



The marginal price will be the incremental bid of the next most expensive resource used to meet demand. This is not the case with Simple NIV tagging. It does not meet the HLD.

4) Do you agree or disagree with SEM Committee's assessment that the pricing outcomes under Simple NIV tagging are preferable, given market fundamentals? If you disagree, please explain why.

No, TEL disagrees. In the week of writing the market has been predominantly long but the prices have been high. This sounds wrong and would not be the case under simple NIV tagging but it is correct under the current market, furthermore it is appropriate. The SEM is a combination of physical systems, if there is an amber alert in one system (e.g. Northern Ireland) then there needs to be some reflection of that in the prices. If there isn't then where is the incentive for a new plant to be developed in Northern Ireland as is currently required.

Furthermore, there could be red alert in Northern Ireland with a loss of load and the prices could remain very low because of Simple NIV tagging and the double lock on the CRM ASP. This is unlikely to be the case under the current methodology as the shortage in the North will see every available plant running which will push up the balancing price.

Volatile prices incentivise balance responsibility. Balance responsibility is a key driver for ex-ante liquidity, which leads to the efficiency of the interconnector.

One argument for simple NIV tagging is that it will allow participants to forecast the BM price. However, it is not impossible to forecast the balancing market under the current methodology, but it is more difficult. TEL have consistently asked for a report that will detail the NIV and FPN's in both Northern Ireland and in Ireland (at a jurisdictional level). This report would provide participants with a greater ability to forecast the Balancing Market price.

Option 2

1) Do you support this Capacity Market option (Option 2) and its implementation in the SEM?

TEL supports option 2. Option 2 is the product of an industry working group, where a number of options were discussed at length and this proposal appeared to have the support of industry, the MO and the RA's.

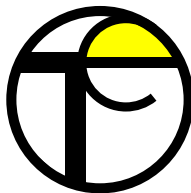
2) Do you have any concerns regarding the removal of Difference Charges where Operational Constraints are binding, including the risk of unintended consequences? If so, please explain these concerns.

There is always the risk of unintended consequences, however at this stage TEL cannot see any.

TEL contend that this measure could go further. If a plant is available with four hours' notice, and if that plant is priced at less than the strike price, then the plant should not be liable to a difference change, just because the TSO has not called the unit.

3) Do you consider this proposed change is in keeping with the broader CRM detailed design? Please explain your view.

Yes, it goes some way towards relieving the exposure on those plants who are available to provide power but are not called by the system operator.



4) Do you have any views on this option from a consumer perspective?

This solution will provide investment incentives and in turn provide the consumer with a secure and sustainable power system.

5) Do you have a strong view regarding an alternative option which could be implemented, i.e. preferably requiring only a configuration change rather than a system change?

If a plant is providing DS3 service of RM8 then they should be exempt of any exposure. While this may involve a system change, this in itself should not be a reason to maintain the unfair risks that some generators are exposed to.

We would appreciate the opportunity to have a bilateral discussion on this consultation with the RA's.

Yours sincerely,

Cormac Daly
Regulation and Business Development Manager