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13<sup>th</sup> August 2010

## Proposed RAs option for all-island harmonised Transmission Loss Adjustment Factors

Dear Billy

Mutual Energy welcomes the opportunity to put forward its views on the proposed decision on TLAFs from 1<sup>st</sup> October 2010. We have a number of concerns with the process for how this decision has been arrived at and the likely consequences for the market, and Northern Ireland in particular, of applying uniform TLAFs.

### Objectives

The RAs/TSOs stated objectives for locational signals are: efficiency; transparency; predictability; stability; efficient dispatch; cost reflectivity; and consistency. The decision paper states that a uniform TLAF is the closest match to achieving the objectives of predictability, stability and transparency with little regard being given to the importance of the other objectives. The decision represents a major step-change from the previous regime and, given that it is proposed as an interim solution for one year (with further changes proposed to be implemented from October 2011), we would argue that this change does not meet any of the objectives. It demonstrates a significant level of instability through an unpredictable major regulatory decision, and is unlikely to provide any comfort to financiers of current or prospective investments in the market.

### Inconsistency

The TSO preferred options paper published in November 2009 stated that a uniform TLAF would not be cost reflective, result in cross subsidisation and remove any locational signal from both the market and short term dispatch resulting in more inefficient dispatch and ultimately increase costs to consumers. This paper also states that *"A uniform loss adjustment approach would not be*



*compatible with the June 2005 SEM High-Level Design.*” For these reasons the uniform TLAF option was effectively discarded so it is difficult to reconcile these statements with a subsequent RA decision that uniform losses are a suitable short term solution.

The TSOs workshop presentation in July 2010 referred to the responses to the above paper which showed little support for compression as a short term solution. Risks of cross-subsidisation, increased regulatory risk, inefficient dispatch and diluted locational signals were cited as the main concerns. A uniform TLAF is essentially an extreme form of compression and most of the stated concerns would be even more acute than under compression so these views are at odds with the subsequent decision.

### **Lack of supporting evidence**

While the issues with the current TLAF methodology are well documented it is not clear from the RAs decision paper how applying uniform tariffs for (at least) one year is an improvement on the current regime. As stated above, applying a new methodology for a short term period does not provide any stability – TLAFs are volatile as the generation mix changes but that is a long term problem and adopting uniform TLAFs in the short term does little to address it.

There does not appear to have been any empirical analysis undertaken to support the RAs proposed decision and it is not subject to an impact assessment – it is poor practice for such a major decision to be taken without an impact assessment and detailed analysis being carried out given the impact it will have on the market and its participants<sup>1</sup>. This is further emphasised by the fact that this level of work *is* deemed necessary in relation to the “splitting” proposal before it will be considered for implementation.

### **Impact on the Market**

The adoption of a uniform TLAF will not result in efficient dispatch as it does not provide any economic signals. This would be expected to increase costs to consumers due to an increase in constraint costs and potentially SMP. Inefficient dispatch will also have consequences for the environment through increased CO2 emissions. These outcomes are contrary to the principals of the SEM and the objectives of the RAs to protect the interests of consumers.

### **Impact on Northern Ireland**

This decision impacts on the value of Moyle Interconnector capacity. Moyle users who have purchased capacity 2-3 years in advance will find their capacity devalued and may factor this decision (and any perceived increased regulatory risk) into their bids in future capacity auctions. This could reduce Moyle’s revenue stream which would eventually impact NI consumers since the investment in Moyle is underwritten by them.

In relation to Northern Ireland specifically, the overall downwards movement in NI TLAFs represents a transfer of wealth from NI to RoI (and from privately owned plant to RoI semi-state) and the subsequent increase in NIE PSO charges will further specifically impact NI consumers.

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<sup>1</sup> Review of CER public consultation process – decision paper 06 June 2008 concluded that major CER consultations would include a regulatory impact assessment

Given the lack of supporting analysis for this decision its implementation would be a particularly unfair outcome for Northern Ireland.

**Preference**

It is clear from the foregoing that we do not favour implementing a uniform TLAf, particularly in the absence of any substantive evidence to suggest that it is appropriate.

The decision paper states that the RAs were focused on addressing the sensitivity issues of the current methodology (*"in the interests of promoting fairness, stability and predictability"*) rather than maintaining the status quo until an enduring solution is found. As set out above, this decision is contrary to the stated objectives and while it clearly favours certain market participants there is no evidence that it will bring any benefit to the market as a whole as appropriate analysis has not been undertaken. In this context we feel that the current methodology should be maintained for the year commencing 1<sup>st</sup> October 2010 and the relevant parties should work towards an appropriate enduring solution that meets the stated objectives of efficiency; transparency; predictability; stability; efficient dispatch; cost reflectivity; and consistency.

Please feel free to contact me if you wish to discuss any of the above.

Yours sincerely,

A handwritten signature in purple ink that reads "Paul McGuckin". The signature is fluid and cursive, with a long horizontal stroke at the end.

Paul McGuckin  
Mutual Energy Ltd