



**Response by Energia to SEM Committee
Proposed Decision Paper SEM-12-024**

Treatment of Losses in the SEM

04 May 2012

1. Introduction

Energia welcomes this opportunity to respond to this, the second Single Electricity Market (SEM) Committee proposed decision paper on the treatment of transmission losses in the SEM to be published as part of a remarkably long process of reviewing locational signals in the SEM. Locational signals are a feature of the SEM High Level Design (HLD) and as such it is important that these are retained, as they remain relevant to the continued fulfilment on the HLD's objectives.

This relatively brief response to the proposed decision paper considers two general points;

1. Arguments forwarded against the use of locational loss factors in the SEM;
2. The considerations of the SEM Committee in arriving at the approach outlined in the proposed decision paper, (i.e. the continuation of compression).

An alternative approach proposed by Energia and contained in our response to the consultation paper (SEM-11-098) is once again reiterated herein. This approach involves the fixing of locational TLAf values in line with the decision to fix the BNE for 3 years, and this would be reasonable given minimal expected change in demand and generation over this period¹. This suggestion would retain a locational element and reduce the administrative burden on regulatory authorities (RAs), system operators and market participants prior to the introduction of new market arrangements. We note this approach is not addressed by the RAs in this proposed decision paper and request that this be given serious consideration in the implementation of a final decision.

2. General Comments

Arguments against the use of locational TLAfs

Interestingly, opponents to the use of locational TLAfs in the SEM have never engaged in a discussion around the merits or otherwise of a locational approach but rather focussed on the specifics of the approach as applied in the SEM. One may therefore be able to take comfort from the HLD decision and respondents' comments in relation to that, that a locational approach is generally preferred.

Despite this observation, a number of other peculiarities surrounding the opposition to locational TLAfs, are apparent from the responses. The five points below summarise the weak arguments forwarded;

1. Inconclusive results favoured a change to uniform TLAfs
2. The current methodology is highly volatile, is arbitrary and is a flawed approximation of system losses.
3. The current methodology provides a poor locational signal as investments cannot be relocated.

¹ These TLAfs have already been calculated by the TSOs for 2011-12 with EWIC as published online @ http://www.allislandproject.org/en/transmission_current_consultations.aspx?article=5d9a6485-4f5d-431f-a207-2a6fc4005557&mode=author

4. Locational TLAFs constitute a barrier to trade and place SEM generators at a disadvantage relative to those in GB.
5. TLAFs are to be replaced by an approach recovering losses through TUoS as part of regional integration and the adoption of the European Network Codes.

Somewhat bizarrely the argument around (1) centres around removing volatility and uncertainty from the industry, and that this be achieved by making a significant regulatory change based on inconclusive results. We suggest that rather than addressing volatility and uncertainty, such an approach would introduce such risks into the regulatory process, a far more wide reaching implication than that which these respondents have sought to erroneously address.

The current approach to estimating TLAFs is based on an ex-ante analysis of complex system interactions undertaken by the TSOs and availing of the most accurate information available at the time of modelling. A simple observation that the results can be volatile is as much praise for the approach as it could be considered a criticism. For example, it would be a damning criticism of the approach if, in response to the introduction of c900MW of new CCGT capacity in a single peripheral location (double capacity the TSO had indicated as preferable), the impacts on all generators, particularly those in the area, were not pronounced.

On the issue of whether the approach is arbitrary and a flawed approximation of system losses, it must be conceded that the approach employed is not perfect. However, absent the alternative of a system utilising real-time losses, the current methodology captures, in aggregate, the losses one can reasonably expect to be attributable to generators on the system, given the system characteristics and expected system performance, (including generator running times). A far more arbitrary approach is proposed by those advocating uniform. The current methodology is not perfect but it gets you close to the correct answer by giving a reasonable and predictable locational signal. It does this without much of the expense required to attain the ideal end position (real-time losses). It also provides a signal of the cost of different locations, thus improving economic efficiency by not simply charging the same for all locations.

Locational signals are a commonly used mechanism, particularly with respect to long term capital investments and networked assets, whereby the signal is designed to ensure that rational investors locate in accordance with the signal. Following the investment it is expected that the signal to new investors may change but within this rational investor paradigm, the expected locational benefits identified by the signal to the investor are expected to be realised. The inability of a generator to relocate should not be an issue as long as other investors act rationally and observe the locational signals in the market. The argument advanced opposing the locational approach is, at best, considered to be naïve. Where locational signals in the SEM are ignored by investors (e.g. where two significant investments proceed but locational signals and system requirements only support the case for one of these), it is inappropriate to conclude that they do not work, on the contrary, it may be a basis for strengthening such signals.

As noted in the proposed decision paper, the current TLAF approach is not a barrier to trade and in fact a move to a locational approach to TLAFs in GB had recently received industry approval, only for OFGEM to postpone its introduction while necessary changes ahead of European market compliance were advanced. On the expected phasing out of TLAFs under the EU Network Codes, we concur with the view expressed in the proposed decision that such details within the EU Target Model have not yet been finalised and does not form an appropriate basis from which to begin making fundamental changes to the market foreseen and agreed in the SEM HLD.

In summary, the arguments forwarded in opposition to the current TLAF approach in the SEM are considered to be lacking principled objections and in many cases are substantially flawed.

Considerations of the SEM Committee in reaching this proposed decision

The proposed decision paper details the following four points as being central to the decision forwarded in relation to Locational/Compressed/Uniform TLAFs;

1. The inconclusive modelling results;
2. The polarised responses from industry;
3. The current developments with respect to the future structure of the SEM in a regionally integrated market (SEM-12-004);
4. The development of European Network Codes (under the provisions of Regulation EC 714/2009) which will cover rules regarding harmonised transmission tariff structures including locational signals and inter-transmission system operator compensation rules.

In respect of (1), Energia's response to the consultation paper detailing the modelling results (SEM-11-098) provided a comprehensive assessment of these results and highlighted significant concerns in relation to it. As this proposed decision does not rely on these results and proposes to reject the option of splitting the treatment of losses, further comment on the results are not considered to be warranted in this context.

Regarding both (3) and (4), Energia's views in relation to these are already provided herein. We note the proposed approach, no change, is consistent with the approach adopted in GB citing similar reasons of change in respect of EU Target Model compliance. Energia's response to SEM-12-004 stresses the importance of retaining locational signals in the all-island market post-2016.

Finally, the inclusion of (2) is considered to be a regrettable admission from the SEM Committee on the regulatory decision making process. The mere fact that there is a divergence in industry opinion on the treatment of losses in the SEM should have no bearing on the statutory and regulatory duties of the SEM Committee, irrespective of how polarised opinion on the topic is. The inclusion of this consideration is considered to be irrelevant to the SEM Committee's decision making process and is inappropriately included in the considerations of this proposed decision.

In light of the comments contained herein, Energia remain supportive of the proposal forwarded to the SEM Committee in response to SEM-11-098. In the interest of brevity and to avoid undue duplication of a proposal the SEM Committee have yet to address, the following extract outlines our proposal for the treatment of losses in the SEM which confronts certain perceived issues with the current approach. In our view this approach could be easily implemented as an extension of the final decision and would be a relatively painless process for all involved, preserving desirable aspects of locational TLAFs while we concentrate on the introduction of new market arrangements over the next few years.

Extract from Energia response to SEM-11-098

In taking a decision to implement compression as an interim step, the SEM Committee recognised both the competing nature of certain objectives and the ability for these important objectives to be reflected in what amounts to a compromise position. Compression, as implemented, importantly preserves a locational TLAF approach while amending it predictably to provide for greater stability around the outturned TLAF.

In light of concerns around the stability and predictability of a purely locational TLAF approach, many of which are shared by Energia, we consider there to be an appropriate alternative approach to TLAFs in the SEM. This approach preserves the objective benefits of a locational approach while imposing stability and predictability by fixing the locational TLAF value for generators for a three year period. The fixing of TLAF values for generators is considered to remove the need for compression, although such an approach would not be inconsistent with this alternative. The precedent for such an approach has already been published in a draft decision paper by the SEM Committee with respect to the Capacity Payment Mechanism (SEM/11/088)...Importantly such an approach would not constitute a significant change to arrangements in the SEM and would provide substantial stability and predictability. Together these are important issues for market participants and investors, particularly in the context of SEM compliance with the electricity target model. We note that a proposed change to adopt a locational losses approach in Great Britain has been deferred to allow the industry and regulators focus on the required changes pursuant to compliance with the European model.