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Mr Philip Newsome  
Commission for Energy Regulation  
The Exchange  
Belgard Square North  
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Dublin 24

21<sup>st</sup> December 2012

Dear Philip,

The Viridian Group welcomes this opportunity to respond to the SEMC consultation on its Next Steps Proposed Decision Paper relating to the Implementation of the European Target Model in the SEM. This response focuses on the main high level strategic issues from Viridian's perspective. The individual businesses within the Viridian Group are submitting their own more detailed responses.

### **1. Governance and Project Arrangements**

The project to implement the EU Target Model represents the most significant project since the establishment of the SEM and its successful design and implementation is vital to ensure a viable market for consumers and market participants alike that is sustainable and balanced. This can only be achieved by ensuring investments are properly remunerated since security of supply will otherwise be compromised. In this regard, we welcome the SEMC's statement that "*It is important that the total remuneration from energy payments, capacity payments and ancillary services is sufficient to ensure security of supply*" and we look forward to further detailed consultation on this issue. A broader statement of intent to ensure an efficient, competitive and liquid market would also be helpful as commercial risk management from both generation and supply perspectives has been given little or no consideration in the process to date.

Along related lines, Viridian has significant concerns with the proposed governance and project arrangements which do not include a formal and structured interface for industry participant involvement and engagement in the process for the specific delivery of this complex project. The Stakeholder Forum provides for engagement on specific EU developments but does not extend to the development of the SEM and similarly, the proposal to establish a "Project Office" does not provide any confidence on the potential for meaningful engagement. Given that this project will have significant commercial impacts for all participants in the market, the omission of a specific forum for industry engagement is extremely concerning and would not provide the "balance" that will be necessary if a sustainable long-term market is to be delivered.

Viridian is not averse to the proposals put forward by the SEMC in relation to engagement with the EU, with the departments, and with Ofgem. However, our concern is that the most critical forum for the delivery of a commercially viable and sustainable market is

missing. We understand that this omission was categorised at the Information Forum on 27 November 2012 as an oversight. Such engagement should be the primary element of any Governance and Project arrangement and its omission raises fundamental concerns over the commercial and economic integrity of the arrangements proposed.

Our concerns are further elevated by both the proposals on the Implementation of the EU Target Model consulted upon in January 2012 (SEM-12-004), and by the actions of the RAs in the period since the closure of that consultation (on 20 April 2012). The initial proposals were TSO centred and made no attempt to consider commercial viability and the impact on market participants, specifically in relation to how the market would function in practice and how participants could manage risks (we note this was a common concern raised by respondents to the consultation). There has been very little engagement with industry participants since the closure of that consultation and while that consultation noted that there were a number of further issues to be explored, including in relation to central dispatch, this issue had been discussed unilaterally with the TSOs with the RAs seeking corroboration from an external consultant. Our expectation would have been that consideration of such an important topic would have included engagement and consultation with the market participants most directly affected by such a matter, yet no such consultation occurred.

It is therefore evident that the actual experience of engagement between the RAs and the industry participants over the last year has been poor and could not be considered to be in accordance with best regulatory practice. In addition, it has eroded confidence that those industry participants, who will be most impacted by changes to the market design, are being afforded virtually no opportunity to share their knowledge and expertise as we collectively seek to determine the design of appropriate wholesale market arrangements that meet the needs of stakeholders on the island of Ireland as well as being compliant with the EU Target Model.

## **2. Other Matters**

### ***High Level Principles for the Market***

Viridian welcomes the decision to re-affirm the High Level Design Principles and supports the SEMC's recommendations. We would note however that the existing SEM market does not satisfy all of the current HLD principles; for example, in relation to Efficiency/Equity/Competition where interconnector users are treated more favourably than generators (i.e. interconnector units achieve firm ex-ante positions compared to generator units whose commercial position is determined ex-post). This differential treatment may have evolved during practical implementation of SEM but equity of trading and risk management opportunities for generators and suppliers in the new market must be a fundamental principle.

### ***Market Design and Implementation***

Viridian welcomes the statement of intent that the EU Target Model will be implemented in a coherent and stable manner. The project will inevitably place a major burden on resources and it will be important to use the finite resources that participants and other stakeholders have available to them efficiently. The commitment to the stability of the current market is particularly welcome in this context. It would be helpful to clarify for the avoidance of doubt that this commitment extends to the fixed point of 31 December 2016 (as clearly indicated on page 13 of the proposed decision paper but not later specified).

It will also be important that the impacts of any proposed market design be fully assessed against viable alternatives and that a detailed and comprehensive Cost Benefit Analysis (CBA) is concluded to provide confidence and positive reassurance for all stakeholders that the effort will provide tangible benefits. This analysis must take into account the impact on market participants, including their risks and costs.

We concur with the decision to drop the previous “evolutionary” versus “revolutionary” approach and welcome the decision not to progress the so-called evolutionary options proposed by the TSOs which were based upon the strictures of current market design, and scheduling & dispatch. We submit that the acknowledged lack of clarity and coherency of these options, required to make commercial, policy and Target Model compliance assessments, was largely symptomatic of the process followed (including failure to engage with industry participants or to take advice from independent experts with proven experience of market design) and of the self-imposed (market design, scheduling & dispatch) constraints within which the options were conceived and developed. Viridian favours a wide-ranging, inclusive, independently informed, and unbounded assessment of the options going forward. We maintain that this will produce the most efficient outcome. Given lessons learned to date it is highly surprising and disappointing to see a proposed decision that “there will be a working assumption that changes to the SEM high level design will be based on central dispatch”. It is unclear what this means or achieves and we consider it an unnecessary decision at this stage, in advance of the commencement of a detailed design appraisal. While we currently have no firm views on the scheduling or dispatch models (and we note the TSOs believe both central and self dispatch options are workable), we strongly suggest that this design element should be considered alongside all the other elements of the market design without imposing any unnecessary constraints at this stage. We therefore urge the SEM Committee not to make a decision or working assumption regarding dispatch at this stage.

Viridian strongly supports the retention of a Capacity Payment Mechanism in the market and while we note that it will need to comply with any future EU rules, we consider there are very valid reasons why such a mechanism is appropriate in a small, largely islanded market with finite interconnection to the GB market. Such constraints reduce the scope for investors to access a wider, deeper market and hence imposes higher revenue risk volatility which would inevitably increase the cost of capital for investors in the market. The CPM serves to counter-act this potential for volatility and is therefore a vital mechanism to facilitate investment and security of supply at a reasonable cost in such a market. We also suggest that interconnector flows could be excluded from capacity payments to remove any distortion between markets.

Viridian also welcomes the statement that the SEMC recognises the importance of total remuneration in the market from energy payments, capacity payments and ancillary service payments. It is vital for the long term viability of the market that current investors earn a reasonable return since that sets the context for future investment. This issue is particularly relevant where the penetration of renewable generation is still to increase substantially if government targets are to be achieved. A key challenge in the new market design will be to promote and facilitate renewable generation while also ensuring that the conventional generation capacity and flexibility needed to maintain security of supply is properly remunerated.

As a final but important clarification Viridian would like to point out that locational signals should remain an integral feature of any re-designed SEM. The desirability of locational signals from the SEM Committee’s considered perspective has been clearly established following a prolonged locational signals workstream and it would be helpful and appropriate to clarify this early in the context of market re-design.

### **3. Conclusions**

The redesign of the wholesale electricity market to ensure compliance with the EU Target Model is the most significant development in the electricity markets on the island of Ireland since establishment of the SEM.

Designing and implementing a market that can accommodate compliance with the EU Target model, facilitate increasing renewable penetration and ensure conventional generation is sufficiently remunerated to ensure long term security of supply for consumers will be a difficult challenge. It is concerning that thus far, the RAs have failed to properly engage with the industry and to draw on its expertise such that the best possible market can be designed and deployed in a manner that provides a balanced outcome for all stakeholders, and Viridian firmly believes that such a collaborative approach will ultimately deliver the best outcome for consumers.

Viridian is concerned that to date the TSOs have been the only market participants with whom the RAs have fully engaged and that there is a real danger such narrow engagement distorts the whole process to its detriment. Viridian considers it vital that all market participants are given the opportunity to be fully engaged in the process to ensure a more rounded consideration of all the issues that need to be addressed, drawing upon all of the knowledge and expertise that exists within the industry.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian Thom', with a stylized flourish at the end.

Ian Thom  
GROUP CHIEF EXECUTIVE