

Items for clarification in relation to RA's Make-Whole Payment Proposals

The Chair of the Modifications Committee requested Participants to submit feedback to the Secretariat relating to the RA MWP proposals (Modifications Mod_09_14 and Mod_10_14). This submission is from ElectroRoute Energy Trading Limited and contains a number of items for clarification.

Introduction

The debate on SEM modifications Mod_09_14 through Mod_12_14 to date has been both basic and introductory in its nature. The level of fundamental debate around market design principles and efficient market operation has been markedly absent. This absence of informed debate is of concern given that some of the modifications would have profound impacts on the design of the market and the nature of electricity trading between SEM and GB. In order that rational examination of these modifications can be undertaken it is essential that the Regulatory Authorities define the fundamental principles of market design that they believe govern cross border trading between jurisdictions. To this end the following set of questions are aimed at clarifying the basic principles that must be established before any examination of a market modification in this space can be conducted.

Items for clarification regarding statements in RA's modifications:

Q1) In one of the Regulatory Authorities' modifications they state that they "do not believe that this [Mod] will distort efficient cross border trade". Can the RA's share the work conducted on which this conclusion was drawn? The work would have to inherently comprise a definition of "efficient cross border trade" and an impact assessment of the modification.

Q2) As a consequence presumably the Regulatory Authorities would agree that if any Mod did distort efficient cross border trade that it then would be unsuitable to proceed to implementation?

Items for clarification regarding fundamental market principles:

Q3) What, in the view of the Regulatory Authorities, is the most efficient means of scheduling import and export flows between the SEM and GB markets?

Q4) Do the Regulatory Authorities view the current "bid to flow" method, which significantly bypasses the SEM dispatch process, as a valid means of arranging cross border trades?

Q4a) If so, why do the Regulatory Authorities believe that this method is valid for interconnector units and not for all other forms of participants? (e.g. generators who are scheduled by the SEM dispatcher)

Q5) Do the Regulatory Authorities believe that the SEM dispatcher can make valid dispatch decisions in relation to cross border trade in both import and export directions? If so how?

Items for clarification regarding Market Pricing:

The SEM market engine (under the assumption of cost reflective bidding) minimises the cost (not price) of supplying the demand in any particular day. In doing so the SEM produces some relevant price signals:

Shadow price (SP): reflects the incremental cost of energy in each half hour (HH)

System Marginal Price (SMP): reflects short run marginal cost (SRMC) of energy over the 24 hour trading day period. In particular note that SMP is not a cost reflective signal in any one HH period. The average value of SMP over the day may approximate the short run marginal cost of production (SRMC) in the SEM market over that day, however SMP is only a valid cost reflective price signal at a daily, not HH resolution.

Capacity Payments (CPGP): SMP + CPGP taken on average over a month or year may approximate the long run marginal cost (LRMC) of energy in the market.

Q6) What do the Regulatory Authorities believe are the relevant price signal comparisons for triggering efficient cross border trade between the SEM and GB?

Q7) How should an interconnector participant bid into the market to establish what in the Regulatory Authorities' opinion would be efficient cross border trade?

Q8) How, in the opinion of the Regulatory Authorities, should the costs of interconnector capacity be treated in this bidding process?

Items for clarification regarding the need for a valid price signal on a granular basis:

Unlike other market participants who are obligated to submit bids relevant to a full trading day an interconnector trader may only be active in the market for as little as a single half hour period. Consequently this places an obligation on the market to create rational cross border trading outcomes on a very granular basis. This is unlike other generator market participants where revenues over a daily, weekly and annual basis are manipulated (via, SMP/uplift, make-whole payments, and capacity payments) to create rational sets of prices and revenues over the long run.

Clearly questions must then exist around whether SMP is the correct HH price signal against which international trade is to be arranged around. The SMP reflects the incremental costs (SP) in some HH periods and then takes on a near arbitrarily high cost recovery status at other HHs of the day such that the average over a 24 hour period may approximate the short run marginal cost (SRMC) of production.

Q9) Do the Regulatory Authorities believe that the SMP is a valid price signal on which half hourly cross border interconnector trade should be arranged or do the RA's believe that the SEM dispatch engine is better placed at making such a decision?

Items for clarification regarding dispatch and pricing disjoint

While cross border trades are dispatched in the ex-ante time frame they are settled against ex-post prices which quite often are very different on a HH basis (although more similar on a daily average

basis). The near arbitrary movements in uplift caused by the uplift mechanism creates great difficulty in choosing the correct HH period in which to trade. This often means that import trades are scheduled in more hours of the day than would be rational as the volumes seek to ensure that they don't miss out on the HH periods of high uplift prices. Conversely, export trades are scheduled in less periods than may be rational as volumes seek to avoid periods where uplift is very high. The mean absolute value of the half hourly SMP prices changes between EA1 where volumes are dispatched and EP2 where trades are initially priced is over 15 €/MWh (between Jan-13 and Oct 14). A near unprecedented pricing risk in the electricity sector.

Q10) Do the Regulatory Authorities believe that the ex-post pricing nature of the market and the erratic uplift movement already hamper trade in the export direction and exaggerate it in the import direction from a volume perspective?

Directive 2009/72/EC of 13 July 2009 concerning common rules for the internal market in electricity sets out, amongst other things, objectives and duties and powers of the Regulatory Authorities. Article 36 provides that in carrying out the regulatory tasks specified in the Directive, the Regulatory Authorities must take all reasonable measures in pursuit of a number of objectives including:

"...eliminating restrictions on trade in electricity between Member States, on trade in electricity between Member States, including developing appropriate cross-border transmission capacities to meet demand and enhancing the integration of national markets which may facilitate electricity flows across the Community".

Q11) Do the Regulatory Authorities believe that the market as it stands has adequately eliminated restrictions on cross border trade between markets?

Q12) Do the Regulatory Authorities believe that the modifications Mod_09_14 and Mod_10_14 represent an additional restriction on trade between markets ?

Items for clarification regarding Constraints and Make Whole Payments

The issue of make-whole payments is not particular to interconnectors, the effect whereby a unit who is purchasing out of the pool can be dispatched on and then be charged a price above its bid is a universal feature of the SEM market. Exporting interconnectors, demand side units, storage facilities all are governed by the same concepts.

Q13) Do the Regulatory Authorities believe that the cost/price recovery principles reflected in the constraints and make-whole payment mechanisms should apply equally to all participants?

Q14) Do the Regulatory Authorities believe that an export trade (in the case of an IC unit) or an off-taking trade (in the case of a DSU) should not be forced to pay more than the price (bid price) it said it was willing to pay at the time the contract was struck/volume dispatched?

14a) If not, on what basis should the market be allowed to charge participants more than their bid?

Q15) Mod_09_14 and Mod_10_14 represent changes that only affect interconnector units. How do the Regulatory Authorities justify a change in the mechanism for one class of market user and not all users equally?

Items for clarification regarding retroactive market changes

Modifications, Mod_09_14 and Mod_10_14, will instigate changes which will affect the value that can be realised from import and export interconnector capacity and may restrict a company's ability to realise such value out of both import and export capacity concurrently. Interconnector capacity has been sold forward until September 2016 and many interconnector users will have arranged trades in power and renewable certificates over this period under the assumptions of the existing SEM rules.

Q16) What is the Regulatory Authorities opinion on instigating changes which effect the value of products already sold under a regulated framework ?

Q17) Have the Regulatory Authorities discussed the market changes with OFGEM who may have an equal interest in the nature of cross border trade and who is jointly responsible or approving interconnector access rules ?

Items for clarification regarding the SEM Modifications Process

Q18) Given the magnitude of the market design changes at stake, do the Regulatory Authorities believe a sufficiently fundamental debate has been had in relation to these topics thus far? If not, what would it seek to do at this stage to ensure that such a debate did occur?

Q19) In light of the complexities do the Regulatory Authorities believe that a commercial impact assessment is required to inform better the design decisions that need to be made in relation to this topic?

Q20) Given that these changes effect trade between member states, do the Regulatory Authorities believe that it would be prudent, to consult with other regulatory authorities and examine in detail the legality of such changes in relation to the relevant international treaties and directives?