Moyle Interconnector Response to SEM-19-024 (Balancing Market and Capacity Market Options Consultation Paper)

Option One: Simple NIV tagging in the Balancing Market

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

We agree that there was an issue with the imbalance price algorithm at the introduction of I-SEM in that system constraints, particularly the North-South tie-line, was causing significantly inflated all-island prices when there was an acute energy imbalance in one location on the system.

This issue was largely removed by Mod_09_19, which removed several system operator (SO) flags from the imbalance price algorithm.

The Simple NIV tagging mechanism proposes to remove all system operator flags from the imbalance price mechanism. This approach makes logical sense, as SO flags refer to system constraints, which are beyond the control of individual units. If a unit is called in the Balancing Market, for whatever reason, then it should have the opportunity to set the market price.

The Simple NIV tagging approach also proposes to remove Non-Marginal Flags. These refer to when a unit itself is physically constrained. Moyle believes that these flags should remain in the imbalance pricing algorithm, as it is not appropriate for a unit that could not actually deliver a change in MW to or from the system to be setting the price.

It is correct that SO flags should not influence the price because units have no influence over the transmission system and its constraints, which lie fully within SONI and Eirgrid's remit. However, the owners of individual unit's do have control over their unit's physical capabilities, therefore it is correct that if they cannot physically deliver, they should not have the opportunity to set the system price.

Keeping Non-Marginal flagging may also help mitigate, to some extent, market power issues arising in Northern Ireland when the North-South Tie-Line constraint is binding, as large units will be flagged out when they reach a physical constraint, meaning that they cannot act as a price setter.

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

Analysis presented in the consultation document only looks at high-level patterns, rather than the underlying fundamentals of the pricing algorithm. If Simple NIV tagging were to be introduced, then units would likely change their bidding behaviour to take into account the new method. Therefore, the analysis presented could either understate or overstate the benefits of Simple NIV tagging. Without more fundamental analysis, it's difficult to see what unintended consequences there may be.

One of the issues that Simple NIV tagging aims to mitigate is frequent negative pricing as a result of all available units being at their Lower Operating Limit and therefore priority dispatch units having to be dispatched down. The consultation document states that this is against the original policy decision that priority dispatch decremental prices should not be used in determining the system imbalance price and is therefore a result of incorrect implementation.

The consultation document also states that the Simple NIV tagging will not solve this issue, just merely reduce the likelihood of it happening. In this case, we feel it would be better to just introduce a change to fully implement the original policy decision, rather than attempting to do so using a blunt tool such as Simple NIV tagging. One of the main rationales for removing non-marginal flags seems to be to address this issue, which can more effectively be addressed in other ways and which will enact the original policy decision.

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.**

The consultation document outlines that: "The effect of Simple NIV tagging is to use price and the NIV itself as the system to identify energy and non-energy actions. Any actions with a price which is more expensive than the marginal action, and any actions in the opposite direction to the NIV, are identified as non-energy actions."

Although it is not explicitly stated in the consultation document, we assume that the process of PAR tagging and calculating an energy-weighted average imbalance price will remain in the Simple NIV tagging algorithm. If this is not the case, it would not be clear to us how this proposal is different to the simple stack/unconstrained schedule method, albeit under a different name. We would appreciate if it was explicitly clarified that PAR tagging will remain under the simple NIV tagging process.

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

The consultation document lists a greater correlation between imbalance prices, the NIV, System Demand and Wind Generation as a positive of the Simple NIV tagging proposal. It is important to re-emphasise that the analysis presented does not look at the fundamentals of the pricing algorithm, and so correlation does not necessarily equal explanation in this case. It is possible that participant bidding behaviour would be significantly different under the Simple NIV approach, and therefore these correlations may not hold in reality.

If one of the objectives of this proposal is to reduce volatility in imbalance pricing, this is already accounted for to some extent by the averaging of imbalance price periods over the settlement period, and there are other tools at the disposal of regulators to reduce volatility further. For example, increasing the PAR figure from 10MW could have this desired effect.

The consultation document states that "a certain amount of volatility in the Balancing Market is to be welcomed, as long as it is caused by market fundamentals, as it will encourage liquidity in the ex-ante markets". Whilst in theory this may be true on a 'normal' day to day basis, what we have actually seen is liquidity moving from intraday timeframes to the balancing market when units have tripped, leading to higher imbalance prices. Generator units have not made capacity available intraday so that it can be available to the balancing market instead, anticipating that system tightness will give a much higher price in that market – this then leads to an inability for short units to trade away imbalance positions intraday.

Continued volatility could therefore be detrimental to liquidity in the ex-ante markets, and for this reason we would not agree that volatility in the imbalance price is something necessarily to be welcomed where it leads to high prices that are predictable.

Option Two: Removal of Difference Charges where operational constraints are binding

We understand that this change is proposed as a result of the high imbalance charges we have seen on occasion in the balancing market to date. No unit has become subject to difference charges as a result of ex-ante prices. As such this ‘problem’ is limited to the balancing market and amending the pricing algorithm should reduce the likelihood of it repeating.

Currently the best way to avoid an exposure to Difference Charges is to get a position in the ex-ante markets. If the risk of Difference Charge exposures is retained, then this incentivises units to get called earlier, rather than waiting for the balancing market to get called and cashing in on high imbalance prices. Given the risk of this is now reduced anyway and could further be reduced by the implementation of all or part of Option 1, it is perhaps not unfair to expect generator units to bid in such a way that they obtain a position ex-ante to avoid Difference Charges. The units are being significantly rewarded through Capacity Payments, so even if they are units with high start-up or marginal costs, there may be times when it is reasonable to expect that they will generate at a marginal loss to avoid even more punitive Difference Charges, in exchange for their ongoing Capacity Payments.

Notwithstanding the view expressed above, we believe that this option needs significantly more analysis before a decision is made on its implementation either way. There is a possibility that it fundamentally alters the risk profile of the capacity market, at least for some units. Different units are likely to be protected by this amendment at different times and there could potentially be unintended discriminatory outcomes as a result of this change. Therefore, the effects of this proposal need to be better understood before it is progressed.