

# Proposed RA options for all-island harmonised TLAFs

Synergen's response to SEM-10-039

## 1 Introduction

This paper is Synergen's response to the consultation paper SEM-10-39 published by the RAs on 18<sup>th</sup> June 2010. Synergen has no objection to this response being published.

### 1.1 Background

Synergen has previously submitted responses to the TLAF consultations issued by the TSOs (notably SEM-09-107 and SEM-09-60). Within these responses Synergen has consistently supported the principle of cost-reflectivity within the TLAF arrangements. This is not to say that Synergen believes that the existing methodology is perfect, indeed we have previously set out reservations about:

- the extent to which the ex-ante values are not based on stochastic modelling;
- the marginal determination of values, and the averaging adjustment leading to transfers of values between participants;
- TLAFs not reflecting actual dispatch rules (notably with respect to priority dispatch); and
- TLAFs not reflecting actual losses in dispatch<sup>1</sup>.

Despite these reservations, Synergen considers that varying TLAFs by location across the market remains an important element of cost reflectivity within the market arrangements. In this context, other factors are also important; transparency, predictability, and to an extent stability are all desirable features of future TLAF arrangements, but only in the context of efficient, cost reflective TLAFs – they are not robust acceptance criteria in isolation of other considerations.

Synergen is extremely concerned at the RAs' proposal as set out in SEM-10-039 to adopt uniform tariffs for scheduling and dispatch in the short term due to the market inefficiency such postal allocation introduces. The cost benefit of this change has not been demonstrated by the RAs.

Regarding the longer-term approach, Synergen has not supported the "splitting" option – but we note that that taking this forward is subject to an impact analysis, and that further options will be analysed. Regarding the long-term option, our comments are thus more limited, concentrating primarily on the conceptual basis of splitting, and the process for the assessment of it, and other longer-term options given that there

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<sup>1</sup> Although this is an assumption and we have not got the data to undertake analysis to substantiate it, we do not believe it is a contentious one. Synergen recognises that the impact of intermittent generation on real time losses increases both their volatility, and predictability.

will further scope for engagement on these matters within the timetable set out in SEM-10-039.

Our objections are (at the highest level) that uniform TLAFs:

- will most likely increase costs;
- are detrimental to efficient dispatch outcomes; and
- unduly lead to uneconomic wealth transfers between generators.

Synergen agrees that the existing TLAF mechanism has some limitations, principally of execution. To be clear, Synergen considers that the **principle** of cost reflective TLAFs is correct, and robust. Concerns regarding the existing methodology are in relation to the execution of this principle. It is critical that we do not move away from a sound principle to correct flaws in the practice of TLAF arrangements. Arguments that we should move towards uniform TLAFs because the existing methodology is flawed do not address the central economic arguments of scheduling and dispatch efficiency. Parties that support uniform TLAFs need to demonstrate that they are more appropriate in the SEM than cost reflective TLAFs – and Synergen does not believe that this case has been made either by the RAs, or by those parties that are advancing the argument for a uniform TLAF approach.

Regarding “splitting” Synergen does not believe that there is a rationale for the adoption of one approach for scheduling, and another for dispatch. We note that adoption of this approach is subject to cost benefit assessment, and thus at this stage we are prepared to see whether a robust and transparent case for such an approach emerges. We have previously stated our objections to “splitting” and at this time our position is unchanged in that we continue to oppose “splitting” as presented by the RAs. Synergen objects to “splitting” as we believe the SEM regime should ensure that **both** the market schedule and the physical dispatch are efficiently determined.

Thus, Synergen’s believes that both the short-term and long-term solutions set out in SEM-10-039 has fundamental flaws and that an appropriate solution must be based on:

1. both scheduling and dispatch being treated in the same manner; and
2. TLAFs should be (broadly) cost reflective.

## 1.2 Structure of Response

In the remainder of this paper we focus on the short-term solution as follows:

- specific concerns related to matters raised in SEM-10-039;
- the principles of the SEM and the RAs changing objectives and the likely impact on market efficiency through likely price effects;
- regulatory risks associated with the proposed approach;

- the process adopted, including the need for a demonstrated cost benefit; and

We then present conclusions related to the short-term solution and conclude the paper with a consideration of the long-term solution, including the consistency of the short and long-term solutions, and other regulatory initiatives and consider the assessment requirements associated with the proposed long-term approach.

## 2 Specific issues raised SEM-10-039

Synergen is concerned about a number of statements in SEM-10-039 which are addressed below, with extracts from the paper *highlighted*:

- The paper comments on a view (attributed to the TSOs) that there are ***“pressing concerns associated with the present TLAF methodology.....”*** (SEM-10-039 Section 2.2). This view is implicitly accepted by the RAs, but Synergen does not accept that this would be an industry consensus. There are concerns, as Synergen recognises, but these need to be addressed in a considered and robust manner. Even if concerns are pressing, it does not mean that a radical change of direction should be adopted as early as October without an impact assessment. Synergen strongly believes that significant changes to the existing methodology can only be taken forward after an impact assessment has been undertaken, and the change is determined to have a positive benefit.
- ***“It is apparent that the existing methodology is not promoting efficient dispatch, given the ex-ante determined values and actual losses is having an undue impact on the market schedule”*** (SEM-10-039 Section 2.4.2). This is somewhat unclear, but clearly if the values in the schedule and dispatch are the same, and not accurate, then the dispatch will not be optimal. Moving forward, the concern that Synergen has is (in the long term) more about, a distorted schedule than inefficient dispatch. The RA position seems to be that an inefficient schedule is acceptable (under splitting) if the dispatch is accurate. For reasons of design consistency, equity, and efficiency Synergen does not concur – notably given the reliance on infra-marginal rent for generators. In “uniform” schedule with “cost reflective” dispatch generator would see a proportion of generation move from marginal price to pay as bid if not scheduled but dispatched on that volume as a result of a duality of TLAF treatment. This is more consistent with pay-as-bid than with marginal pricing principle.
- ***“In the short term, the critical principle that the RAs are adhering to is that reform will only be progressed if it offers progress towards a long term solution or it is an improvement on the existing TLAFs from the point of view set at the start of this workstream.”*** (SEM-10-039 Section 2.4.3.). Whilst this is clearly an either/or position it provides little clarity, as these positions are not consistent. Uniform TLAFs do not (even in the RAs view) represent a long-term position and moves further away from a long-term position than the existing arrangements.
- ***“....the RAs, whilst accepting that compression would reduce the range in TLAF values are of the view that this approach is arbitrary ....”*** (SEM-10-039 Section 2.4.3). This is not a reasonable position. A selected range of TLAF values is no more arbitrary than a uniform value, but is at least somewhat cost reflective.
- ***“It is possible that these [existing TLAFs] are not much more representative of real time losses than uniform TLAFs would be ...”*** (SEM-10-039 Section

2.4.3). This is supposition and not demonstrated. Conclusions cannot be thus based on this assumption.

- ***“... as regards to real time loss factors ....the perceived difficulty and possible high associated cost.... make this “not a feasible option”.*** (SEM-10-039 section 2.4.3). This is merely a statement of supposition, not fact. Conclusions based on this assertion are thus unfounded and invalid.
- ***“In the responses to SEM-09-107 and in feedback in industry forums held as part of the consultation, Generators almost unanimously supported the move to uniform loss factors .....*”** (SEM-10-039 section 2.4.3). Synergen has considered all of the 21 responses to SEM-09-107 to seek to verify this statement. A number of parties opposed uniform tariffs – and some like Synergen opposed compression but did not comment on uniform TLAFs (we understand that like us they did not consider it as a viable option – as it was not one of the preferred options consulted on). Our best estimate is that 10 of the 21 responses were in some way supportive of a uniform TLAF. This does not include respondents that supported jurisdictional based TLAFs (as these are not uniform on an SEM basis<sup>2</sup>). Synergen thus considers this statement of “almost unanimous” support to be misleading as it would allow for at best a couple of dissenting voices – not a lack of endorsement from the majority.
- ***“The analysis [RAs’ detailed Impact analysis] will determine the best treatment of losses in the market schedule.”*** (SEM-10-039 Section 2.5.1) Whilst Synergen clearly supports a full ranging assessment, this statement makes it clear that **these options have not been assessed to date**. Thus, the short-term approach is, by admission, not assessed. It thus runs the risk of not only being reversed when fully assessed, but also doing significant damage to the market as a whole in the short term.

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<sup>2</sup> Synergen does not support jurisdictional specific charging / pricing arrangements unless this includes energy pricing i.e. two separate SMPs.

### 3 Consistency with SEM design and objectives

The SEM design reflects some localised structural issues (market size, types of generation, the relative need to stimulate new investment, the size and nature of the market participants etc). Whilst market designs balance complexity, cost and efficiency, Synergen had hoped that as the SEM matured, the arrangements could become more competitive – i.e. there would be less emphasis on central control and a greater move towards market based outcomes. A move towards uniform TLAFs is entirely contrary to the stated intent of the SEM and step further away from an efficient market. The remainder of this section covers:

- why uniform TLAFs are inconsistent with the stated design intention of the SEM;
- the consistency of the RAs approach in SEM-10-039 with other areas of market reform; and
- the requirement to have efficiency as a primary objective.

#### 3.1 High level design principles

Specifically regarding losses, the RAs High Level Decision paper (AIP-SEM-042-05) states ***“It has been decided that transmission losses in the SEM will be accounted for by applying locational loss factors to the outputs of each generator. These loss factors will be calculated on the single combined transmission system and will be set annually (ex-ante). The loss factors may vary by season and time of day. The exact method of calculating these locational loss factors will be determined in parallel with the development of the detailed market rules.”***

Synergen does not believe that there is any plausible interpretation of this decision, and the RAs proposed approach with regard to uniform TLAFs (in the short-term) other than that they should, in some cost reflective manner, reflect the locational value of individual generators, and this cannot be interpreted as a locational value that is common to all generators.

Synergen thus believes that the SEM Committee decision is contrary to the SEM High Level design. This view is consistent with that clearly expressed by the TSOs in SEM-09-107 which stated ***“A uniform loss adjustment approach would not be compatible with the June 2005 High Level Design”***.

#### 3.2 Changing objectives

How various options regarding TLAFs are assessed, is highly dependent the evaluation criteria used, and how those factors are weighted.

The TSOs in SEM-09-107 placed a significant weighting on dispatch efficiency – whilst recognising that transparency, stability and predictability were also important. In SEM-09-107 the TSOs set out their own assessment criteria regarding losses. Under this approach high weightings were given to “efficient dispatch” (25%) efficiency (20%) and cost reflectivity (20%). Volatility, predictability and transparency

related to the other 35% of their weighting factors. Whilst SEM-09-107 was a TSO paper, it was made clear to stakeholders that the RAs had been kept closely informed regarding its development and content and it would have been difficult for stakeholders to conclude that the RAs had fundamentally rejected these criteria<sup>3</sup>. In the context of TLAF consideration, Synergen broadly concurs with the assessment approach set out by the TSOs.

The TSOs' position appears to be in line with the SEM objectives, the principles of the T&SC and the RAs' stated position at the time that the TSOs published the paper. Notwithstanding the RAs references to SEM-09-001 as a reflection of its objectives with respect to locational charging, the RAs provided considerable insight into their thinking on efficiency objectives for scheduling and dispatch in SEM-09-073<sup>4</sup> stating **"...the short term objective, of minimising the cost of production given the existing portfolio of generation, is achieved in minimising the costs in generation dispatch....."** and that **"The objective of dispatch should thus be to simply achieve short-run efficiency by minimising the cost of production....."**.

The RA's position on the desirability of dispatch efficiency has thus (historically) been unequivocal. In SEM-10-039<sup>5</sup> the RAs have chosen to place a considerable emphasis on **"promoting fairness, stability and predictability"**. This statement is somewhat inconsistent with the statement of objectives in Section 1.1 of SEM-10-039 that notes **"However, in this paper the RAs are proposing to place a particular weighting on the principal objectives of TLAFs delivering efficient generation dispatch (in an optimal fashion) over that of allocating losses to particular generators on a cost-reflective basis"** This also being supported by the statement that **"....increased predictability and transparency and reducing volatility for market participants (as well as cost reflectivity as objectives)"<sup>6</sup>.**

Synergen does not believe that a uniform TLAF approach in scheduling and dispatch could lead to efficient dispatch. Whilst it could be argued that splitting seeks to achieve this, the short and long-term objectives are not clearly distinguished in the paper – if indeed they do exist. Our comprehension is thus that in the short term, the emphasis is on "fairness, stability and predictability" whilst in the longer term the aim is to deliver efficient dispatch in the absence of cost reflectivity to individual generators. **Synergen believes that the short term solution proposed is not consistent with an objective of achieving efficient dispatch** – and thus as this response concentrates on the short term proposal, we believe that it is a reasonable reflection of the RAs position to conclude that efficiency has been given a very low priority.

Unlike the TSOs, the RAs have not set out any weighting of their definitive assessment criteria, nor are the criteria expanded upon in detail. Further, Synergen does not consider, as set out, that the short-term objectives form a robust basis for assessment. Specific comments are below:

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<sup>3</sup> In particular, the RAs didn't raise any objections to these criteria is at the public fora.

<sup>4</sup> See SEM-09-073 Section 3.2 and Section 3.3

<sup>5</sup> See SEM-10-039 Section 2.4.1

<sup>6</sup> See SEM-10-039 Section 2.4.3 which also references AIP/09/001

- **Fairness:** This seems to be like beauty, in the eye of the beholder. Fairness is an entirely subjective criteria; it is not a measurable objective; indeed one interpretation appears to be that this means increases cross-subsidies between participants. In short, if fairness means cross-subsidisation between generators, then this transfers wealth in the unconstrained schedule from generators with low loss factors to those with high loss factors. Whilst the RAs may take the view that the existing TLAF methodology is inaccurate (being based on ex-ante values not actual outcomes) the underlying principle seeks some cost reflectivity, and to minimise production costs – objectives that appear to inherently more “fair”. Synergen does not consider that the **socialising** of the cost of losses based on other generators’ investment decisions to be “fair”.
- **Predictability:** This is desirable, and measurable. Synergen thus accepts that this is a reasonable objective. However, our view is that a transparent methodology, that is consistent over time, is predictable. This is because the methodology is predictable, and thus over time, outcomes can be forecast. Whilst real time TLAFs may not be predictable on an hour-by-hour basis, they would average out to a predictable value over time. Wind penetration, and the nature of lumpy investment in a relatively small system have over the last few years made TLAFs more volatile in the RoI. We consider that the second of these factors will now have largely stabilised, although clearly real time losses on the system will be increasingly driven by the profile of intermittent generation. As the RAs note in SEM-10-039, there may be considerable costs in moving to a system such as marginal dynamic losses – which would be cost reflective in real time, but more volatile. Such an approach may be predictable over time, but may inconsistent with the stability criteria.
- **Stability:** We take this to mean that the arrangements provide for TLAF values to be the same, or within a limited range, over some temporal horizon. Clearly stable does not equate to uniform. For example, this criteria could be equally met by fixing TLAFs for a 3 year period at some average of their existing seasonal and time of day values and furthermore by the RAs committing to fix the methodology for a five year period.

In SEM-10-039 the RAs refer back to the original objectives that they set for future Harmonised Generator TUoS and TLAFs (SEM-09-001). Whilst the present assessment stresses the need to reduce volatility, there was no such objective set in the original criteria. Whilst criteria may be refined over time, it is not clear that the RAs are arguing that they have made explicit changes to the objectives to be met – as evidenced by the references back to the original objectives. Synergen therefore does not believe that reducing volatility is an objective of the future TLAF arrangements, and thus options cannot be validly assessed against it.

In SEM-09-001, the RAs set out some assessment criteria that no longer seem to be being applied in the assessment of (at least) the short-term option presented. Notably, these included:

- that arrangements are non-discriminatory;
- transparent (including the duty to promote competition in generation);



- cost-reflective; and
- encourages efficient use of the network and network investments.

Synergen does not believe that the RAs have applied their own criteria from SEM-09-001, despite the references to it in the present paper. The short-term solution is inconsistent with these RA objectives and in Synergen's view would not meet any objective assessment against them.

### 3.3 Efficiency as a primary objective

One of the key principles of the SEM design was efficiency – this being balanced with other criteria of Security of Supply; Stability; Practicality; Equity; and pro-competitiveness. We believe that in placing such a high emphasis on a sub-set of criteria, the RAs short term solution of uniform TLAFs does not adequately balance a more comprehensive set of objectives. Synergen considers that it is unreasonable for the RAs to allocate a minimal weighting on the efficiency of TLAF arrangements when determining their future nature. This applies in the short term – where we believe efficiency is a critical issue. This also applies in the long term as we reject the premise of efficiency in a non-cost reflective manner (whilst this *could* give dispatch efficiency it does not address broader efficiency criteria, or indeed equity issues). On this issue, we concur with the TSOs in terms of their emphasis on dispatch efficiency, and efficiency criteria in SEM-09-107, and a number of other respondents to that paper.

Market prices will be less efficient given that, as previously discussed, the use of uniform TLAFs in dispatch is, by definition, inefficient. All parties agree that the ex-ante methodology (applied a year in advance) cannot be fully reflective of real time losses, and these participants have set out their concerns on the basis of the modelling in a number of forums. So, Synergen is not suggesting that the TLAF methodology is necessarily “right” in real time, or indeed that the methodology is perfect. What we can observe, however, is that the present approach **seeks** to reduce losses and production costs through the application of TLAFs that in some aggregated, approximated, manner reflect the underlying economics of the system. Under uniform TLAFs we believe that there would be adverse market outcomes associated with the elements of SEM pricing – specifically the impact on end customer prices. Regarding price impacts, Synergen considers that a uniform losses approach will have an impact on SMP, and will certainly increase constraint costs and the cost of losses. This concurs with the TSO view in SEM-09-107 the TSOs stated that there would be significant impacts on SMP, Infra-marginal rent, Error Supplier Units and Economic Signals. Based on the evidence available, it appears likely that costs in the SEM will increase, and that such an increase would not be based on any underpinning cost driver but solely a move towards socialising underlying costs within the SEM that are currently allocated in a manner that seeks to be cost reflective.

Further, Synergen considers that as production volumes (MWh produced) would rise under the uniform TLAF approach (as more MWh are required to meet demand than under a cost-reflective losses approach) emissions would increase. Synergen considers that this is contrary to the RAs' statutory obligations to reduce environmental impacts.

A uniform TLAF just less than unity socialises locational generation investment decisions (and to a lesser extent network investment and demand location) between generators. Plant that has an output that is subject to significant losses becomes a cost that is borne by customers as a whole and by more cost efficient generators. This is in line with the TSOs' view<sup>7</sup> that **"...cross-subsidisation occurs in that a generator off-setting losses could find itself paying more for a generating unit increasing overall losses on the system"**. It would be prudent for the RAs to request that the TSOs assess the materiality of this effect.

When considering TLAF options, the TSOs were clear that uniform Loss Factors are entirely inconsistent with the SEM design and explicitly stated that uniform Loss Factors are inefficient. The TSO view on a uniform Loss Adjustment Factor was set out in section 5.3 and 5.31 of SEM-09-107. They also set out some stark views earlier in their paper. Synergen concurs with the TSOs' views<sup>8</sup> that:

- **"a system without an efficient dispatch is of little value"**
- **"an efficient dispatch of generators will ultimately reduce losses..."**
- **"TLAFs therefore not only support efficient real-time dispatch of the system but also help to promote the efficient location of generation plant"**
- **"A losses methodology should be cost reflective"**<sup>9</sup>

In Synergen's view, uniform Loss Adjustment Factors were dismissed by the TSOs in 2009, and indeed our comments in response to that consultation concentrated on the "compression option". Synergen believed that this approach would lead to changes in the merit order, and this was also the position of the TSOs (as referenced in Section 2.4.3 of SEM-10-039). The potential changes that arise from a uniform Loss Factor approach are of even greater concern. There could be significant changes in market outcomes solely as a result of a decision to not reflect in a cost reflective manner the locational value of electricity generated. As a starting point, changes to the market outcomes should be a consequence of increased competitive efficiencies within the market; between both existing players and with new entrants. Such efficiencies should be cost reflective.

To take a proposal such as uniform TLAFs forward, there would need to be a net positive cost benefit to the approach. This would require that the RAs first quantify the changes in SMP, constraint costs, reserve and losses. Assuming that there are increases in these costs, there would need to be a greater reduction in other costs – and the only major cost that has been associated with the volatility is the cost of capital implications (noting that reductions in revenue to generators with "poor" TLAFs and increased scheduling / despatch to those with "good" TLAFs is not a cost – it is a wealth transfer and thus outside any CBA). In the absence of this, and there is no such evidence in the paper, then there is no demonstrated positive CBA to the uniform TLAF approach.

<sup>7</sup> See SEM-09-107 Page 34

<sup>8</sup> SEM-09-107 Page 15

<sup>9</sup> Note – this was not just "efficient" but cost reflective i.e. a differential allocation between generators.

Regarding the socialisation of costs between generators, there is a material re-distribution of wealth that would flow from a uniform TLAF approach – both in terms MSQ volumes, and revenues per MWh generated. As noted earlier, Synergen believes that value transfers between generators should occur for reasons of underlying efficiency over time, but they should not be consequence of changes to the market that are by their nature inefficient. Not only may these wealth transfers occur with regard to MSQs and constraint payments, but they will also flow through to CPM revenues. There is no economic rationale to support such a re-distribution, as it serves only to reduce long term and short term efficiency through cross-subsidisation.

Synergen further considers that as an inefficient dispatch would result from uniform TLAFs this would be contrary to the System Operator Licence.

Whilst the increased level of wind on the system will reduce the accuracy of year ahead ex-ante TLAFs, it does not mean that the principle of cost reflectivity is flawed. The challenge thus seems to be to apply cost reflective principles, but accept that objectives of stability, predictability (and probably cost) militate against a “pure” approach such as dynamic marginal losses. However, this is an issue of execution / practice of the principle of cost reflectivity, not the principle of it. Therefore, Synergen strongly believes that TLAF differentials should be maintained in the scheduling and dispatch of plant. The compression approach it at least seeks to maintain this principle, albeit in a diluted form. To dismiss compression as “arbitrary”, but to impose uniform TLAFs instead, appears to us to be illogical, and inconsistent.

## 4 Regulatory Process

### 4.1 Regulatory Risks

The SEM as a market needs to develop over time, and change. There is a clearly regulatory risk associated with market change, but such adjustments should be a large extent predictable, if not in their detail in their general direction. This is why underpinning principles such as efficiency are so critical – they clearly capture the high level policy. In the case of any proposal to adopt uniform TLAFs, the SEM Committee decision appears to be contrary to the intent of the SEM and any reasonably anticipated developments. We consider that this increases risk both in terms of regulatory approach and direction, and that this will give rise to an upwards pressure on the cost of capital. We would assume that in any CBA, the uncertainty engendered by the RAs present approach over efficiency in the SEM is fully reflected (and explicitly stated) in any assumptions made over future costs of capital when considering the uniform TLAF approach.

### 4.2 Regulatory Process and cost benefit questions

The consultation process regarding locational signals in the SEM had previously been led by the TSOs with input by the RAs. Whilst SEM-09-107(a) notes that the final RAs' position may not be the options proposed by the TSOs, never the less SEM-09-107(a) states that "***There has been significant input to this paper [SEM-09-107] provided by the Regulatory Authorities (RAs, meaning the CER and NIAUR)***" and thus the process appears to have involved the TSOs leading, but with a guiding hand from the RAs through the RAs commenting on draft consultations, and being in close liaison with the TSOs. Thus, Synergen's assumption was that the RAs had every opportunity to influence or change the assessment criteria used by the TSOs, and that the RAs were not in complete disagreement with the methodology, assessment criteria and conclusions of SEM-09-107.

In order to avoid such confusion, Synergen believes that all SEM consultations should be explicitly issued by the RAs.

Synergen responded to both SEM-09-60 and SEM-09-107. The latter paper was issued in November 2009 and Synergen's response to the "preferred options" paper, focused on the main TLAF proposals presented. It did not comment specifically on uniform TLAFs as these were not consulted as a preferred option (or even a viable option) as they had been dismissed by the TSOs. In that submission, Synergen explicitly requested that preferred TSO options (which somewhat reduced efficiency, but were certainly not as extreme as removing TLAF differentials altogether) were not adopted by the RAs as they were contrary to the design of the SEM and inefficient.

In many of its consultation responses, Synergen has requested that any changes in the market are subject to an explicit, and demonstrated cost benefit assessment. We are thus extremely concerned, and disappointed, that a complete reversal of policy direction and existing market design is being proposed in the absence of such analysis.

Further, Synergen wrote to the RAs in the light of the SEMC decision to adopt uniform TLAFs. In that letter Synergen requested both an urgent public consultation and a public forum – both of which we are pleased to see the RAs have taken forward. However, we also requested that the RAs publish immediately all of the documents which the SEMC considered in arriving at its ‘minded to’ decision on the uniform TLAF approach, i.e.:

- the RAs’ internal impact assessment and modelling of SEM outcomes under the approach proposed (i.e. the evidence on which the proposed approach was adopted);
- any conclusions drawn by the TSOs in consideration of responses to SEM-09-107 are published; and
- any relevant submissions made directly to the RAs by interested parties.

Synergen again urges the RAs to publish this material immediately, as well as the advice to them from the TSOs referred to in SEM-09-107(a).

To take forward the uniform TLAF approach from 1<sup>st</sup> October 2010 on the basis of the material currently made publicly available, and the concerns and questions raised by participants, appears to amount to a lack of due process.

## 5 Conclusions on short-term options

Synergen is extremely concerned at the RAs' decision to adopt uniform TLAFs (for scheduling and dispatch) with effect from October 2010. We consider that some legitimate concerns over the existing methodology and approach seem to be addressed in an inappropriate manner – the RAs should be making the cost reflective principles work more effectively, not abandoning them. The RAs should thus work on approaches that improve the existing arrangements, not abandon them.

Synergen considers that there is no demonstrated benefit to the market as a whole in moving to a uniform TLAF approach. There is no compelling case for such an approach from those participants that have advocated it, and the TSOs (who have no individual commercial interest in one approach over another) clearly see it as conceptually weak, and inefficient. In the absence of a demonstrated benefit to a uniform TLAF approach Synergen considers that there is no robust rationale for such an approach. The RAs must thus maintain the existing arrangements until impact assessments and a cost benefit assessment have been conducted.

Regarding the short term approach, Synergen believes that it is not only inconsistent with the RAs "***principal objective of delivering efficient dispatch.....***" but it is inconsistent with the mooted longer term approach – which does seek to achieve this. Thus, we would move from:

1. Cost reflectivity in scheduling and dispatch; to
2. No cost reflectivity in scheduling and dispatch; to
3. No cost reflectivity in scheduling, but with cost reflective dispatch.

There is no consistency in this approach, nor sound rationale for it. To the extent that the RAs seek to minimise regulatory risk premiums in the cost of capital, Synergen can only see the effect being adverse.

Synergen is extremely concerned that (at least in the short term) efficiency as an objective is being abandoned. This is inconsistent at all levels with not only the RAs own design principles, but contrary to how the SEM could reasonably be expected to develop. The RAs approach of stability and predictability being pre-eminent criterion would (if adopted for TLAFs) logically be carried through to other areas. However, it is possible that we may move to flatten TLAFs on the one hand, whilst potentially making other market elements such as Capacity Payments more volatile and less stable. There is a need for clarity and consistency of approach in the way in which the SEM develops, and it is not evidenced in the short-term TLAF approach.

Finally, but not least, there is a considerable body of opinion amongst participants that uniform TLAFs should not be adopted, as well as a number of participants that would favour it. Synergen thus considers that the suggestion in the paper that the RAs proposal represents something of a participant consensus (specifically the statement that "***generators almost unanimously supported a move to uniform loss factors***") is incorrect and may erroneously influence responses to this consultation.

## **5.1 Assessment requirements associated with the proposed long-term approach**

Synergen welcomes the RAs' approach of undertaking a robust assessment of the splitting option and all other potential approached TLAFs. Synergen believes that there should be no "short-term" solution, and that this assessment / review of options should determine future TLAF treatment as a one stage process.

In undertaking this assessment Synergen urges the RAs to first establish clear assessment criteria, building on principles of minimising cross subsidies and creating efficient outcomes, balanced by stability and predictability (although to our mind these are important, but secondary objectives). In undertaking this assessment there should be a clear two-stage process. First, relevant data should be published along with objective assessment criteria. Second, the RAs conclusions and supporting analysis should be published and open to consultation. This one-stage approach would reduce both costs and uncertainty.

More broadly, Synergen welcomes the RAs' recognition of the clear links between the approach they take on TLAFs and other regulatory reviews, including the ongoing consideration of Scheduling and Dispatch principles. Synergen also believes that a consistent approach in terms of objectives is desirable. This would be relevant in the CPM Medium Term Review where not only will the efficiency of the arrangements be considered (including whether price signals can be reacted to and determine outcomes) but also stability and predictability will be important considerations.