
Response to the SEM Committee's Consultation

on

Measures to Promote Liquidity in the I-SEM
Forward Market

(SEM-16-030)

from

BORD  **MÓNA**

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Introduction

Bord na Móna welcomes the opportunity to provide an input into the RA's consultation on the Measures to Promote Liquidity in the I-SEM Forward Market.

Bord na Móna operates Edenderry Power Plant, a peat/biomass generating unit (REFiT PPA), Cushaling peaking plant, Bellacorick, Mountlucas and Bruckana wind farms, and the Drehid landfill gas facility (the latter three units also operate under a REFiT PPA). The most recent portfolio additions are Mountlucas and Bruckana wind farms; these have made a significant contribution to our renewable portfolio with greater than 50% of our electricity generated now classified as carbon neutral.

Bord na Móna appreciate the need for increased liquidity in the forwards market, and fundamentally see the benefits of hedging prices against the DAM for our conventional units.

However, BnM thoughts on the structure and possible regulatory intervention of the Forward markets in the I-SEM is coloured by the unique position of its largest asset Edenderry Power Limited (EPL). Currently, in the SEM and expected to carry through to the I-SEM, EPL operates with both 'Hybrid Plant Status' as well as a REFiT backed PPA contract for its renewable outturn. These characteristics distinguish EPL from other dispatchable units on the system, and given that EPLs fuel costs (both conventional and renewable) are positive costs to EPL, the unit's business case and viability also differs significantly from WtE plants even those that may have attained hybrid status and have a REFiT PPA.

It would appear that given the relative size of EPL in the all island market, coupled to the workload facing the RAs in designing the I-SEM, the above unique characteristics of EPL may have escaped the attention of the SEM Committee. Bord na Móna would therefore like to take this opportunity to highlight its concerns over one particular aspect of this Consultation (SEM-16-030), namely the criteria proposed for imposing Forward Contract Sell Obligations (FCSOs) on selected generators. Put simply and based on the rationale discussed below, Bord na Móna believe that EPL's mandatory FCSO (if implemented in the SEMC's decision) should be set to zero.

Rationale behind EPL's FCSO being set to zero

Should the SEMC be minded to implement mandatory FCSOs on selected generators, BnM believe that the FCSO value assigned to EPL should be set to zero. EPL, notwithstanding its dispatchable nature, is unique from all other plants on the power system having 'Hybrid Status', a REFiT PPA and positive fuel costs for the totality of its outturn (both conventional and renewable). In the sub-sections below, these points

are expanded; in addition further evidence is adduced relating to EPL's supply chain and regulatory constraints which re-enforce the uniqueness of EPL relative to other dispatchable plants in the market.

REFIT PPA

Under the Irish Government's REFIT 3 scheme, Edenderry Power Limited qualified for a PPA for the production of Renewable Electricity from the co-firing of biomass at the plant, see Statutory Instrument No. 556/2015. Obviously, there is no logic in mandating a unit in receipt of a FiT (based on annual market revenues) to enter into Forward CfD struck against the DAM price.

In the Consultation paper, however, there is no acknowledgment of EPL's REFIT PPA and Table 2 (page 16) merely cites all of EPL's 2015 MSQ as the basis for calculating its share of the 'market'. Unlike existing REFIT backed PPAs for wind and other renewable technologies, there is an upper limit in the REFIT scheme of 336,384 MWh pa for EPL. While it may be tempting to simply deduct the REFIT volumes from EPL's MSQ quantum listed in Table 2, to determine an effective MSQ and subsequent market share, the intricacies/obligations of Priority Dispatch, together with the vagaries of biomass supply logistics, and other regulatory constraints, discussed below, prevents such a straight forward approach being adopted without discriminating against and fettering the discretion of EPL to generate renewable energy, and therefore leads to the inevitable conclusion, that in equity, EPL's mandatory FCSO (if implemented in general by the SEMC) be set at zero.

Hybrid Status & Priority Dispatch

Notwithstanding that EPL is exposed to market prices for its non-PPA output, the nature of Hybrid Status / Priority Dispatch in the I-SEM implies that in essence EPL is participating outside the market. Under SEM-13-006, Edenderry Power Limited has qualified for Hybrid Plant Status, entitling the unit to Priority Dispatch (PD), the unit can produce up to 336,384 MWh pa of REFIT backed renewable generation with a carbon intensity less than that of the mid-merit reference plant. In this respect it is important to note that it is not the REFIT backed volumes that have PD, but rather the EPL unit as a whole when availing of Hybrid Status. While it is understood that the application of Priority Dispatch in the I-SEM will differ to that currently operating in the SEM, the fact remains that in the Balancing Market (BM) timeframe EPL, as a renewable generator, is entitled to Priority Dispatch but must do so as a Price Taker. Specifically, the SEM Committee decision¹ for implementing PD in I-SEM is "*that the*

¹ I-SEM ETA Detailed Design –Building Blocks Decision Paper

current policy for Priority Dispatch will remain in I-SEM. The implementation will be only relevant in the BM, where the concept of price-making and price-taking generation shall be maintained whereby Priority Dispatch generation will be price-taker." The SEM Committee have also decided that in order to preserve the Price Taking status PD units should not be in a position to set the imbalance price. For a dispatchable PD generation with marginal costs, the decremental price will represent avoided fuel costs only. In such situations EPL is no longer treated the same as a conventional dispatchable plant from a market point of view, but instead inherits a basis risk profile more typically associated with non-dispatchable units, as there is a potential mismatch between the BM price and a Forward strike price settled against the DAM. In this respect EPL exhibits price risk characteristics more akin to intermittent generation rather than dispatchable units; adhering to the SEMC's own stated position of non-discrimination, setting EPLs mandatory FCSO to zero should therefore follow, assuming mandatory FCSOs are implemented in the final decision.

Biomass Supply

It must also be noted that unlike gas and coal, the biomass market and supply chain is relatively illiquid and immature respectively. Again the significance of this illiquid market and immature supply chain distinguishes EPL from every other dispatchable plant on the system and the practical implication is such that biomass volumes (and the associated REFIT PPA MWs) cannot be accurately determined in advance. This does not impact on EPL's ability to operate as a baseload plant and meeting its nominated position on a day ahead basis, as peat (where stockpiles of on average 18 months are easily accessible) can be the swing fuel in times of lower than expected biomass deliveries². However, unlike a typical conventional plant, EPL runs a volume risk on its feedstock mix (peat/biomass) over the short term that cannot be easily hedged, i.e. proxy hedges for conventional fuel, carbon and or electricity prices do not mitigate this particular volume risk. Again this peculiarity is unique to EPL and suggest that a non-discriminatory regulatory approach requires EPLs mandatory FCSO (if implemented in general by the SEMC) be set at zero.

EU Commission Decision (2013/731/EU) – Transitional National Plan

An additional volume risk further complicates EPL's generation forecast and hence its subsequent ability to accurately predict what volumes can be physically backed off in forward contracts. On December 9th 2013, the EU Commission issued a Commission

² On an annual basis EPL must ensure that its carbon intensity at least meets that of the mid-merit reference plant to ensure that its Hybrid Status is maintained.

Decision (2013/731/EU) addressed to Ireland and detailing terms and conditions of the Transitional National Plan (TNP) in accordance with Article 32(5) of the Industrial Emissions Directive (2010/75/EU). The annexes in the Commission's Decision outline the emission ceilings and downward trajectory for NO_x, SO_x and Dust for 6 plants including EPL in the period to July 2020. The Environmental Protection Agency subsequently revised EPL's operational IPPC licence (P0482-04) to take cognisance of the Commission's Decision. Again EPL is distinguished from all the other plants listed in the Commission's decision, as it is the only generator from the 6 units listed that produces RES-E. All the other plants use fuels whose technical specification and emission rates are typically within tight tolerances. Similarly peat consumed at EPL has physiochemical characteristics that are well established and predictable. On the other hand, biomass is by definition³ a catch-all for a wide range of combustible but sustainable materials (carbon neutral) whose physical and chemical characteristics have a commensurate wide range of values. As noted above, the market and supply chain for biomass is immature and EPL is essentially a 'volume taker', purchasing whatever biomass (wood chip, saw dust, pellets, PKS, miscanthus etc.) is available on spot markets in furtherance of the Irish Government's policy objective of RES-E generation and its obligations under the RES Directive 2009/28/EC. This inability to accurately forecast the emission profile from the biomass component of the fuel mix and the subsequent emissions profile from the unit as a whole, which itself is limited by the decreasing ceilings detailed in the IPPC licence, is ultimately a constraint on the units MWh produced each year until July 2020.

Again this point highlights the unique position that EPL occupies within the generation fleet and that in reality while the plant is 'conventional' in nature, it cannot be considered 'dispatchable' in the market sense of the word, further underpinning Bord na Móna's request for EPL's mandatory FCSO (if implemented in general by the SEMC) be set at zero.

FCSO conclusions

In summary, Bord na Móna notes the comments of the SEM Committee in §8.8.8 of SEM-16-024 wherein it is stated that *"the SEM Committee recognises that imposing an FCO on a volume of a generation company's capacity/output is significant and would not seek to do so without adequate justification"*. While EPL is a conventional baseload plant, access rules (Priority Dispatch arising from RES-E production), Price Taking obligations with non-zero marginal fuel costs, an existing REFIT PPA,

³ Article 2, 2009/28/EC defines 'biomass' as meaning the biodegradable fraction of products, waste and residues from biological origin from agriculture (including vegetal and animal substances), forestry and related industries including fisheries and aquaculture, as well as the biodegradable fraction of industrial and municipal waste

immature supply chains with an inherent forecast uncertainty, as well as legislative restrictions on production, **clearly distinguishes EPL from all other plants in the market and underpins a sound justification for setting EPL's mandatory FCSO (if implemented in general by the SEMC) at zero.**

Specific Comments on the Options Presented

Option 1

As noted above Bord na Móna, although not vertically integrated and therefore not an active supplier in the market, accepts that current forward volumes could be described as inadequate. While essentially believing in the capacity of the market to deliver market solutions and being cognisant of the fundamental upheaval of the market redesign facing participants, there is therefore a certain attraction and merit in leaving the current general arrangements in place (without any additional regulatory interventions) for forward trading. Implicit in this statement is Bord na Móna's support for the removal of trading barriers discussed in §9.2 of the Consultation paper.

However, the bilateral nature of current arrangements and the associated collateral costs need to be assessed relative to the new trading arrangements discussed in §6.2 of the Consultation. It must be assumed that these new trading arrangements will not be without costs (both collateral and transactional). Independent Market Participants like Bord na Móna are not in a position to carry out this impact assessment, and would respectfully recommend that the RAs quantitatively determine the potential for reducing costs (and hence attracting more volumes) before moving away from Option 1 towards more active regulatory interventions.

Option 2

While not privy to the submissions of other Market Participants at this moment in time, it is expected that there will be calls in responses to this Consultation to increase forward liquidity *via* regulatory interventions. Again remaining cognisant of the impending upheaval taking place in the SEM, the introduction of FCSOs on selected generation companies (while leaving current market power ring-fencing arrangements in place) is perhaps the least intrusive and novel intervention available to the SEM Committee and has merit.

Similar to Option 1, Bord na Móna could support Option 2 but would contend (as per the arguments advanced in the previous section of this submission) that the mandatory FCSO for EPL be set to zero.

Option 3

Notwithstanding conditional support for Option 2 above (EPL's mandatory FCSO set to zero), Bord na Móna believes that it may be premature to implement Option 3 at the commencement of the I-SEM.

Option 4

The imposition of MMOs on vertically integrated participants represents a radical new measure for the single electricity market, which appears from the international evidence presented in the Consultation paper to increase liquidity in the reference markets, and as such may have merit in the I-SEM.

Bord na Móna being primarily a generator would not expect to be directly impacted by such a regulatory intervention.

However, in the Consultation paper the impression is given *that the capacity to be an MM is based on financial throughput of a business*⁴, and for the avoidance of doubt, Bord na Móna seek confirmation that it is not the SEM Committee's position that a single criterion such as financial throughput (or a related nominal market share) is solely adequate to determine the capacity of an organisation to act as a Market Maker? It is suggested that other criteria, including an organisation's trading resources, customer base and portfolio structure should also be considered.

Option 5

The comments provided above for Option 4 are also applicable for Option 5 with the additional proviso that if mandatory FCSOs were to be introduced Bord na Móna would contend (as per the arguments advanced in the previous section of this submission) that the mandatory FCSO for EPL be set to zero.

⁴ SEM-16-030 at pp 59

Conclusion

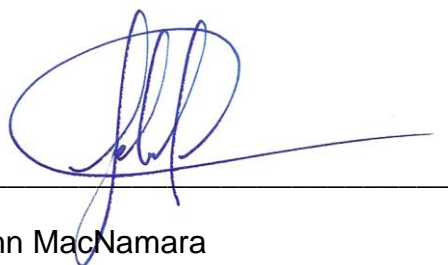
Bord na Móna understand and appreciate the need to drive more liquidity into the forwards timeframe. Ideally, this liquidity should be delivered by the market, and accepting that barriers to entry may exist, removing or diminishing those barriers should in theory be sufficient to increase liquidity. This being the case, **Bord na Móna implicitly supports Option 1 as an enduring solution.**

However, being pragmatic and in the absence of quantitative impact assessments, regulatory interventions may be necessary. **Bord na Móna potentially sees merit in Option 2** but would strongly contend that while EPL is a 'conventional' plant by design it is not comparable with other dispatchable plant in the 'market' definition of the term and would strong contend (as per the arguments advanced in the previous section of this submission) **that if Option 2 were implemented the mandatory FCSO for EPL be set to zero.**

Bord na Móna believe that **the immediate introduction of Option 3 is premature** and note that **Options 4 and 5 would not commit Bord na Móna (as a small non-vertically integrated participant) to Market Making obligations** (although as noted in the body of this submission Bord na Móna has concerns that a single criterion of *financial throughput* should not be the sole basis for obligation MM volumes on participants).

Finally, after the Workshop in Dundalk, it transpired that bilateral dialogues had taken place between the RAs and certain Market Participants. Provisional arrangements were made to have a teleconference between the RAs and Bord na Móna, however public holidays and Annual Leave conspired against these discussions taking place. In light of this, and noting the uniqueness of EPL in the market we would gladly welcome the opportunity to further discuss this submission and the wider issue of forward liquidity.

For and on behalf of Bord na Móna,



John MacNamara

Commercial and Regulatory Affairs Manager