



**Response by Energia to ISEM TSC
Operational Parameters Credit Cover &
Imbalance Settlement**

Consultation 17-009

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1. Introduction

Energia welcomes the opportunity to respond to the Regulatory Authorities (RAs) Trading & Settlement Code Operational Parameters, Credit Cover & Imbalance Settlement Consultation Paper. Energia has participated extensively in the development of the Trading and Settlement Code to date. This has been achieved by engaging constructively in the consultation process and actively participating in Rules Working Group meeting, submitting some extensive and substantive comments to both for consideration. We have also provided independent expert evidence to the Working Group on fundamentally important topics. Notably in the context of this response Energia has previously requested that Credit Cover be appropriately reviewed and that it not be excessive. However this request does not appear to have been factored into the development of this paper as the RA have greatly expanded the credit cover and collateral required.

Credit requirements that are disproportionate to the associated risk place an excessive financial and administrative burden on stakeholders. This can increase cost in the market and disproportionately impacts both smaller players and new entrants. The credit requirements in I-SEM have increased significantly from SEM. Despite previous requests, the justification and proportionality of such an increase has not been evidenced.

This response makes some general comments in relation to credit cover and Imbalance settlement before expanding on these initial comments and finally concluding.

2. General Comments

2.1 Credit Cover Parameters

The credit cover parameters outlined in this consultation will have a considerable impact to overall credit requirements for participants and the supporting analysis also provides helpful understanding to the underlying assumptions for the proposals made. The proposals contained within the consultation paper will result in an unnecessary duplication of credit/collateral which will result in an excess cost burden on existing participants in the market. The increased burden may also present a barrier to entry for new participants. As Energia noted in their response to the Trading & Settlement Code consultation a comprehensive holistic review of credit and collateral arrangements across all I-SEM markets is necessary to ascertain a complete impact assessment and to make a proper informed evaluation of the appropriateness of the current design and provisions.

Energia note that no proto-typing of credit scenarios has been undertaken to date, in particular events which are assumed to be exceptional or unusual to test the knock-on impact to the rest of the market i.e. stress test the potential domino effect of participants failing to meet obligations has on other participants and the impact of the ASP and bad debt provisions. Energia consider the market design in I-SEM as unique and warrants extensive modelling and testing to ensure the collateral requirements are not excessive.

A significant increase in credit requirements is anticipated in I-SEM and Energia also believe that there will be significant over-collateralisation of the market which is further compounded by

- Energia would like to highlight that there remain several unresolved issues for credit that must be addressed before Go-Live. These include the inability to use ECC credit requirements on the SEMOpX trading platforms (ETS and M7), transitional credit requirements, and interaction between NEMO and SEMO particularly around contract refusal and participants under settlement reallocation agreements. Failure to resolve these issues before I-SEM will also mean that participants will have to post unnecessary & excessive credit with NEMO and SEMO.
- Reduced netting capability for generators & suppliers to net positions across NEMO/SEMO markets and also driven by the fact that the balancing market provisions for generators are not assessed on the same basis. Energia believes that a single administrator of credit would reduce the credit burden on participants and as such we welcome further consideration of single collateralisation across all I-SEM markets to help streamline collateral arrangements for participants.
- The credit provisions in NEMO ultimately require pre-funding of trades which imposes a significant credit burden on suppliers who may consider being a price-taker in ex-ante markets given the unpredictable and potentially volatile nature of imbalance pricing under I-SEM. The implications of this provision could mean having to post collateral up to the price cap which may considerably exceed the market clearing price resulting in excessive credit being posted.
- The Undefined Exposure (UDE) in the balancing market for a supplier is based upon historical assessments of 100% of supplier net demand and does not make any assessment of the allocation of demand purchases across Ex-ante and Balancing markets. The resultant impact of this is that a supplier who can accurately forecast demand and purchases 100% of their demand in the Ex-ante markets will be required to post credit for 100% of their net demand in the ex-ante markets and in the balancing market a further 100% demand assumption is applied to the UDE credit provision.
- The cross-market consequential risks of trading halts, default & suspension are a significant concern and the removal of a time to remedy period for participants exacerbates this which forces participants to post excessive credit to provide headroom for market volatility.

Energia request that the Regulatory Authorities (RAs) when considering the proposed parameters reflect on the excessive credit & financial burden for participants as a result of current drafted design and provisions. And also reflect on the appropriateness of the parameters and methodologies which all lean to the risk adverse end of the spectrum thus significantly impacting over-collateralisation of I-SEM markets.

2.2 Imbalance Settlement

Energia note there is no change from the imbalance parameters between those used in SEM to those proposed in I-SEM for uninstructed imbalances. For most Energia see no reason to deviate from those parameters but have included in this response a suggestion to remove penalties for generators who are operating below the dispatch instruction (providing a service in frequency response) but are within tolerance. In

this instance generators should be charged the avoided fuel costs and not the imbalance price.

In addition, Energia do not agree with the decision to have an information imbalance charge but concur with the parameters proposed for the new imbalance information.

Further commentary on the imbalance settlement parameters is provided in section 4 below.

3. Recommended Values for ISEM Credit Cover Parameters

As noted earlier in section 2 Energia anticipate significant increase in credit requirements in I-SEM and Energia also believe that there will be significant over-collateralisation of the market and as such Energia request that the Regulatory Authorities (RAs) when considering the proposed parameters reflect on the excessive credit & financial burden for participants as a result of current drafted design and provisions. And also reflect on the appropriateness of the parameters and methodologies which all lean to the risk adverse end of the spectrum thus significantly impacting over-collateralisation of I-SEM markets.

3.1 Fixed Credit Requirement for Suppliers

Energia agrees with SEMO's assessment of the drivers behind fixed credit requirements for suppliers and considers the proposal not to deviate from current values in SEM as reasonable.

3.2 Fixed Credit Requirement for Generator Units

Energia agrees with the proposal not to deviate from current fixed credit values for generator units in SEM as reasonable.

3.3 Fixed Credit Requirement for Netting Generator Units

Energia also agrees that current fixed credit values for netting generator units in SEM should remain in ISEM.

3.4 Fixed Credit Requirement for Capacity Market Units

Energia is in support of this parameter being set to €0 for I-SEM go-live.

3.5 Number of days in the Undefined Exposure Period

Energia understand the intention of the undefined exposure period to ensure that a participant has sufficient collateral in place to cover the time taken to exit the market and consider this an important parameter. However Energia do not consider the assumed time in this parameter to be reasonable and in fact consider this to be excessive. Energia request that when the regulatory authorities (RAs) are reviewing the Undefined Exposure Period (UDE) parameter that full consideration is given to the likely over-collateralisation of the I-SEM market and the resultant credit burden and cost on participants. Bearing this in mind it is important for the RAs to ensure that the UDE parameter does not have excessive time built into it and so that excessive credit burden is avoided where possible.

Energia note that the SOLR event which occurred in Northern Ireland in December 2016 is an example of how the timelines assumed in the UDE is excessive. In this example the Supplier affected ceased to incur costs in the SEM after 3 days. Energia recognise that this example involves a relatively small participant and the time to action was at the quicker end of the spectrum Energia still consider the 14 Day period proposed as excessive and that it imposes a mandatory credit level

significantly in excess of what in reality is required in a market which is already over-collateralised.

Energia therefore propose and request the RAs to consider a shorter 7 day value which is considered to be a more reasonable reflection of the maximum debt exposure period.

3.6 Number of days in the Historical Assessment Period

Whilst it is difficult to fully assess the impact of the proposals around historical assessment period, it is clear that the number of days in the Historical Assessment Period will impact credit cover volatility driven by market conditions such as fuel prices and generator availability. Reducing the number of days will increase credit cover volatility for participants which ultimately will result in participants factoring in greater headroom in credit cover provisions. Energia appreciate that a reduced number of days will also mean that such potential credit cover spikes may then be for a shorter duration however this in turn will have an adverse operational impact for participants to manage as well as adversely impacting banking relationships.

Taking into account the challenge of striking the right balance between more volatile postings versus smoother credit cover postings with some headroom built in Energia propose that current SEM values as the latter would be preferable and will allow participants time to gain experience in the new ISEM market instead of having to manage shorter and likely more regular periods of volatility. By keeping the current SEM assessment period of 90-100 days these short term issues are smoothed out to create a more appropriate and reasonable assessment picture. It is proposed that this parameter is reassessed post go-live as more analytics are available to make a better informed decision.

3.7 Analysis Percentile Parameter

Similar to the reasons noted in section 3.6 above Energia do not see any reason why this parameter should be changed, not least without proper analysis and proto-typing so that a more informed decision can be made when making such assessment. Energia also considers the current 95% percentile confidence level to be a reasonable risk for the market to manage.

3.8 Credit Cover Adjustment Trigger

The 10% trigger point suggested by the RAs is not warranted. Changes from SEM such as higher renewable penetration, more volatile prices, removal of BCOP and further changes to obligations of suppliers and wind generators mean the 10% trigger is no longer appropriate. Therefore, Energia request that further consideration is given to the appropriateness of a Credit Cover Adjustment Trigger applied to generators for which it is not unreasonable to assume significant variations in traded volumes across markets and that generators also must manage availability risk and will be exposed to TSO balancing actions which also result in variations of trading across markets. It seems unreasonable to impose this parameter on generators which ultimately results in additional operational burden to be managed. Energia consider that this parameter set as part of SEM arrangements is no longer appropriate to generators in I-SEM and therefore disagree with the current proposal to reduce the Credit Cover Adjustment Trigger and also highlight the proposal to reduce this parameter is wholly unreasonable.

Energia recognise that suppliers may not be exposed to the same degree of volatility as outlined above for generators and support the requirement for such a parameter

to provide some degree of an indication of change but that a proposed reduction to 10% is unreasonable and will impose unnecessary operational burden on suppliers. Energia consider that the Credit Cover Adjustment Trigger applied to suppliers is no less than the current level of 30%.

3.9 Level of Warning Limit

In the current SEM Energia consider the Warning Limit as tolerance flag which is used as part of internal operational procedures to manage and forecast credit requirements. Energia do not see any other merit in this parameter and also consider that such internal procedures & tolerances will be in place regardless of the Level of Warning Limit parameter.

3.10 Level of Breach Limit

Energia consider that a breach limit lower than 100% effectively imposes a compulsory credit headroom which in this proposal is 7.5% - a significant additional an unnecessary level of credit in an already over-collateralised market. When considering any parameter related to Breach Limits it is imperative that both participants and the regulatory authorities clearly understand the implications of exceeding breach limits.

Energia welcome further analysis of the consequences of exceeding the Breach Limit and the consequences on trading in the ex ante markets. Energia has significant concerns that a breach limit with SEMO results in a suspension on trading in the ex ante markets with no time to remedy. This is a significant change from SEM which allows participants 2 days to remedy a credit cover increase notice (CCIN). Often in SEM both SEMO & participants know that the CCIN will be remedied within the 2 day period if invoice settlement takes place in that timeframe thus avoiding the need to physically post more collateral. This option will no longer be available to participants and a temporary trading suspension in the ex ante markets will be applied regardless of known cash settlement taking place within 2 days.

Energia request that the regulatory authorities (RAs) consider the potential significant impact on the liquidity of the ex ante markets caused by the trading suspension of some units. For example a large integrated participant whose generator & supplier units have reallocation agreements in place – a credit increase for example for the supplier unit will result in a temporary trading suspension of the generator unit in the ex ante markets. This could remove up to c40% of the generation from the ex ante markets.

Participants will be adverse to any risk of limiting its ability to trade in any market and the current proposed arrangements and parameter is that participants will need to hold additional headroom in their credit postings in order to avoid the potential of being suspended from ex ante trading. The resultant over-collateralisation must be seriously considered when assessing the parameter proposed.

Energia would welcome the introduction of a breach remedy period following a CCIN in the balancing market prior to a trading halt being enforced in the ex-ante markets. This will only be effective if the breach remedy period is sufficient to allow participants to action the breach by posting additional collateral in the form of cash or letter of credit to be put in place in a timely manner i.e. this would need to be similar to SEM arrangements - approximately two working days.

Energia therefore would be willing to accept the breach remedy limit proposed (92.5%) **ONLY** if a 2 working day remedy period applies in I-SEM as it does in the

current SEM. Energia consider that this has sufficient headroom /risk buffer for any credit or debt risk that may be incurred during the two day remedy period.

4. Recommended Values for ISEM Imbalance Settlement Parameters

Energia note there is no change from the imbalance parameters between those used in SEM to those proposed in I-SEM for uninstructed imbalances. For most Energia see no reason to deviate from those parameters but have highlighted in this section parameters which require further consideration and outline Energia proposed values.

4.1 Uninstructed Imbalance Parameters

The uninstructed imbalance charges algebra identifies undelivered quantities outside of tolerance. Generators output differs from dispatch instructions by responding to fluctuations in system frequency. This is the correct behaviour by generators and Energia acknowledges that the algebra takes this into account by widening the tolerances depending on the direction of the frequency response action the generator takes. However, Energia feel there is a gap for generators operating within tolerance but still deviating from the dispatch instruction given by the TSO. Under the I-SEM algebra for undelivered quantities generators are penalised when operating below their dispatch quantity but above the PUG tolerance due to high system frequency. When a generator is operating within the PUG tolerance due to high system frequency they are charged at the imbalance rate, which is overly punitive for something which is out of their control. A better methodology would be to charge at the lesser of Offer Price and imbalance price when operating below dispatch quantity but above the PUG tolerance, similar to when operating above dispatch quantity but below DOG tolerance when generators should be paid the better of offer price and imbalance price.

When operating outside tolerance Energia currently sees no reason to change the parameters required for calculating the uninstructed imbalances charges in I-SEM. However, Energia do feel that the algebra for undelivered quantities within tolerance needs to be addressed to ensure generators who are offering a service in frequency regulation are not penalised.

4.2 Settlement Recalculation Threshold

Energia agree with the value proposed for the settlement recalculation threshold of €15,000. However, Energia do see merit in a higher threshold during the transition years from SEM to I-SEM. As participants become more comfortable with the complex settlement the threshold could be reduced to €15,000. The experience of SEM was that several resettlements were required for the first few months due to system error.

4.3 Imbalance Weighting Factor for each Imbalance Settlement Period

Energia has significant concerns in relation to the choice of an imbalance settlement period of 30 minutes. It is anticipated that the DAM will be the market timeframe most participants trade. With the DAM likely being the most liquid market it makes balance responsibility more difficult with participants required to trade imbalances created from DAM positions being split into half hourly quantities.

The issue of splitting DAM hourly quantities into half hourly quantities may create unmanageable imbalance for wind and demand that can forecast accurately. Unless the IDM has significant liquidity the design of I-SEM does not allow participants to be balance responsible which was the intent of the high level decisions.

Energia believes that all the I-SEM markets should be traded at hourly level (or the level of granularity the DAM trades at in the future). This removes imbalance exposures for participants who can accurately forecast. This may also allow more order types to be used in the IDM auctions which seem to be constrained due to Euphemia only currently designed to solve hourly orders.

4.4 Information Imbalance Charging Parameters

Energia appreciates that information imbalance charging will not be introduced at I-SEM go live and that the parameters are proposed to be zero. However, we remain concerned that the provisions facilitating its introduction are included within the market rules and will be implemented within the central market systems. Furthermore, we are concerned by the perceived potential conflict of interest EirGrid may be subject to if requested by the SEMC to provide a recommendation regarding the value of charges. This potential conflict arises because information imbalance charging is intended to make dispatching the system easier for the System Operator by improving the quality of information received via PNs (although this outcome is by no means certain), but its introduction is likely to have a detrimental impact on the efficiency of the ex-ante energy markets.

If information imbalance charging is introduced it will penalise balancing market participants for events that are outside of their control. This is because the ability to deliver a contract volume equal to an intended PN position is significantly influenced by extraneous factors, such as commodity price movements, changes to wind generation levels, changes to demand forecasts, plant availability, the behaviours of other market participants, and liquidity levels in the intra-day markets. Therefore charging a participant for changes to its PN relative to its final PN is unlikely to significantly improve the quality of the information provided to the System Operator. This is because those changes are predominantly necessitated by the market design that requires participants (including those that submit PNs) to update their trade positions within day to reflect changes in market conditions so the energy market as a whole can reach an efficient economic outcome. Therefore, if information imbalance charging is introduced its cost is likely to be passed through to consumers via the bid / offer prices of market participants, increasing costs, without delivering a significant improvement in the quality of the information received by the System Operator through PNs. If participants cannot recover these costs from the market they will distort trade incentives, particularly approaching gate closure, when the weighting of the charge is likely to be greatest. Under this scenario information imbalance charging would act as a barrier to intra-day market trade specifically at those times when the requirement to trade is likely to be greatest (e.g. because the errors associated with wind forecasting will be least).

Energia therefore recommends that information imbalance charging is not introduced at any time under I-SEM trading arrangements. Its introduction will not improve the quality of the information received by the System Operator (changes to PNs should arise as a result of efficient trading activities) but will introduce inefficiencies into energy market outcomes and increase costs for consumers.

5. Conclusion

Excessive credit cover requirements place a significant financial and administrative burden on market participants. As outlined throughout the response and in previous engagements with the RAs, setting of credit requirements needs to be proportionate and evidence based. The approach taken by the RAs in relation to credit cover and collateral will greatly increase the amount of credit cover required in I-SEM. The knock on effect of this will be a significant increase in the financial and administrative burden to existing market participants and a potential barrier to entry for new entrants.

Given the financial and administrative burden that these requirements will place on participants it is essential that any increase in credit cover is proportionate and evidenced based. A piecemeal approach to assessing the credit requirements placed on stakeholders in I-SEM does not account for the collective burden that meeting all I-SEM credit requirements will have. With an increase of credit cover of this magnitude the onus is on the RAs to adequately assess the need for, and impact of such excessive credit cover. This exercise has not been carried out by the RAs. As such, Energia maintains that extensive modelling and testing needs to be undertaken to ensure that the requirements put in place are reasonable and take into account the impact that these requirements will have on participants. Energia consider the market design in I-SEM as unique and that it warrants extensive modelling and testing to ensure the collateral requirements are not excessive.

Furthermore, Energia would like to highlight that that there remain several unresolved issues for credit that must be addressed before Go-Live. These include the inability to use ECC credit requirements on the SEMOpx trading platforms (ETS and M7), transitional credit requirements, and interaction between NEMO and SEMO particularly around contract refusal and participants under settlement reallocation agreements. Failure to resolve these issues before I-SEM will also mean that participants will have to post unnecessary & excessive credit with NEMO and SEMO

The over-collateralisation of the market outlined above will be further compounded by:

Credit Cover Adjustment Trigger

The 10% trigger point suggested by the RAs is wholly unreasonable. Changes from SEM such as higher renewable penetration, more volatile prices, removal of BCOP and further changes to obligations of suppliers and wind generators mean the 10% trigger is not appropriate.

Number of Days in the Historical Assessment Period

By keeping the current SEM assessment period of 90-100 days these short term issues are smoothed out to create a more appropriate and reasonable assessment picture. It is proposed that this parameter is reassessed post go-live as more analytics are available to make a better informed decision.

Level of Breach Limit

Energia consider that a breach limit lower than 100% effectively imposes a compulsory credit headroom which in this proposal is 7.5% - a significant additional an unnecessary level of credit in an already over-collateralised market. When considering any parameter related to Breach Limits it is imperative that both

participants and the regulatory authorities clearly understand the implications of exceeding breach limits.