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11th of January 2018

RE: EAI Response to DCCAIE Consultation on REFIT-ISEM Interactions

TO: ISEM_ESS@DCCAIE.GOV.IE

Dear sir/madam,

The Electricity Association of Ireland (EAI) welcomes the opportunity to respond to the Department of Communications, Climate Action, and Environment's (DCCAIE) consultation "*Electricity Support Schemes: Transitioning to I-SEM Arrangements Proposed Decision Paper*".

EAI has previously articulated a position that renewable energy participants in I-SEM should make reasonable endeavours to be physically balanced in the new market. EAI also advocates a principle of no retrospective change, i.e. the transition from SEM to I-SEM should 'grandfather' the rights of generators who have accepted *letters of offers* and commissioned plants before 2020, including preservation of the principle of reimbursement embodied in the Scheme. This approach is consistent with EAI stated policy, to provide support to renewable energy required to reach the 2020 target of 40% of final electricity consumption met by energy from renewable energy sources.

Background

It is noted that this Proposed Decision Paper has been developed after several summer workshops facilitated by the Department, which enabled industry and stakeholders to articulate concerns, pitfalls and potential opportunities in the initial Options Paper. The EAI acknowledges and appreciates these engagements.

Discussion

Following on from this process, there is now common ground between the EAI and the Department, such that Option A (100% DAM) is no longer any party's preferred option. In the interest of brevity, this submission will make no further comment on Option A (100% DAM).

The Decision Paper's substance question, for intermittent wind generators, is whether Option B (lower of DAM / 80:20 blend) achieves a better balance for consumers and investors over Option C (Dutch approach)?

Electricity Association of Ireland Ltd

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Directors

In the first instance, it must be taken as given that each individual wind farm owner/operator will endeavour to trade commercially, independently and without market collusion. Under no circumstances could the EAI countenance a scenario, as articulated by the Department, where "generators were to agree to trade all their output in the balancing market", or any other market for that matter.

Secondly, it is noted that the Proposed Decision Paper acknowledges the limitations of its cited modelling such that "it does not factor in possible arbitrage trading between timeframes". However, while the limitations are acknowledged, the Paper's conclusions, and in particular the estimated Total Consumer Costs for each of the remaining Options ignores the identified deficiencies. The graph in section 4.1 has an axis that extends to 0% DAM, at which point there is significant divergence between the Options B & C relative to the delta at *circa* 70% DAM. It is, therefore, important to articulate what 0% DAM represents in the real world i.e. wind operators holding back all generation and spilling into the BM. If such a scenario were to transpire (and persist), there would be arbitrage opportunities for suppliers and asset-less traders to exploit the resulting price differential between the DAM & BM which would result in price convergence between the timeframes, reducing the absolute cost of power traded in the BM. This suggests that in practice, and based on Eirgrid's own modelling, the difference in total costs between Option B and C is minimal.

Assessment of Options

EAI, by virtue of its membership extending across generation/supply/conventional/renewable (both supported and merchant), is in a unique position to offer a holistic view on the two Options. EAI members acutely understand the long-term risks associated with financing and developing infrastructure as well as the shorter-term risks inherent in selling power in different markets timeframes. Notwithstanding the decarbonisation agenda, and the imminent 2020 targets, in order to provide regulatory certainty and to support continued investment in the market, it is important that risks pertaining to the financing of long-term assets are considered and given commensurate priority when assessing the options. It is through this risk spectrum that the EAI has assessed the two remaining Options. However, it must be reiterated that EAI's preferred position in relation to REFIT's SEM to I-SEM transition is a principle of no retrospective change, i.e. the transition from SEM to I-SEM should 'grandfather' the existing rights of qualifying generators, including preservation of the principle of reimbursement embodied in the Scheme.

Option B

Fundamentally, the primary concern in relation to Option B is expressly stated in the Proposed Decision Paper, namely that "[Option] B (Blended) are revenue-only options, where the balancing costs of being long and short relative to forecast day ahead volumes are not explicitly taken into account". Hence, Option B incorporates a degree of protection against exposure to the Balancing Market price. However, the absence of any volume considerations effectively disconnects this Option from real balancing costs that an intermittent generator could experience. In such a scenario, where Balancing costs are strongly influenced by factors other than wind's inherent forecast error (see below), effected generators will have no/limited opportunity to earn the current REFIT floor price. This undermines both the business case for that particular unit, as well as general investor confidence in the Irish renewable/flexible sector at a time of increasing mandatory RES targets.

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Some EAI Members however, see merit in the level of 'de-risking' provided by this Option (and all Members see this Option as an improvement on Option A), however, even those Members who tacitly support Option B require certain assurances/clarifications, including: -

- Confirmation that the 'period' defining the reference price is a discrete trading period in the DAM
- An understanding that the arbitrarily chosen 80:20 blend would not be arbitrarily changed at a future date
- Early codification of the 'R' Factor methodology, incorporating the above bullets and the mathematics used to calculate the TMR and subsequent REFIT payment.

Option C

Again, notwithstanding the principle of grandfathering rights from SEM to I-SEM, there are also some EAI Members who believe that Option C strikes an appropriate balance between minimising consumer costs while providing participants with a higher degree of 'investor' confidence. Proponents point out that Option C is designed to incentivise participants to minimise their Balancing costs – an incentive which is also aligned with the best interest of consumers.

Option C facilitates competition between Participants, as by definition, there will be those whose Balancing costs are higher than the average. Again, this ensures that there is competitive pressure on participants to continuously improve their trading and forecasting – to the benefit of the consumer. As this Option is constructed around actual balancing costs, rather than a deemed reference price, the Option also provides a high-degree of comfort to participants (and their funders) should external factors (other than wind's forecast error), e.g. pump-storage outage, IC failure etc result in higher system wide Balancing costs.

As with Option B above, if the Department is minded to adapt Option C, EAI would strongly recommend early codification of the calculation methodology, in order to give clarity to all stakeholders.

Supported Co-Firing Plants

Finally, there is consensus among EAI Members that the proposed treatment of capacity revenues for Co-Firing plants is simply inequitable. The inclusion of availability-based capacity revenues as part of the TMR in SEM is consistent with the State Aid principle of '*no cumulation of aid*'. However, the Proposed Decision is unilaterally extending this principle to the point that supported plants (which are mandated to offer de-rated capacity in to the RO auction) are required to net off their RO premia while underwriting the PSO consumer against prices above the strike price. Essentially, impacted plants are being exposed to downside risk for no net reward. It cannot be rationally argued that such regulatory 'activism' should flow from the principle of '*no cumulation of aid*'. It is recommended that supported 'Co-Fired' capacity is afforded the choice of opting out its supported capacity from the RO auction.