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SUBMISSION TO CER

Irish Electricity Trading Arrangements - Proposed Decision
CER/03/101, 30th April 2003

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Context

For the purposes of considering this proposed decision, the Irish electricity market must be seen in its wider context - from a legal, supply, environmental, and competitive point of view.

The most significant issues relate to the use of fossil fuels. It is now clear that we are approaching peak production of oil, and that the only question is: how soon? Gas will follow, while we may be able to rely on coal for longer-term supply. However, such a strategy is suicidal for the human race, given the global climate problem. As Chernobyl and other accidents have shown, nuclear is similarly foolhardy.

In any case, imminent production constraints and ultimate shortages will lead to oil price rises, and have knock-on effects on the prices of other internationally traded fossil fuels, bearing in mind supply and demand effects in a world with growing energy demand.

What is more, these energy forms have very large external costs, which are not passed on to consumers, and are carried by governments paying for accident clean up, health services, or military forces required to secure supplies, for example.

In addition, considerable direct and indirect subsidies are associated with traditional energy forms, as shown by various studies[1].

The EU has been developing an energy policy, including its energy market policies, with these issues in mind. That led to the adoption of the Directive on Electricity from Renewable Sources in 2001. In adopting it, the EU has effectively recognised that dependence on fossil fuels and nuclear power cannot continue indefinitely, and that it must develop indigenous energy sources to avoid serious economic problems in the future. It has further supported this view by allocating considerable research funds to renewable energies.

Also, despite the strictures of the Internal Market, the European Court of Justice has seen fit to rule that certain types of support systems for electricity from renewable energy, as used in particular Member States, are neither state aid nor market distortions. Clearly, economic policies that assist the development of these energy forms are so vital to the EU, that the supports can be seen as necessary compensations for existing distortions

Furthermore, the EU plans to implement carbon taxation, emissions trading, and ultimately severe climate penalties, as part of its ongoing energy/ environmental policy.

Even at the current early stage of market development, concerning high level principles, the proposed decision must not only take this wider context into account, but will have to be determined by it.

Priority and guaranteed access

Article 7 of the Renewables Directive obliges Member States to give priority access to electricity from renewable sources, and this concept is already reflected in the Electricity Regulation Act. Article 7 also obliges Member State systems to guarantee transmission of electricity from renewables. The adoption in the future by Government of a guaranteed price system for renewables (sometimes referred to as a fixed price system, even if prices are not fixed, but variable) would imply guaranteed take-off of such power.

However, the proposed trading decision seems to set conditions which might undermine these requirements. The possibility of negative pricing, which cannot be adopted by intermittent renewables, (given there is generally no fuel saving, or large shut-down/start-up costs) would seem to create conditions in which they would not be dispatched, despite zero cost. Such a situation would imply that no power would be generated at certain times, so that under an AER PPA, or any other production based support scheme,

[1] European Parliament, ENERGY SUBSIDIES IN THE EUROPEAN UNION, Final Report, Frans Oosterhuis, Institute for Environmental Studies (IVM), Vrije Universiteit, Amsterdam, May 2001 (unpublished; copy available); it updates a previous study by the same organisation for Greenpeace: *Energy Subsidies in Europe. How governments use taxpayers' money to promote climate change and nuclear risk.* Greenpeace International Climate Campaign, Amsterdam (1997).

revenue would be lost, thereby compromising projects. At the very least, this might be regarded as a breach of an AER PPA.

Although recognising and considering this problem, the CER's "Trading Arrangements and Renewables" paper claims the following benefit on page 2.1: "A guaranteed market for generated power through the spot market", and effectively repeats that claim in similar terms on page 3.6.

To substantiate that claim, while honouring Ireland's obligations, and not compromising government policy on renewables, it is necessary to make special provision for renewables in this market scheme, if indeed negative pricing is to be permitted. However, the implication of the paper seems to be that any special provisions that imply such an apparent benefit to renewables are to be treated as a support, costed and treated under a levy system or PSO (thus bringing the Government back to the state aids approval process).

However, negative pricing is being justified by CER to facilitate the inflexibility of large fossil-fuelled power stations, where it is more economic to stay online at a negative price that to shut down and start up again later. Surely this is the generator's problem, and not one that the whole market should be distorted to accommodate? To view the electricity generated under such circumstances as having no value or negative value seems absurd, especially when scarce fossil fuels are being consumed to produce it.

To then turn this into another penalty against intermittent renewables, effectively because of their zero fuel cost, is to stretch the point. This only goes to show that the market is not neutral, and has to be designed to accommodate various generator types, not just the established inflexible dispatchable type. Otherwise the market will compromise the Government's and EU's longer-term objectives as regards energy sources.

However, as pointed out by the CER in its paper, guaranteeing dispatch to renewables in such circumstances would seem to invite excessive pricing, and to be fair, CER is wrestling with this problem.

The answer to this conundrum seems to be the setting of a ceiling price to be paid to renewable generated energy under such circumstances. AER contracts seem to have this effect, and a German-style guaranteed price system would appear to be capable of providing the same effect. The CER's paper considers a zero payment, which both the former could accommodate where a CfD covered the difference. Presumably a green generator contracted to a green supplier could also contend with this through its CfD. However, as already implied, to treat such an arrangement as some sort of support is to view the market through the lense of long established generating practice, and to miss the point that newer generating models are now with us.

In any case, a decision to allow negative pricing is directly contrary to the interests of renewables, unless provision for an exception is made.

A related issue, though one not entirely within the scope of the market, is 'constraining-off'. The last of the High Level Principles in the proposed decision states:
"16. Generators not called on to generate because of constraints and/or because their offers are too high will not receive any payments in the spot market."

FST's submission on the CER's recent wind penetration study argues that 'constraining-off' risks compromising Article 7 of the EU Directive, at least where that is done for reasons of inadequate grid development. The Directive allows exceptions to priority and guaranteed transmission for safeguarding grid reliability and safety. But that would not seem to include avoidance of expenditure on grid upgrades.

Insofar as the Proposed decision would cast in stone the idea that either such constraining was permissable or compensation payments would not be available from some quarter, then it may fly in the face of our obligations under EU law.

Balancing and load-following

The CER's paper just referred to seems somewhat internally contradictory on the matter of load-following. It suggests on page 2.1 that there would be no requirement for top and spill under the new regime. But, on the subsequent page, it is suggested that there may be a need to apply load following type costs to larger intermittent energy forms such as wind power, to compensate for deviation from agreed dispatch schedules.

In effect top and spill have been required to balance load and generation, and these costs have been particularly significant for intermittent energy forms, despite the single-level top-up price. To now say that load-following costs might apply to these energy forms seems to suggest applying 'top and spill type' costs by another name.

What is more, such discriminatory costs would be applied to the only energy forms in the market that pay their external costs, while it seems as if it will take 20 years or more for all other energy forms to take responsibility for theirs. Emissions trading as discussed in the CER's paper, is welcome but would only attempt to internalise part of the costs associated with climate change, whereas many other costs also need internalisation, and subsidies need to be removed. So, to apply such a policy would again be compromising the country's economic future by hindering the development of renewables.

Renewable generators would, in general, be quite happy to operate without support in an open market where all players carry their full costs (internalisation and removal of subsidies). However, we are a very long way from this position (even with the imminent introduction of emissions trading and carbon taxation). When that position is achieved it might be reasonable to ask renewable generators to pay some of the load following costs associated with their deviation from dispatch schedules, but it would be very

detrimental to ask them to pay them before then, as it could prevent us from ever getting to that position.

Until such time as we achieve that happy position, all renewables should be allowed to deviate from the agreed dispatch schedule, at least to some extent, without incurring penalties or costs for that deviation.