

Single Electricity Market

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| Final REcommendation Report  Mod\_38\_18 limitation of capacity market difference payments to metered demand  06 September 2019 |

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Document History

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| **Version** | **Date** | **Author** | **Comment** |
| 1.0 | 06 September 2019 | Modifications Committee Secretariat | Issued to Modifications Committee for review and approval |
| 2.0 | 13 September 2019 | Modifications Committee Secretariat | Issued to Regulatory Authorities for final decision |

Reference Documents

|  |
| --- |
| **Document Name** |
| [Trading & Settlement Code Part B](https://www.sem-o.com/rules-and-modifications/balancing-market-modifications/market-rules/TSC-Part-B.docx) |
| [Modification Proposal](https://www.sem-o.com/documents/market-modifications/Mod_38_18/Mod_38_18-LimitationofCapacityMarketDifferencePaymentstoMeteredDemand.docx) |
| [Modification Proposal v2](https://www.sem-o.com/documents/market-modifications/Mod_38_18/Mod_38_18-LimitationofCapacityMarketDifferencePaymentstoMeteredDemandV2.docx) |
| [Modification Proposal v3](https://www.sem-o.com/documents/market-modifications/Mod_38_18/Mod_38_18-LimitationofCapacityMarketDifferencePaymentstoMeteredDemandV3.docx) |
| [Modification Proposal v4](https://www.sem-o.com/documents/market-modifications/Mod_38_18/Mod_38_18-LimitationofCapacityMarketDifferencePaymentstoMeteredDemandV4.docx) |
| [Presentation](https://www.sem-o.com/documents/market-modifications/Mod_38_18/Mod_38_18.pptx) |
| [Presentation](https://www.sem-o.com/documents/market-modifications/Mod_38_18/Mod_38_18Slides.pptx) |

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# MODIFICATIONS COMMITTEE RECOMMENDATION

## Recommended for rejection – unanimous Vote

|  |  |  |
| --- | --- | --- |
| **Recommended for Rejection by Unanimous Vote** | | |
| Jill Murray (Chair) | Supplier Alternate | Rejected |
| Alan Mullane | Assetless Member | Rejected |
| William Carr | Generator Alternate | Rejected |
| Joe Devlin | Generator Alternate | Rejected |
| David Gascon | Generator Alternate | Rejected |
| Kevin Hannafin | Generator Member | Rejected |
| Mark Phelan | Supplier Alternate | Rejected |
| Rochelle Broderick | Supplier Alternate | Rejected |
| Robert McCarthy | DSU Alternate | Rejected |
| Eamonn Boland | Supplier Alternate | Rejected |

# Background

This Modification Proposal was raised by SEMO and was received by the Secretariat on 28th November 2018. The proposal was discussed at Meeting 88 on 12th December 2018, Meeting 89 on 20th February 2019, deferred directly at Meeting 90 and Meeting 91, discussed further at Meeting 92 on 27th June 2019 and voted on at Meeting 93 on 22nd August 2019.

This V2 has been submitted to remove changes to paragraph F.20.2.3 which have been raised as a separate Modification. This is because those changes relate to different element of the T&SC and have different justifications and merits that need to be addressed individually. It is expected that the new Modification would have a tracking ID of Mod\_08\_19.

Introduction of QMLFvγ to QDIFFTRACKvγ in a manner analogous to the presence of QCOBuγ in QDIFFTRACKuγ. The absence of this limit means that a Supplier Unit may trade a volume that is multiples of their metered quantity at prices that exceed the strike price, receive difference payments such that the effective price of the trade is the strike price (i.e. 500 €/MWh) and then sell the energy back to Balancing Market at a high price. Where the Balancing Market is functioning normally, the risk of this occurring is low as the participant would be exposed to significant downside risks due to the like spread between the DAM and BM price; however, where these prices are the same (or similar) for example where the Market Back Up Price is used, there is a large and unacceptable financial risk to the market as a whole.

Version 3 of this proposal introduces a factor (Difference Quantity Limitation Factor/FDQL) to allow the limitation of difference quantities to move beyond QMLF, by an amount determined by the RAs. This could either be left to be any value equal to or greater than 1 (which represents 100% of QMLF) or, as presently drafted, this could be prescriptively set to a minimum value greater than 100% e.g. 1.2 (which represents 120% of QMLF) or some other value as agreed. This is to provide comfort to suppliers in relation to a minimum allowance in the difference payment hedge to allow for forecasting errors. The aim here is to strike a balance between ensuring that the hedge provides adequate protection to suppliers whilst limiting this to a reasonable level to mitigate the risk described above in order to achieve both objectives as discussed at previous Committee meetings.

# PURPOSE OF PROPOSED MODIFICATION

**3A.) justification of Modification**

The quantity component of Capacity Market Difference Charges is capped at QCOB, which is the load following obligated quantity. Any Capacity Market Unit in receipt of Capacity Payments in return is obligated to deliver the quantity associated with its QCOB at a price of no greater than the strike price.

Suppliers pay Capacity Charges based on their loss adjusted Metered Quantity during day time hours to fund Capacity Payments and in return receive protection for their demand from prices higher than the strike price. As the TSCB is currently drafted, a Supplier Unit receives protection for any traded quantity even where this may greatly exceed their metered quantity.

This Modification Proposal seeks to confine the protection from high prices to the Supplier Unit’s Metered Quantity plus an allowed percentage to account for forecasting error and thus more closely aligns Difference Payments with Difference Charges whilst allowing for a small and configurable deviation to mitigate against a reasonable amount of demand forecasting error.

**3B.) Impact of not Implementing a Solution**

The absence of this limit means that a Supplier may trade a volume that is multiples of their metered quantity at prices that exceed the strike price, receive difference payments such that the effective price of the trade is the strike price (i.e. 500 €/MWh) and then sell the energy back to Balancing Market at a high price. Where the Balancing Market is functioning normally, the risk of this occurring is low as the participant would be exposed to significant downside risks due to the like spread between the DAM and BM price; however, where these prices are the same (or similar) for example where the Market Back Up Price is used, there is a large and unacceptable financial risk to TSOs and the market as a whole.

**3c.) Impact on Code Objectiv****es**

A.2.1.4 (b) to facilitate the efficient, economic and coordinated operation, administration and development of the Single Electricity Market in a financially secure manner;

# ASSESSMENT OF ALTERNATIVES

N/A

# impact on systems and resources

Impact on Settlement Systems to be assessed by the vendor. An initial impact assessment of applying QMLF without an additional factor was found to be low risk and small impact so it is anticipated that this update would result in a similar outcome, albeit that the addition of the factor results in slightly increased complexity.

# Impact on other Codes/Documents

N/A

# MODIFICATION COMMITTEE VIEWS

## Meeting **88 – 12 december 2018**

The proposer delivered a [presentation](https://www.sem-o.com/documents/market-modifications/Mod_38_18/Mod_38_18.pptx) to confine the protection from high prices to the Supplier’s Unit’s Metered Quantity and thus align Difference Payments with Difference Charges.

This modification is intended to reduce the potential for an aspect of the hole-in-the-hedge which was not considered during market design of the fact that difference charges are capped by actual demand while difference payments have no such cap. It is also intended to improve the incentive on suppliers to be balance responsible by preventing certain potentially perverse incentives of suppliers benefitting by trading intentionally out of balance. These are intended to be done in a way which maintains the core of the capacity market design that customers won’t have to pay above the strike price for the power they consume.

A Supplier Member asked for the reasoning behind the above and had there been any instances of this happening. Proposer confirmed that this had been spotted as a potential event and a SEMO representative stated there was a concern about market exposure. Observer also pointed out that, although there had been no cases since go live, an event was observed during Market Trial, which is why the issue with the calculation as currently in place originally came to light. A Supplier Member stated that the scenario would be very unlikely as it would require perfect forecasting of all prices to be greater than the Strike Price. Observer replied that this REMIT and the RAs’ Market Monitor to deal with as opposed to adding further regulation. A question was raised whether Assetless Units should also be considered for the change and proposer replied that Assetless Units do not get Different Payments therefore they would not be affected.

Due to time constraints it was agreed that this modification would be deferred and participants could take the time to review the slides and what was being proposed to discuss it further at the next meeting.

## Meeting **89 – 20 february 2019**

The Proposer delivered a [presentation](https://www.sem-o.com/documents/market-modifications/Mod_38_18/Mod_38_18.pptx) explaining the rationale behind the Modification. The changes can be divided in two parts: the first is the addition of MGLF in the formula to address a scenario which occurred in Market trial; the second to add MIN/MAX clauses to bring it in line with the Difference Charge calculation.

Without the addition of MGLF, if back up price is used and estimated correctly by PTs, it could end up with large payments to the participant which would not be reflective of the intent of the Code. Instead the addition of the min/max algebra will not have huge impact but it should be corrected.

Discussion took place relating to the change to introduce QMLF at length. The issue of the necessity of this system change was also discussed. It was advised that this was a high impact / low probability event. Interconnector Alternate questioned the possible infrequency of such an occurrence and asked for more worked examples with less extreme values to better understand the Modification Proposal and the related risks with not fixing this issue. Members expressed the opinion that this is considered to be self-policing (e.g. role of MMU unit and REMIT legislation) and there are lots of system changes with priority over this one.

Chair voiced concern of the risk this issue may pose to the Socialisation Fund as demonstrated in the example given by the proposer in their presentation, but acknowledged the fact that more pressing system changes were required. The role of the Market Monitoring Unit was discussed and the idea of over regulation as well as the fact that collateral obligations should deter the likelihood of this risk arising.

The SEMO Member expressed the view that as well from the desire to mitigate against the potentially high materiality impact of the low probability high impact event described, there appeared also to be an argument in principle for limiting the supplier hedge at the strike price via difference payments to QMLF. They went on to state that in their view it was unusual for an option contract to apply a different volume to the payment made when the option is in the money than it does to the coupon paid to purchase the option. The SEMO Member also questioned whether retaining the existing provisions which allow the hedge via difference payments to exceed QMLF could lead to a situation whereby payments in for volumes in excess of QMLF for one or more Supplier could result in the socialisation fund being depleted to the detriment of other Suppliers. RA member asked if this could be implemented by applying a tolerance limit to the MGLF and proposer agreed to investigate the option.

The proposer explained that there were two elements to this modification proposal and the second element in relation to the min/max algebra needed to be corrected, and even if just this min/ max algebra was corrected that of itself would also require system changes. It was agreed that the Proposer would draft a separate version of this Modification Proposal focusing solely on the Min/Max Algebra issue to be considered separately while providing more details of QMLF with less extreme values.

## Meeting **90 – 11 april 2019**

The modification was deferred.

## Meeting **91 – 18 april 2019**

The modification was deferred.

## Meeting **92 – 27 june 2019**

The proposer delivered this proposal in conjunction with Mod\_08\_19. There was an action with SEMO to consider the viability of applying a tolerance factor to MGLF within the approach. SEMO noted that the impact assessment and detailed legal drafting for application of such a tolerance was not yet pursued in detail as they are waiting for guidance from committee as to whether such an approach would be palatable before pursuing it further. They noted that an initial consideration indicated that it should be viable and may provide for a compromise solution that allows for the mitigation the proposal seeks to provide without causing the risk of unhedged trades for suppliers where trade exceeds metered consumption due to forecasting errors which was flagged as a concern at the previous meeting.

A number of suppliers voiced their concerns in relation to this modification as it they could not see a scenario when the high impact event it seeks to mitigate against would ever happen due to the risk that a party seeking to exploit it would expose themselves to and the credit requirements that would occur. The proposer noted that the potential for the sort of high impact low probability event described was not the only reason for raising the proposal. They went on to discuss how it also mitigates against more likely events where one supplier who is paid a difference payment and therefore hedged for volumes beyond the metered consumption could result in other suppliers being impacted by a so called ‘hole in the hedge’. They also re-iterated their view that it was logical to have a link between the capacity charging base and the hedged volume for difference payments.

A Supplier Member advised that they felt that no compromise could be made here as an acceptable parameter for the tolerance could not be known as the level of forecast error was not known. SEMO acknowledged that the exact value may not be known but suggested that taking a conservative approach of having a reasonable fixed minimum value for such a tolerance should provide comfort as it should be possible to determine a value that is extremely unlikely to be exceeded by forecasting error. They noted that this could be determined via a parameter consultation or possibly codified within the proposal if that provided more comfort.

Proposer confirmed this modification does not affect Assetless Units in response to a question on the impact there.

Another supplier representative who had previously shared concerns regarding the impact of the proposed change in terms of unhedged volumes resulting from forecasting errors indicated they would be more open to looking further at option of including a tolerance but they indicated that they would need to see what such a proposal would look like in order to fully consider the implications before committing to a position.

## Meeting **93 – 22 august 2019**

SEMO delivered a [presentation](https://www.sem-o.com/documents/market-modifications/Mod_38_18/Mod_38_18.pptx) on version 4 of this proposal covering changes to the previous content including a tolerance factor to allow for errors in the forecast of the demand while confirming the justification for this modification has not changed. This new version is a proposed parameterised approach with a parameterised value which would allow the relax the limitation to allow for Difference Payments to be based on volumes exceeding Metered Demand by a prescribed amount. This reduces the risk on the Socialisation Fund associated with the hedge applying beyond the Meter Demand.

A Supplier Alternate noted that the forecast error could be very large and raised concerns around viability of a parameter that would accommodate such forecast errors. It appeared that there is a lot of complexity around forecasting methodology and smaller suppliers would not have the facilities to reduce the errors. A discussion ensued around the risks being considered and how these may be handled through market manipulation provisions by the MMU. SEMO Member noted that those provisions would not address the risk in real time but could rather be applied after the fact. SEMO Member acknowledged the Supplier Members points in relation to forecasting error and the diminished benefit of applying a limitation which is multiples of Metered Demand. SEMO Member noted that they were not familiar with supplier Demand Forecasting processes or the potential level of errors involved but accepted the details provided on the subject that would render the parameter potentially unfeasible

The RAs confirmed, were the Mod to be approved, they would consult on the parameter and it may be the case that the same arguments would be put forward by which would dictate a factor too high to be a meaningful deterrent to the problem it is trying to solve. However both SEMO member and the chair made the point that a lot of analysis and good work has been done on this, which should not be lost and should be used to re-submit the Modification Proposal in case the behaviour is actually observed in trading in the future.

# Proposed Legal Drafting

As set out in Appendix 1

# LEGAL REVIEW

N/A

# IMPLEMENTATION TIMESCALE

N/A

# Appendix 1: Mod\_38\_18 limitation to capacity market difference payments to metered demand v4

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| --- | --- | --- | --- | --- | --- |
| **MODIFICATION PROPOSAL FORM** | | | | | |
| **Proposer**  *(Company)* | **Date of receipt**  *(assigned by Secretariat)* | | **Type of Proposal**  *(delete as appropriate)* | | **Modification Proposal ID**  *(assigned by Secretariat)* |
| **SEMO** | **08 August 2019** | | **Standard** | | **Mod\_38\_18 V4** |
| **Contact Details for Modification Proposal Originator** | | | | | |
| **Name** | | **Telephone number** | | **Email address** | |
| **Aodhagan Downey** | |  | | **aodhagan.downey@eirgrid.com** | |
| **Modification Proposal Title** | | | | | |
| **Limitation of Capacity Market Difference Payments to Loss Adjusted Metered Quantity** | | | | | |
| **Documents affected**  *(delete as appropriate)* | | **Section(s) Affected** | | **Version number of T&SC or AP used in Drafting** | |
| **T&SC Part B** | | **F.20.1.1** | | **v20** | |
| **Explanation of Proposed Change**  *(mandatory by originator)* | | | | | |
| This V2 has been submitted to remove changes to paragraph F.20.2.3 which have been raised as a separate Modification. This is because those changes relate to different element of the T&SC and have different justifications and merits that need to be addressed individually. It is expected that the new Modification would have a tracking ID of Mod\_08\_19.  Introduction of QMLFvγ to QDIFFTRACKvγ in a manner analogous to the presence of QCOBuγ in QDIFFTRACKuγ. The absence of this limit means that a Supplier Unit may trade a volume that is multiples of their metered quantity at prices that exceed the strike price, receive difference payments such that the effective price of the trade is the strike price (i.e. 500 €/MWh) and then sell the energy back to Balancing Market at a high price. Where the Balancing Market is functioning normally, the risk of this occurring is low as the participant would be exposed to significant downside risks due to the like spread between the DAM and BM price; however, where these prices are the same (or similar) for example where the Market Back Up Price is used, there is a large and unacceptable financial risk to the market as a whole.  Version 3 of this proposal introduces a factor (Difference Quantity Limitation Factor/FDQL) to allow the limitation of difference quantities to move beyond QMLF, by an amount determined by the RAs. This could either be left to be any value equal to or greater than 1 (which represents 100% of QMLF) or, as presently drafted, this could be prescriptively set to a minimum value greater than 100% e.g. 1.2 (which represents 120% of QMLF) or some other value as agreed. This is to provide comfort to suppliers in relation to a minimum allowance in the difference payment hedge to allow for forecasting errors. The aim here is to strike a balance between ensuring that the hedge provides adequate protection to suppliers whilst limiting this to a reasonable level to mitigate the risk described above in order to achieve both objectives as discussed at previous Committee meetings. | | | | | |
| **Legal Drafting Change**  *(Clearly show proposed code change using* ***tracked*** *changes, if proposer fails to identify changes, please indicate best estimate of potential changes)* | | | | | |
| F.20 Difference Payments  **F.20.1 Calculation of Day-ahead Difference Quantities and Payments**  F.20.1.1 The Market Operator shall calculate the Day-ahead Difference Quantity for each Supplier Unit, v, which is not a Trading Site Supplier Unit, in Imbalance Settlement Period, γ, as follows:  where:   * + - * 1. qTDAxvh is the Day-ahead Trade Quantity for Trade, x, for Supplier Unit, v, in Day-ahead Trading Period, h;         2. DTDAx is the Day-ahead Trade Duration of Trade, x;         3. QEXvγ is the Ex-Ante Quantity for Supplier Unit, v, in Imbalance Settlement Period, γ;         4. is a summation of the quantities for each Trade, x, from the day-ahead market or the intraday market, as the case may be within whose Day-ahead Trading Period or Intraday Trading Period, h, as the case may be, the Imbalance Settlement Period, γ, falls in whole or in part;         5. DISP is the Imbalance Settlement Period Duration;         6. QMLFvγ is the Loss-Adjusted Metered Quantity for Supplier Unit, v, in Imbalance Settlement Period, γ; and         7. FDQL is the Difference Quantity Limitation Factor determined in accordance with paragraph F.20.1.1A.   F.20.1.1A If requested by the Regulatory Authorities, the Market Operator Shall report to the Regulatory Authorities proposing a value for the Difference Quantity Limitation Factor (FDQL) to be used in the calculation of Difference Payments The Market Operator shall publish the approved Difference Quantity Limitation Factor within 5 Working Days of receipt from the Regulatory Authorities’ or two months before it commences to apply, whichever is the later. The Difference Quantity Limitation Factor shall be a value not less than 1.2.          F.20.2.3 The Market Operator shall calculate the Intraday Trade Difference Quantity (QDIFFPTIDvγk), the Intraday Trade Difference Payment (CDIFFPTIDvγk), and the Tracked Difference Quantity (QDIFFTRACKvγk) for each Supplier Unit, v, which is not a Trading Site Supplier Unit, in ascending order of each position, k, in the ranked set derived in accordance with paragraph F.20.2.2, in Imbalance Settlement Period, γ, as follows:  where:   * + - * 1. is a summation over values across all positions in the ranked set prior to and including the current position, k, in the ranked set. Calculations for the first position, (k = 1), will not have a previous position, k’, and the result for this sum shall be the value in the current position, k, in the ranked set;         2. is a summation over values across all positions in the ranked set prior to the current position, k, in the ranked set. Calculations for the first position, (k = 1), will not have a previous position, k’, and the result for this sum shall be zero;         3. QEXvγ is the Ex-Ante Quantity for Supplier Unit, v, in Imbalance Settlement Period, γ;         4. QDIFFDAvγ is the Day-ahead Difference Quantity for Supplier Unit, v, in Imbalance Settlement Period, γ;         5. QTIDvγk is the Intraday Trade Quantity for Trade, x, for Supplier Unit, v, in the position, k, in the ranked set, in Imbalance Settlement Period, γ;         6. PTIDvγk is the Intraday Trade Price associated with the Intraday Trade Quantity (QTIDvγk) for Trade, x, for Supplier Unit, v, in the position, k, in the ranked set, in Imbalance Settlement Period, γ;         7. PSTRm is the Strike Price for Month, m, which contains Imbalance Settlement Period, γ;         8. (k – 1) is for the previous position in the ranked set;         9. (k = 0) is for the 0th position in the ranked set, i.e. where a calculation is being performed on the first position in the ranked set, (k = 1), for which there is no previous position;         10. QMLFvγ is the Loss-Adjusted Metered Quantity for Supplier Unit, v, in Imbalance Settlement Period, γ; and         11. FDQL is the Difference Quantity Limitation Factor determined in accordance with paragraph F.20.1.1A.   Glossary and List of Acronyms   |  |  | | --- | --- | | **Difference Quantity Limitation Factor** | means the multiplier used to calculate the Difference Payment applicable to each Supplier Unit, v, which is not a Trading Site Supplier Unit, approved by the Regulatory Authorities under paragraph F.20.1.1A. |  |  |  |  |  |  | | --- | --- | --- | --- | --- | | Parameter | FDQL | Difference Quantity Limitation Factor | The Difference Quantity Limitation Factor, which represents the multiplier applied to Loss-Adjusted Metered Quantity used to calculate the Difference Payment applicable to each Supplier Unit, v, which is not a Trading Site Supplier Unit. | Factor | | | | | | |
| **Modification Proposal Justification**  *(Clearly state the reason for the Modification)* | | | | | |
| The quantity component of Capacity Market Difference Charges is capped at QCOB, which is the load following obligated quantity. Any Capacity Market Unit in receipt of Capacity Payments in return is obligated to deliver the quantity associated with its QCOB at a price of no greater than the strike price.  Suppliers pay Capacity Charges based on their loss adjusted Metered Quantity during day time hours to fund Capacity Payments and in return receive protection for their demand from prices higher than the strike price. As the TSCB is currently drafted, a Supplier Unit receives protection for any traded quantity even where this may greatly exceed their metered quantity.  This Modification Proposal seeks to confine the protection from high prices to the Supplier Unit’s Metered Quantity plus an allowed percentage to account for forecasting error and thus more closely aligns Difference Payments with Difference Charges whilst allowing for a small and configurable deviation to mitigate against a reasonable amount of demand forecasting error. | | | | | |
| **Code Objectives Furthered**  *(State the Code Objectives the Proposal furthers, see Section 1.3 of T&SC for Code Objectives)* | | | | | |
| A.2.1.4 (b) to facilitate the efficient, economic and coordinated operation, administration and development of the Single Electricity Market in a financially secure manner; | | | | | |
| **Implication of not implementing the Modification Proposal**  *(State the possible outcomes should the Modification Proposal not be implemented)* | | | | | |
| The absence of this limit means that a Supplier may trade a volume that is multiples of their metered quantity at prices that exceed the strike price, receive difference payments such that the effective price of the trade is the strike price (i.e. 500 €/MWh) and then sell the energy back to Balancing Market at a high price. Where the Balancing Market is functioning normally, the risk of this occurring is low as the participant would be exposed to significant downside risks due to the like spread between the DAM and BM price; however, where these prices are the same (or similar) for example where the Market Back Up Price is used, there is a large and unacceptable financial risk to TSOs and the market as a whole. | | | | | |
| **Working Group**  *(State if Working Group considered necessary to develop proposal)* | | | **Impacts**  *(Indicate the impacts on systems, resources, processes and/or procedures; also indicate impacts on any other Market Code such as Capacity Marker Code, Grid Code, Exchange Rules etc.)* | | |
| Not required | | | Impact on Settlement Systems to be assessed by the vendor. An initial impact assessment of applying QMLF without an additional factor was found to be low risk and small impact so it is anticipated that this update would result in a similar outcome, albeit that the addition of the factor results in slightly increased complexity. | | |
| ***Please return this form to Secretariat by email to*** [*modifications@sem-o.com*](mailto:modifications@sem-o.com) | | | | | |