<u>Response of Bord Gáis Energy Supply</u>
to the

<u>Single Electricity Market Consultation Paper</u>
on
<u>Bidding the Opportunity Cost of Carbon Allowances</u>

<u>SEM-08-005</u>

Bord Gáis Energy Supply (BGES) would like to thank the SEM Committee for providing the opportunity to respond to the above mentioned consultation paper published by the Regulatory Authorities (RAs) on February 20th 2008. BGES wrote to the RAs in September 2007 outlining concerns in relation to the decisions and wording contained in various papers on the "The Bidding Code of Practice". We continue to believe that the Bidding Principles form an integral element of the Mitigation of Market Power in the SEM and any dilution of those principles will undoubtedly lead to their effectiveness as a market power mitigation tool. The following are our thoughts in relation to this area and the question on maintaining the opportunity cost principle for carbon (and other cost constituents)

In the consultation paper issued by the All Island Project in February 2006 (AIP/SEM/02/06), the regulatory authorities outlined the primary objectives of the SEM market power mitigation strategy as follows:

- To prevent market participants from abusing their market power
- To maintain efficient incentives for new entry and exit – allowing market participants to see correct market signals and, where possible, have available to them a range of competitive strategies.

Following this, a decision paper was published in April 2006 (AIP/SEM/31/06) which outlined the 5 components of the strategy that was to be employed for the mitigation of market power in the SEM. One component, important we believe, was the implementation of bidding principles, which were to be applied in conjunction with market monitoring to set forth an expected standard of bidding behaviour. Presumably, this was to provide an appropriate level of transparency to the market whilst treating all generators fairly. It was envisaged that the principles would provide room for innovation *to help achieve the objective* of encouraging efficient operation and investment and would help encourage entry.

A fundamental aspect of the market power mitigation strategy was the implementation of short-run marginal cost ("SRMC") bidding for generators. This was clearly indicated to market participants in both the consultation and decision papers in relation to the 'Bidding Principles & Local Market Power' published by the All Island Project in July & September 2006 respectively. BGES had outlined our concerns that bidding principles could be open to interpretation (over rules) which may limit their impact as an effective market power mitigation tool.

Following these decisions, the RAs issued a consultation paper in May 2007 (AIP/SEM/07/198) which outlined the proposed contents and rationale of the Bidding Code of Practice in the SEM. This paper appeared to underline the requirement for SRMC bidding and clear that opportunity cost best represented these costs which wherever possible was to be defined by reference to prevailing market prices. The approach included allowing full cost reflectivity of cost items using the opportunity cost which would enable the creation of a fair market environment for all Generators while providing efficient market signals.

The subsequent 'Response and Decision Paper' (AIP-SEM-07-430) mooted the possibility of allowing generators the flexibility to compete away 'some or all' of the benefits of the allocation of free carbon allowances. In our view, this introduced the possibility of rendering the principle of SRMC bidding ineffective as certain generators, over others, could explain deviations from expected SRMC as their own interpretation of the costs of carbon allowances, if any, which could vary from half hour to half hour, day to day. Such bids do not maintain efficient incentives for entry/exit and do not provide efficient signals to the market. An effective and efficient SEM, and its related retail market, requires much needed investment in the short term. This investment is dependent upon a reasonable level of regulatory certainty in relation to bidding practices in the wholesale market.

The allocation of free carbon allowances is based on historical emissions and was provided by policymakers for a particular objective. It is unfair that the SEM, as the wholesale electricity market, should have to incorporate adjustments to its market based principles to distribute the windfall gains referred to in the consultation paper. It should be up to the policymakers who allocated them to determine the most suitable approach. We therefore support the SEM Committee viewpoint that they are minded to maintain the Bidding Code of Practice as is; ensuring that the opportunity cost of carbon is factored into all generator bids. The SEM has provided an environment in which required investment is being encouraged and incentivised – through the provision of an effective wholesale market environment. It is important that the market is allowed to build on this foundation so that a fully competitive market is eventually formed.