

**NIE Energy Limited  
Power Procurement Business (PPB)**

**Bidding the Opportunity Cost of  
Carbon Allowances**

**Response by NIE Energy (PPB)**

14 March 2008.



## **General summary**

NIE Energy – Power Procurement Business (“PPB”) welcomes the opportunity to respond to the consultation paper on Bidding the Opportunity Cost of Carbon Allowances.

The paper draws out the conflict between on the one hand, the fundamentals of SEM design and, on the other hand, short term benefits for customers. Licence obligations require compliance with the Bidding Code of Practice which requires bids into the market to be based on Short Run Marginal Cost as one of the key principles of the market rules. However, the statements by the RAs in August 2007 suggesting that generators could be given the “flexibility to compete away some or all of the benefits of free carbon allowances” clearly conflicts with this basic principle - the carbon allowances have a market value and to include anything less than this value in generator bids would be uneconomic and anti-competitive. There is no scope for general “efficiency improvements” with carbon allowances unlike other components of cost (e.g. operating efficiency) where it would be legitimate to expect costs to be “competed away” in the market.

## **The Cases for and against Allowing Greater Flexibility**

As the RAs acknowledge in discussing the arguments for allowing flexibility in bidding the opportunity cost of carbon allowances, there is no real case for flexibility other than as a pseudo taxation / claw back measure. However, the RAs’ analysis does not take proper account of the arrangements in Northern Ireland where the value of the carbon allowances allocated to the generating units contracted to PPB is already re-cycled to customers. The distortion of the market price that would result from less than the full value of carbon being included in generator bids would interfere with the recycling arrangements and could result in an unwarranted increase in costs for Northern Ireland customers and potentially an inter-jurisdictional cross subsidy from NI customers to ROI customers.

PPB agrees with the arguments put forward by the RAs in the case against allowing greater flexibility. Further to the points on “rational behaviour” and on the pricing of Directed Contracts, allowing flexibility would make modelling of the market pricing very uncertain and would make the application of, and compliance with, the economic purchasing obligation in PPB’s licence (which is also deemed to cover sales) difficult.

## **Conclusions**

PPB agrees with the SEM Committee’s minded decision not to change the Bidding Code of Practice to allow generators to bid less than the full opportunity cost of carbon. This is the only rational and efficient approach that will help maintain the proper functioning of the SEM and will ensure there is no artificial distortion of either the market or the mechanism that exists in Northern Ireland for the recycling of the value of the free carbon allocations held by the generating units contracted to PPB.