NIE Energy Limited
Power Procurement Business (PPB)

Harmonised Ancillary Service Arrangements and the Bidding Code of Practice

SEM-10-075

Response by NIE Energy (PPB)

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Introduction

NIE Energy – Power Procurement Business (“PPB”) welcomes the opportunity to respond to the SEM Committee (SEMC) Marketing Monitoring Unit’s consultation paper on Harmonised Ancillary Service Arrangements and the Bidding Code of Practice.

<u>General Comments</u>

PPB believes that it is important to keep to the fundamental principles of the SEM market design as enshrined in participants’ licences and the Bidding Code of Practice (BCOP). This clearly requires that generators should bid on the basis of their short run marginal costs (SRMCs) which should reflect the actual cost for each level of generator output delivered to the market. As noted by the SEMC, reserve payments are variable as they are not paid if the unit is not synchronised and generating and vary at different levels of output, and therefore should be included in the calculation of SRMC. Failure to include this Harmonised Ancillary Service (HAS) revenue in commercial offers means that avoidable costs are not being properly reflected and would result in the generator operating at a profit when it is the marginal unit, thereby breaching a fundamental principle of the SEM.

<u>Specific Comments</u>

We note the SEMC recognition of the HAS revenues as a variable benefit and are therefore somewhat surprised at the proposal to treat such a variable component as a fixed element under the BCOP. As the SEMC note, an objective of the market arrangements is to ensure energy and capacity signals are not distorted. In our view, it would be dangerous to be selective in how various cost/benefit components of Commercial Offer Data (COD) are treated and we consider that it is vital to maintain consistency in the treatment of variable components of COD.

Policy Option 1

Option 1 treats the HAS payments as variable and it is acknowledged in the consultation document as being the best method of meeting the policy objectives as it prevents double-payment of any HAS element and ensures correct energy and capacity price formulation/ signals. Although the mechanics of including the HAS payments in the formulation of the bids is not simple it is also not unduly complex and as HAS payment rates are fixed for a year it should not be too difficult for the MMU to perform its duties.

In terms of the effect of Option 1 on SMP, the inverse relationship between HAS revenues and the level of output means incremental prices will be higher leading to higher shadow prices, offset by lower uplift costs.

Policy Option 2

In Option 2 the variable HAS revenues are treated as fixed with the total HAS revenue being deducted from the capacity pot calculation and with the COD not being adjusted. The flaw with this approach is that a generator will not want to go above min gen as they lose revenue. The main benefit put forward for this option appears to be that it will make the job of the MMU easier at the expense of distorting the market design principles.

Policy Option 3

The Do Nothing approach of Option 3 which allows individual generators to determine how to factor HAS payments into COD, although simple, is liable to make the role of the MMU more arduous. It will also make market modelling virtually impossible (impacting on the CFD market) and increase concerns over market dominance. It is hard to see how the potential for gaming, double payment and the inevitable lack of transparency is in the best interest of consumers.

Conclusion

PPB do not consider it tenable to distort a key principle of the SEM and that the strict interpretation of licence obligation and the BCOP should not be compromised just because of some perception of difficulty for the MMU in monitoring the market. The SEMC recognise that Option 1 is economically superior and we also consider the treatment of HAS revenues as variable components in COD with the removal of HAS revenues from the CPM BNE price to be the correct methodology. We disagree with the statement that "the impact of this Policy would thus not present material harm to customers" as we believe inconsistent interpretation and implementation of the general SRMC principles increases the spectre of regulatory inconsistency and risk that can not be in customers' long term interests.

In conclusion, PPB would recommend that Option 1 be adopted by the SEMC as it treats all HAS revenues correctly and that consideration of the options for consistent application of HAS revenues by all generators be consulted upon in due course.