Response to Consultation on

Harmonised Ancillary Service Arrangements and the Bidding Code of Practice

20 December 2010

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SSE Renewables agrees with the SEM Committee's view that of the three options presented to address the treatment of Variable AS payments in light of provisions under the BCOP, Option 2 is preferable. This conclusion is based on comparison with Option 1. While Option 1 may appear economically 'purer', considered against the significant increase in complexity to commercial bidding, the associated deterioration to the monitoring function of the MMU, and the noted fact that the relative sums involved imply that any distortion to price signals would be immaterial, it offers a weaker proposition on balance.

We have entirely discounted Option 3 because in our view the necessary competitive forces do not yet exist to a level that will warrant a 'relaxation' to the Bidding Principles. The permissiveness arising from this option will only lead to gaming and lack of transparency around price formation, as noted in the consultation paper.

Option for Future Consideration: Co-optimisation of Ancillary Services with Energy

The options proposed in the consultation are based on the premise of *deductions*, or otherwise, of Variable AS benefits in constituting the COD (with a complimentary treatment within the Capacity Payments mechanism). However this looks at revenue streams, without addressing the particularities of the products. Ancillary services, as a suite of products, is distinct from energy and capacity. Hence the proposals to net resulting payment streams provide for simplified treatments.

The question has been phrased as to whether to treat the Variable AS payments as fixed or variable costs under the SRMC regime. This problem can also be approached differently by treating ancillary services on a co-optimised basis with energy. Under this treatment, there would be no need to *net off* ancillary services payments from energy bids; the relevant costs would be submitted to the market on a cost structure distinct from, but associated with, energy.

Co-optimising ancillary services with energy provides for a more sound economic treatment of the two products whereas it recognises both their distinctness and their close association. On that basis, if economic purity was the basis for choosing a treatment option, we would recommend this treatment over Option 1.

We recognise however that implementing co-optimisation may be feasible over a longer timeframe than the requirement to have policy in place for 2012. On the basis of the timeline requirement, we recommend Option 2, given its simplicity for both implementation and application, the transparency it maintains in regard to the function of the MMU and the relative insignificance of any distortion it introduces to price signals.

Further Work

The consultation notes that "the quantum of the BNE deduction [under Option 2] will not match the quantum of the reduction in SMP that would result from Option 1, though the relative magnitudes are not known". While we appreciate the heuristics involved in presenting the issue, we would suggest that numeric analysis quantifying these relative magnitudes may be necessary to inform a decision on this matter. Having this analysis will help in evaluating the ‘acceptability’ of the distortion to price signals, however insignificant, and the diseconomy to customers that may accompany the adoption of any option.

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