



## **Gaelectric Holdings Plc.**

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Response Paper to:

**I-SEM Balancing Market Offer Controls**

**Gaelectric Holdings Plc. Response**

18/11/2016

**Public**

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### **Document Details**

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## INTRODUCTION

Gaelectric Holdings Plc. (Gaelectric) recognise the development of I-SEM as an important step towards greater integration of European markets via more efficient trading across interconnectors. We are equally cognisant of the risks associated with the market and are fully supportive of a market design which addresses these in a prudent manner. It is important that regulatory oversight across the various markets has the effect of reducing participants' exposure to activity which could be deemed as predatory or derived by market power.

We are therefore supportive with the intent of this consultation response, however we believe that such topics should acknowledge other ongoing workstreams of parallel importance, or recognise obvious conflicts which need to be addressed. By way of example, the paper seems to be devoid of consideration for regulation in neighbouring markets and DS3 and the unique challenges that the programme represents in relation to opportunity cost.

The dynamic of opportunity cost represents an important consideration in the development of balancing markets. Part of this dynamic will require I-SEM market participants to move away from cost reflective bidding towards a risk adjusted approach. This will occur across all three markets. We see in neighbouring European markets that thermal plants often offer below cost on day-ahead exchanges to avoid the risk of cycling whilst other assets often trade above/below cost on the intraday market in consideration of their exposure to balancing risk.

These just two examples of permitted trading at prices that are not necessarily reflective of the cost of generation. Examples also exist in the balancing market. During stress events, the market operators can step in and trigger Administered Scarcity Pricing whereby market prices rise to reflect the value of the scarcity to the system rather than the cost of generation. This acts as an incentive for generators to ensure availability.

Notwithstanding these provisions, we accept that the system and market operators face certain challenges. The constrained nature of our grid means that there are certain generators located in constrained areas that effectively must run at all times. If a generator knows they will always run for system reasons, there must be provisions in place to prevent any uncompetitive bid/offer patterns emerging.

It is important to realise that there is a difference between such provisions, and energy based actions however. We do not believe that the bidding restrictions for non-energy actions should be mirrored for remaining participants who operated on a risk-adjusted bidding methodology. Such a heavy-handed approach would be contrary to bidding practices in other markets and potential market operator actions in the balancing market.

Extending bidding controls to energy actions may result in artificially low prices in the balancing market which could have unintended consequences on liquidity in the ex-ante markets. The aim for system operators and market participants has always been to promote as much liquidity in the day-ahead market which actually assists the TSO's when balancing the system.

Therefore, introducing measures to lower Balancing Market offers may result in artificially low prices. This would incentivise suppliers to buy increasingly larger volumes in this market and could push

market liquidity closer to delivery, increasing the potential for unnecessary early TSO actions and resulting in under recovery of revenues for generators. All of these are sub-optimal outcomes and should be avoided.

In summary, we support bidding controls for assets behind constraints, however for other participants, a more considered approach to regulation of bids must consider the dynamics of the I-SEM market and care must be taken that an overly restrictive approach does not result in unintended consequences.

## CONSULTATION QUESTIONS

***Q1. Do you agree with the proposed approaches to offer controls in the Balancing Market for I-SEM outlined above? If a respondent does not agree with any part of a proposed approach, please specify why and provide detailed alternative.***

We acknowledge that there may be incentives for anti-competitive bids from must run generators (by virtue of medium/long term constraints) in the I-SEM Balancing Market. Therefore, bidding control are appropriate to counteract this. However, Gaelectric believe that, at least initially, balancing market offer controls should be limited to non-energy actions as detailed in the Market Power Mitigation Decision paper.

Regarding the regulation of energy actions using an offer control mechanism in I-SEM, Gaelectric do not believe that the use of tight bidding controls will be feasible. We believe that a general incentive will exist to remain competitively priced, however we do accept that an oversight committee (akin to the Market Monitoring Unit) will need to have a remit to investigate any uncompetitive bidding patterns. The outcome of this process should include some provision for penalties where market power/uncompetitive behaviour has been proven.

It is not necessarily appropriate for prescriptive bidding control or offer limits, but should consider certain metrics that can be contained within a bid/offer; including opportunity cost, risk-adjustment & short run marginal costs.

Furthermore, there are European regulations such as REMIT to ensure against anti-competitive behaviour in the market. During the market power consultation process, it was proposed that a market abuse condition would be contained within a generators licence and should a generator be found in breach of this condition, they would face penalties. Gaelectric believe that, in tandem with European regulations, this approach should be adopted via an oversight committee.

As mentioned above, we also believe that regardless of the offer control mechanism (Principles or Limit) and action type (Energy or Non-Energy), adequate provisions for opportunity costs should be included in Balancing Market bids and offers. Of particular interest is DS3; as an availability based payment, there will be a constant opportunity cost of participation in the market for generators that needs to be priced into energy market offers.

Energy Storage also faces opportunity costs associated with being dispatched away from their ex-ante traded position. This is due to their finite reserve and potentially being unable to meet market positions they had traded for delivery later in the day. This is particularly apparent in a central dispatch

market. Provisions for each of these opportunity costs must be made in any balancing market offer controls that are introduced in I-SEM. Similarly for conventional thermal generation that has traded in the ex-ante markets, the opportunity cost of being dispatched away from these positions should be reflected in the balancing market offers they submit.

Consideration may also need to be given to the new Capacity Remuneration Mechanism that will be implemented from I-SEM go-live. Not all generators will clear this auction therefore they will not have their fixed costs covered by capacity payments. It is possible that provisions would need to be considered for such generators to recover long run costs via operations. Whilst we are concerned by such prospects given the volatile impacts- our overriding concern is that the process put in place is an enduring structure and not subject to constant regulatory change and uncertainty via future changes.

Given the likely need to consider these new dynamics, and the potential for some volatility in the market (which should be strongly monitored), we believe that the SEM Committee needs to make public comment on the need for a wider Price Average Reference (PAR) volume in the I-SEM balancing market, particularly on a trial basis.

Whilst we recognise the need for a more dynamic market place which values scarcity; provisions must be in place to prevent excess volatility. This has long been accepted as a metric to manage such risk.

***Q2. Which of the options identified within this Consultation Paper would be most appropriate for the introduction of offer controls under I-SEM? If a respondent does not agree with any of options identified, please specify why and provide detailed alternative. If a respondent has a preferred option, please indicate whether any aspect of the preferred option should be amended?***

As stated above, Gaelectric believe that very prescriptive balancing market offer controls should be limited to non-energy actions. When deciding on how best to control these market offers, the SEM Committee should have an appreciation of the different generator operational characteristics. We believe that it may not be possible to implement an extremely detailed and prescriptive set of rules that should apply to all generators. Any balancing market offer controls should adopt a principles approach as opposed to enforcing a prescriptive formula. An oversight committee would then monitor this.

Gaelectric believe that BCOP should continue as the mechanism through which non-energy balancing market offers are regulated. Market participants are familiar with the format of these controls and it has been relatively successful in regulating market prices in the SEM. Implementation of this approach would be a relatively quick process as the existing implementation structures already exist. Given the amount of change currently underway in the market, replacing a functioning price control mechanism without an untested and more complex regime seems unnecessary. It will introduce avoidable implementation risk and may have unintended consequences on price formation and market liquidity. For energy balancing offers, we believe a more principled practice may be required, however with strong oversight and accountability where pricing is considered uncompetitive within a methodology that considers opportunity cost, risk-adjustment and other relevant elements.

## CONCLUSION

Gaelectric would like to thank the SEM Committee for taking this opportunity to engage with industry participants. This issue could have potentially significant impacts on price formation in the I-SEM markets subsequent market liquidity. Should you have any further questions on any of the issues raised above, please do not hesitate to contact us.

Kind Regards,  
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