

# I-SEM

## Offers in the I-SEM Balancing Market

### SEM-16-059

If you have any questions in relation to our response, please don't hesitate to contact Lisa Fahy ([lisa.fahy@sse.com](mailto:lisa.fahy@sse.com))

## Overview

Please find below SSE's response to the SEM Committee consultation on Offers in the I-SEM Balancing Market. SSE will participate in I-SEM as a supplier, generator and intermediary. The intention of the consultation paper is to determine the offer arrangements that will be applied to actions deemed to be non-energy in the I-SEM Balancing Market. SSE has serious concerns with the proposals in the paper, which have the potential to detrimentally impact market participants and customers.

The SEM Committee has flagged its intent to develop and implement ex-ante offer controls where market behaviour is deemed to warrant this. Monitoring will be carried out by the MMU and reported to the SEM Committee. The catalyst for this activity is unclear in the paper, and creates uncertainty for market participants seeking to actively engage in the I-SEM market.

To deliver the range of services to the electricity system envisaged under the new arrangements in the I-SEM – system services, reliability obligations, balancing energy, and non-energy balancing services – a generator will incur a range of costs all of which will have to be recovered over the range of markets such a generator accesses if it is to be held whole and remain sustainable. In general it will reasonably aim to distribute these costs most appropriately within the markets/services<sup>1</sup> where they arise, an objective that can be approximated by cost classification into short- and long-run costs, with short-run costs applied to short-duration markets (such as daily markets) and long-run costs to longer-duration markets (such as annual markets). However, irrespective of the distribution of these costs across distinct but interacting markets, from a generator's perspective the totality of costs have to be recovered for a 'missing money' situation not to arise.

Both options within the consultation paper prescribe an exclusive list of cost items which it proposes generators are limited to employing in constructing their complex offers for the I-SEM Balancing Market, offers which in general will go towards satisfying the non-energy actions required by the TSO and in sequence are likely to be activated well in advance of energy actions. Thus complex offers have execution precedence over simple offers; by implication relevant costs not reflected in complex offers have a low likelihood of being recovered via inclusion in simple offers. And by further implication and under the principle of achieving full recovery to ensure sustainable operations, a generator under such requirements, may seek to reallocate costs, which in its judgement would be short-run costs, into a long-duration market such as the Capacity Market.

The scenario described above is problematic on many levels. By proposing such prescriptive cost itemisation, the requirements possibly limit the scope for market competition between market participants, impinge on the licence condition for generators to ensure Commercial

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<sup>1</sup> The term 'markets' will be used to represent both markets and services where the context requires

Data is cost reflective and create a situation for misapplication of costs, which consequently could lead to distortions in interacting markets.

By contrast the SEM BCOP represents a ‘truer’ set of costing principles which permit the judgement of generators as Prudent Operators as required under their respective licences. There is no demonstrable reason why that arrangement, with suitable adjustments, could not continue. The charge that the historic challenges posed to various cost items under it represent a failure does not hold true in our view; they only prove the fact that differences in interpretation of costs exist. In fact, those challenges have helped clarify the treatment of generator cost items in general, irrespective of being in the current SEM or the impending I-SEM, and have strengthened the document consequently. If anything, the BCOP should be preserved and simply brought into line with the I-SEM design particularities. The SEM Committee has acknowledged that BCOP has worked well in SEM and SSE believes it can satisfy the requirements of I-SEM with minor adjustments.

If however a new document is preferred, cost listings should at most serve as guidelines, not an exclusive provision, adopting the full learnings from the SEM BCOP.

## Response

At the outset SSE notes the term ‘non – energy offers’<sup>2</sup>, presumes the ability to distinguish between energy and non-energy offers. This term is not part of the market design and only adds confusion to the paper. Following clarification from the CER, SSEs understanding is that complex offers (comprising the 3 parts outlined in the paper) will be the offers initially assessed for balancing purposes by the TSO.

The options put forward by the SEM Committee are categorised as ‘offer principals’ or ‘offer limits’ SSEs view is that the proposals are not true principals but are, in effect, a prescriptive set of costs. They provide a set of defined rules in relation to costs, which a generator must comply with in order to compete in the market. However, those rules fail to account for the costs faced by generators accurately. They force generators to exclude contributory items from their offers. In short, the proposals are seeking to exclude legitimate costs from offers, which means the offers are not reflective of the true market conditions for generators.

SSE believes a better and more reasonable approach would be to develop a set of genuine offer principles similar to the BCOP to provide participants with a reasonable structure to develop their offers within.

SSE is genuinely concerned that the proposals in the paper conflict with existing licence intentions to ensure participants can compete fairly in the market. The provisions in the current licences set out clear guidance on what can be included in offers. Market participants must operate in a prudent manner and the RAs must ensure their costs can be recovered. The impact of excluding genuine costs may result in a market that does not

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<sup>2</sup> Mentioned within the advantages section of option 1.

provide for full cost recovery, leading to exits and further concentration of market power which is what this paper is trying to mitigate against. Ultimately this would have a significant impact on end user prices. Under the new market design a generator who is not successful in the capacity market would not be able to reflect their genuine costs in the balancing market and may inappropriately become unviable.

SSEs response to each of the consultation questions is below:

**1. Do you agree with the proposed approaches to offer controls in the Balancing Market for I-SEM outlined above?**

The BCOP was drafted in such a way that it is not overly prescriptive or definitive for particular bid components. However, it ensures an appropriate approach is taken to creating bids. The reason for this approach was to facilitate generation reflecting their actual characteristics to provide a true bid in the market. The variation between the components of a bid for each generation portfolio must be facilitated by market procedures in order not to create market distortion. A one size fits all approach is not appropriate.

SSE believes reform in whatever guise should build on the approach taken in SEM as much as possible to ensure market participant's positions are not inappropriately negatively impacted.

As outlined above, the introduction of genuine offer principles would be preferred by SSE. We are particularly concerned with the proposals on operation and maintenance and start-up costs as outlined in Section 4. There is little justification in the paper to support the changes proposed and SSE would urge the RAs to reconsider.

Operations and Maintenance costs are comprised of both fixed and variable costs. The variable elements are driven by the running hours and number of starts of a unit. The suggestion that this element of cost is the same annually is not reflective of reality. In addition, start-up costs are impacted by maintenance costs. Excluding these costs on the basis that the BCOP provides "minimal detail" is not appropriate.

The proposed treatment of incremental operating costs and gas transportation is also not appropriate; the proposal is effectively restricting the procurement strategy of gas fuelled generators in order to ensure their costs are recoverable. This will only provide certainty to the network and could be considered, in effect, a cross subsidy of the gas market.

As a more general point, moving the eligible costs (whatever they may be) from the licence to a bidding code of practice is not desirable. Making this change will undermine the credibility of the concepts and guiding principles. SSEs view is that these components should be maintained in a document with appropriate governance procedures and position. Retaining these principles (once developed) in the generation licence will ensure changes are made in agreement with affected parties and only following due consideration.

## **2. Which of the options identified within this Consultation Paper would be most appropriate for the introduction of offer controls under I-SEM?**

SSE strongly opposes a number of the SEM Committee's proposals and stances in the paper. Considering the calculation of limits for a single generator or grouping generation types and applying a binding limit on them on the basis of eligible costs that have been defined by the RAs, is confirmation that the RAs believe all units are the same. This in effect becomes an administered balancing arrangement, not a balancing market. This is a flawed approach, the reality, as reflected in SEM, is that a market schedule is produced based on offers in the market. It would be impossible for the TSO to produce a market schedule if there were no cost differentials therefore the application of standardised pricing elements is not realistic.

SSEs preferred option is for reasonable guidelines/principals to be developed. The offer principles as currently proposed are too prescriptive. The principles must be delivered in conjunction with market participants to ensure real and legitimate costs are eligible for inclusion. The introduction of offer limits is akin to price controlling market participants; this is not appropriate in a competitive market and may serve to set a bid target. Some generators, for various reasons are treated as must run by the system operator. There is an inherent risk for price manipulation given the system operational constraints and the designation of generators to address these. These participants have a guaranteed energy revenue stream due to their location. While these units might not be price setting their offers will provide a reference point for the market so they are important.

### **Local market considerations**

Units located next to 'must run' generation will have an opportunity to increase their bid price for being constrained off to reflect the local market conditions. Put simply, bid prices may be higher as units know they will be included in the stack and later removed to allow system constraints to be addressed. The risks for excessive balancing prices are linked to these actions rather than the market proper.

In GB National Grid contracts directly with generators required for locational/system support reasons. SSEs believe bilateral contracts are worth considering for the Irish market. Adopting this approach would see must run generations being addressed separate to the balancing market allowing all others to bid in and reflect a price based on market conditions without competition from generators who are required anyway.

Our view is that there is an inherent risk for excessive pricing if these units are constrained off rather than being constrained on. This issue warrants further consideration by the SEM Committee.

### **Conclusion**

SSE believes option 1, offer principles, is the most appropriate approach to take to the balancing market to ensure market distortion does not occur due to inappropriate

parameters being placed on generators' offers. However, we do not believe the SEM Committee have achieved an appropriate set of principles in its consultation due to the level of actual costs being excluded from offers. The principles developed must recognise the position of market participants and the inherent risks with operating in the market.

A workshop is required to explore the proposals in the paper itself and the proposed changes in the annexes. On the basis of the proposals in the paper it could be perceived that the RAs do not fully understand the potential implications of these changes or the operation of the market in general.