Capacity Market Code Urgent Modifications – Set 2 Consultation

SEM-19-006

Introduction

SSE welcomes the opportunity to respond to the SEM Committee's Capacity Market Code consultation regarding the following modifications:

- CMC 01_19 Interim Solution for Conducting Capacity Auctions
- CMC 02_19 Negative Interest
- CMC 03_19 Treatment of Exempt Price Quantity Pairs

Below we have outlined some comments relating to this consultation. We understand the urgency of these modifications is likely related to preparing for the CRM T-4 auction. Particularly, CMC 01_19 and CMC 03_19 as they relate to changes outlined in the SEM Committee decision on T-4 parameters, SEM 18-155. We responded to the SEM Committee's consultation on T-4 parameters. Specifically, we drew attention to the treatment of locational constraints in the market design and the prioritisation of locational constraints in the auction design.

Specifically, we raised the following concerns in our previous response on T-4 parameters:

1. The proposed solution to manage exit and entry **locational constraints**, namely multi-year-pay-as-bid Reliability Options; and the effect of such an approach to the auction.
2. The **auction format** proposed to change from Option B to Option C, where we believe this exacerbates the effect of the solution for locational constraints above, and otherwise our comments regarding the solution N.

We questioned the prudence of a move to a pay-as-bid scenario to manage locational constraints, to the detriment of all other participants in the market. We are of the view that locational constraints are best addressed through network reinforcements, rather than the capacity market, and/or separate market-based solutions operating in the same way as ancillary services. This would ensure an equal basis for all licensees in the CRM and remove the requirement for the secondary step removal of in-merit plant from the auction results. We appreciate that under state aid, locational constraints needed to be addressed, however, we question whether this could not be achieved in other ways, without potentially distorting the market.

SSE response

CMC 01-19: we have no further comments relating to this proposed change. We feel these have been raised under CMC 03_19 and our previous response on T-4 parameters.

CMC 02-19: We note there is a similar modification proposed for the Trading and Settlement Code, to provide this provision to the SEM bank, under both codes. Our only concern under this mode, and the TSC mod, is that this is providing a system change to update process in line with an ECB change, enacted in 2014. We wonder that there was not an opportunity for this change to have been incorporated to SEM bank operations, in time for go-live. Therefore, we do not consider that this is an urgent mod in and of itself.

We understand that the tender for providers of the SEM bank is currently out for procurement. This could be seen as an impetus for this modification at this time, however the previous provider already facilitated the SEM bank from 2018, without this update being made. When there are so many other urgent system changes needed to address known defects and system errors that materially affect the outturn of the market, we would still question whether this should be marked as an urgent mod, to the detriment of other more critical modifications.

CMC 03-19: This modification enacts the intended auction format changes reflected in the T-4 parameter decision. At the time of the T-4 parameters consultation, we made it clear that we considered the move to pay-as-bid and change to auction format, was understandable, but we felt it was not a prudent approach to market design, to include locational constraints in this manner.

The modification as drafted, references “availability”. When proposals have been recommended by market participants based directly or indirectly on availability, we are advised that under state aid rules, the market design is no longer driven by availability signals. It is not clear from this modification, what the intent of this term is. Therefore, clarity would be welcome.

Under the T-4 parameters consultation, the underlying approach could be ascertained from the proposals on auction design. However, the actual effect in the CMC and working of the market, was still unclear. The modification provides this detail on actual effect. Seeing how this is intended to work in practice, we consider that this approach likely encourages higher prices by those units (potentially above their RO), in location constrained areas. This is because as drafted, the changes to the auction suggests that those with a 1-year RO will be prioritised over a cheaper option (unless the MWs offered, is affected by Net Social Welfare parameters). The aim of prioritising locational constraints for a limited period, i.e. 1 year, is sensible, in case it is resolved in the near term. It also indicates that a locational constraint should not be a permanent feature, if possible. However, as drafted, if a 1-year RO is indeed prioritised over cheaper options able to meet the specific demand or load, it provides a strong implicit incentive for 1-year RO units, to set prices high. Thereby, providing the maximum benefit in that one-year period, (in case they might be knocked out in the following period). Furthermore, it is unclear still how the 1-year locational constraint RO under T-4, coordinates with the T-1, 1-year auction period.

We have experienced situations now in the new market, where locational constraints are giving rise to the opportunity for higher prices by those units in those areas. Therefore, whilst it is the intent to move Auction Format closer to that intended under State Aid—we do not feel that distortion of signals in favour of units in location constrained areas, at a higher cost to customers—was the ultimate intent. It will also discourage new entry into those areas (should there be the facility to enter).

Therefore, we reiterate, that whilst State Aid provided certain market obligations, the driver is the removal of barriers and levelling of the playing field. We are not convinced that market distortions through such proposed modifications or CRM design decisions, are in the spirit of the State Aid requirements.