

Single Electricity Market Committee

Gas Transportation Capacity Costs

Consultation on BCOP Modification Directions

31 July 2013

SEM-13-051

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1 INTRODUCTION AND SUMMARY

- 1.1 Electricity generators are paid in a number of ways. One of them is through the price they receive for the units of electricity they are scheduled to generate. That price is based on the marginal price established in the 'pool', a centralised system which matches electricity supply to demand. That marginal pool price is determined automatically on the basis of 'bids' which generators make for any particular day. The pool price also has an impact on the price which consumers pay for their electricity. In very basic terms, increasing the costs which generators include in their bids will increase the marginal pool price and increase the ultimate price of electricity.
- 1.2 There are various rules about how generators construct their bids. In particular they are required by their licences to bid their 'short run marginal cost' ("**SRMC**"), which is valued using the concept of 'opportunity cost', which is defined in a document called the Bidding Code of Practice ("**BCOP**"). The SEM Committee has a role in interpreting and applying those rules and principles and has the power to change them in some circumstances¹.
- 1.3 As is explained in detail in section 3 of the SEM Committee's recent paper SEM-13-039², in addition to paying for any gas which they use, electricity generators are required to pay for the capacity that is needed to transport that gas across the gas network. The SEM Committee has been asked to reach a view on whether the cost of that gas transportation capacity ("**GTC**") forms part of generators' SRMC (as defined in their licence) and, if so, at what value.
- 1.4 This consultation supplements the SEM Committee's provisional conclusions on that and other questions, which was set out in SEM-13-039. This consultation explains why the SEM Committee is proposing to make enduring changes to the BCOP and to produce finalised, consolidated, guidance on the subject. This paper also contains a version of the BCOP which shows what such changes may look like. In summary the proposed changes to the BCOP would:
- 1.4.1 provide a specific valuation principles for GTC;
 - 1.4.2 specify a principle of good market behaviour which provides that generators must make 'reasonable' assessments when including GTC costs in their bids; and

¹ The SEM Committee's powers of amendment come from paragraph 5 of Conditions 15 & 17 of generators' licences in ROI and NI respectively. That paragraph provides that *"The [SEM Committee] may publish and, following consultation with [generators] and such other persons as the [SEM Committee] considers appropriate from time to time by direction amend, a document to be known as the Bidding Code of Practice..."* and paragraph 13 of the BCOP which provides that *"In accordance with paragraph 5 of the relevant conditions, this Code may, following consultation with the holders of generation licences and such other persons as the [SEM Committee] consider appropriate, from time to time be amended by direction."*

² Available via this link:

http://www.allislandproject.org/en/mmu_current_consultations.aspx?article=bf4f81f2-248a-4a41-95da-086b6e427e90

- 1.4.3 specify a principle of good market behaviour which would require generators to bid on the basis of an expectation that they would not unreasonably be exposed to penalty charges.
- 1.5 The SEM Committee would welcome any comments on SEM-13-039 and the proposals contained in this document, which should be sent to joe.craig@uregni.gov.uk before the 26 September 2013. Specific questions which responses might consider are set out in section 5 below. Once it has considered any responses received, the SEM Committee will make a final decision on how the licence and BCOP apply as regards GTC costs and what, if any, further action it should take.

2 PREVIOUS CONSULTATIONS

- 2.1 When it decided on the terms of the BCOP in 2007, the SEM Committee was of the view that the availability of GTC products meant that the cost of GTC could not form part of generators bids. However, the SEM Committee noted that that availability may change and so its view may need to be updated in the future³.
- 2.2 In September 2012, the SEM Committee published SEM-012-089⁴. That consultation responded to calls for the SEM Committee to reconsider the view it expressed in 2007. It posed various questions about changes in the availability of GTC products and whether there was good cause to disapply the general valuation principles contained in the BCOP.
- 2.3 In June 2013, in response to calls for clarity as to the SEM Committee's view on the treatment of GTC costs and to allow stakeholders a further opportunity to comment on this complex matter, the SEM Committee published SEM-13-039. That paper set out the Committee's provisional conclusions on SEM-12-089 through both provisional guidance and a provisional good cause determination.⁵ To date, the SEM Committee has received a number of comments on SEM-13-089. It summarises some of them and its response to them in Annex 1.
- 2.4 This consultation supplements SEM-13-039 and explains why the SEM Committee is proposing to make enduring changes to the BCOP. The SEM Committee does not consider any of the comments which it has so far received to SEM-13-039 to fundamentally alter its view of how the relevant part of generators licences⁶ and the BCOP apply to GTC costs. However, having reflected on some of the comments received, the SEM Committee is proposing to provide a slightly different valuation principle on an enduring basis from that which is currently specified in its provisional good cause determination. Annex 2 contains a version of the BCOP which illustrates how it may be amended.

³ See AIP-SEM-07-430, available via this link: <http://www.allislandproject.org/en/market-power-decision.aspx?article=7fdc1ef8-3e0e-4267-9b82-0a2c65b1056f>

⁴ Available via this link: http://www.allislandproject.org/en/sem_publications.aspx?year=2012

⁵ The SEM Committee expects generators to bid on the basis of SEM-13-039 unless and until that guidance and good cause determination are updated or revoked. The Committee understands that it may take time for generators to change their bidding practices and would be mindful of that should it be called on or consider taking any action with respect to licence compliance.

⁶ Referred to throughout this paper as '**Condition 15/17**'

3 RATIONALE FOR ENDURING ACTION

- 3.1 SEM-12-089 and SEM-13-039 recognised changes in the GTC products which are available to generators and the need for the SEM Committee to clarify its view of how Condition 15/17 and the BCOP apply to GTC costs. Having acknowledged uncertainty around how the current terms of the BCOP value GTC costs, the SEM Committee made a provisional good cause determination, which remedied that uncertainty on a provisional basis.
- 3.2 In SEM-13-039, the SEM Committee stated its intention to apply any changes on an enduring basis. Section 4 sets out the content of the enduring changes which the SEM Committee is proposing to make. This section describes the reasons why the SEM Committee is proposing to make those changes by directing modifications to the BCOP and finalising its guidance.
- 3.3 There are various actions which the SEM Committee could take to clarify the treatment of GTC costs on an enduring basis. For example, it could:
- 3.3.1 Modify Condition 15/17 to make explicit provision for when and how GTC costs ought to be included in generator bids;
 - 3.3.2 Confirm and make enduring the provisional good cause determination that was set out in SEM-13-039;
 - 3.3.3 Confirm and make enduring the provisional guidance that was contained in SEM-13-039;
 - 3.3.4 Modify the BCOP to make explicit provision for the valuation of GTC costs where those costs are part of a generator's SRMC; and/or
 - 3.3.5 Modify the BCOP to include principle(s) of good market behaviour which ought to be observed by generators when formulating their bids.
- 3.4 The following paragraphs explain what these different courses of action would involve and sets out some of their relative advantages and disadvantages. In considering those advantages and disadvantages, the SEM Committee is mindful of all of its statutory objectives,⁷ in particular the need to promote transparent pricing in the SEM.
- 3.5 **Modification of Condition 15/17:** This is the licence condition which specifies that generators must 'bid' their SRMC and provides a definition of SRMC for these purposes (see Annex 3). This is a high-level definition which does not currently make specific provision for different costs, but the SEM Committee could seek to modify the licence to include specific rules for when and how GTC costs are to be included.
- 3.6 Condition 15/17 contains the primary set of rules about how a generator must bid, which are further elaborated through the principles set out in the BCOP. Given that the necessary clarity can be provided without amending the licence, the SEM Committee considers licence modification to not be the most proportionate way forward in this case at this time.

⁷ Details of which are set out in Annexes 4 and 5.

- 3.7 Confirm and make enduring the provisional good cause determination:** Paragraph 8 of the BCOP sets out principles which generators must follow when they are valuing their SRMC and constructing their bids. For the reasons set out in SEM-13-039, the SEM Committee has made a provisional good cause determination which disapplies those principles as regards GTC and clarifies the way in which GTC costs ought to be valued where they are to be included in a generator's bid.
- 3.8 That determination is a public document and the SEM Committee could simply confirm it on an enduring basis (amending it if necessary). This option would be relatively quick and simple to implement and previous good cause determinations have applied on an enduring basis, albeit they have only applied to specific generators. However, this option would not change the terms of the BCOP itself. Given that the good cause determination applies to all generators who are to include GTC costs in their bids, it would arguably be more transparent for the GTC specific valuation principles to be included in that document, alongside the other valuation principles.
- 3.9 Confirm and make enduring the provisional guidance:** Because the rights and obligations contained in Condition 15/17 are defined in high-level terms and they are supplemented in the BCOP by principles, rather than prescriptive rules, the SEM Committee is, from time to time, called on to provide guidance explaining more fully how it would interpret those documents and so its view of how generators should construct their bids.⁸ SEM-13-039 contained provisional guidance regarding GTC costs.
- 3.10 The SEM Committee could confirm that guidance and state that it applies on an enduring basis. Such guidance could relatively easily be updated in the future as matters develop and if new queries arise. This option would not require any change to either Condition 15/17 or the BCOP. However, given the uncertainty which existed prior to SEM-13-039 around how the BCOP applies to value GTC, the SEM Committee does not consider that this option alone would enable transparent pricing the SEM. Nonetheless, some form of guidance is likely to be a useful supplement to any other regulatory action the SEM Committee takes.
- 3.11 **Modify the BCOP to make explicit provision for GTC valuation:** The BCOP contains various principles which generators must follow when constructing their bids, including ones which state how costs are to be valued. As noted above, the SEM Committee can direct modifications to the BCOP when it considers it appropriate to do so and after consultation.
- 3.12 This option would involve the SEM Committee directing a modification to the BCOP which meant that the general valuation principles in paragraph 8 of the BCOP would not apply to GTC and which set out specific valuation principles generators should follow in relation to GTC. The BCOP already makes specific provision for the valuation of certain costs (e.g. start up and no load costs) and so this option would follow the existing framework for generator

⁸ The SEM Committee recognises that guidance, of itself, has no legal force. However the SEM Committee also recognises that it can give licensees insight into how the Committee would be likely to interpret the licence in the event of any enforcement action. It can therefore help secure compliance with licences and so is a useful part of the regulatory tool kit.

bidding. It would also enable the GTC valuation principles to be relatively easily identified (and so be more transparent) to any future generator. Subject to any comments received through consultation, this option could be implemented relatively quickly.

- 3.13 **Modify the BCOP to include principle(s) of good market behaviour:** In addition to setting out valuation principles, the BCOP can set out principles of good market behaviour which generators must follow when constructing their CODs. As explained in SEM-13-039, one of the situations where such principles may be appropriate is where generators require further certainty about the way in which they ought to construct their bids.
- 3.14 Condition 15/17 contains general rights and obligations and operates such that generators will have to submit their bids on the basis of an expectation, formed in advance of any trading day, as to the costs which would or would not be attributable to their plants were that plant to generate electricity on that trading day. In relation to GTC, this will involve assessing a plant's expected market schedule quantities and what, if any, proportion of its required GTC would fall within categories A, B or C (as set out in SEM-13-039). It will also involve a generator assessing the probability of its being able to buy or sell GTC within the trading day for which that capacity is available. Such assessments will determine whether or not a generator can expect GTC costs to fall within its plant's SRMC.
- 3.15 Further, where GTC costs would fall within a plant's SRMC and so should be included within a generator's bid, the proposed valuation principles mean that an assessment may have to be made of the amount which a generator would receive or pay for that GTC. In some cases this may be known in advance, but in others it may not and so the generator would have to bid on the basis of an expectation as to what the amount would be.
- 3.16 There are various factors which could influence such assessments and so, in the absence of any specific provision, the scope and incentives for generators to formulate misleading bids may be increased. Specifying a principle of good market behaviour that clarifies how a generator ought to make such assessments should limit such scope and incentives, supporting transparent pricing and consumers' interests. The SEM Committee is also proposing to specify a principle of good market behaviour in relation to penalty payments which generators may incur, further explanation of which is provided in paragraphs 4.10 & 4.11 below.
- 3.17 Therefore, having considered its statutory objectives, the representations it has received and the various advantages and disadvantages of the options available to it, the SEM Committee is proposing to: **direct modifications to the BCOP which would a) provide specific valuation principles for GTC and b) set out principles of good market behaviour which generators must follow when constructing their bids.** Details of the proposed modifications are provided in the following section.
- 3.18 If the SEM Committee makes such a direction, it would also propose to revoke the provisional good cause determination it made in SEM-13-039 and to publish finalised guidance on the treatment of GTC costs.

4 CONTENTS OF PROPOSED CHANGES

PROPOSED MODIFICATIONS TO THE BCOP

4.1 Section 4 of SEM 13-039 sets out the reasons why the SEM Committee considers specific provision needs to be made as regards GTC. Annex 2 contains a version of the BCOP which illustrates the modifications the SEM Committee is now proposing. There would be three core modifications:

GTC valuation principles

4.2 First, the inclusion of specific valuation principles which generators must follow where they include GTC costs within their bids. The provisional good cause determination set out in SEM-13-039 applies such that, at present, where generators must include GTC costs in their bids, they must value them at the amount which they 'would expect to' pay or realise for acquiring or disposing of GTC on a within day basis.

4.3 It has been suggested that this approach is flawed because any BCOP definition of opportunity cost must be an objective one. The SEM Committee does not agree with that. SEM-12-089 acknowledged that it is easier to monitor generator bids where the BCOP defines opportunity cost by reference to particular, objectively set, prices, e.g. the spot price for gas. However, the SEM Committee does not consider anything within either Condition 15/17 or the BCOP to require such an approach to the valuation of costs⁹ and, as was explained in SEM-12-089 and SEM-13-039, it is not possible in relation to GTC.

4.4 The SEM Committee has considered specifying exactly what the 'benefit foregone' by reference to 'most valuable realisable alternative use' of GTC is in any particular case. Whilst this approach may lead to more transparent pricing in the short term, the SEM Committee considers that it would lead to increasingly inflexible and complex bidding as increasing numbers of scenarios are highlighted and prescribed. In turn that could decrease the transparency of pricing in the SEM and ultimately work against the consumer interest.

4.5 However, the SEM Committee has reflected on the comments it has received and recognises that removing the element of expectation from the valuation principle could help make valuations included in bids more demonstrable and so make pricing more transparent and help make monitoring of those bids simpler and more effective (which the SEM Committee considers to be in the consumer interest). It is therefore proposing to amend the BCOP and specify valuation principles for GTC that refer to the amount which a generator 'would' pay or receive, i.e. to remove the element of expectation from the valuation.

4.6 This approach would continue to follow the BCOP definition of opportunity cost as being the '*benefit foregone...by reference to the most valuable realisable alternative use...*' but would

⁹ Indeed, it notes that generators include individual assessments of the particular risks which their plant and equipment are exposed to when reflecting paragraph 8(iii) of the BCOP in their bids.

more closely align GTC specific principles to Condition 15/17's definition of SRMC. In some cases the amount which a generator 'would' pay or receive may be known in advance and so it will be easier for generators to provide evidence of the amount they include within their bids. Even where the precise amount is not known in advance, the SEM Committee expects it to be relatively easier for generators to evidence an assessment of the amount which they 'would' pay or receive than the amount they 'would expect' to pay or receive. Nonetheless the SEM Committee recognises that some guidance as to the assessments which generators will have to make when forming the expectations that underlie their bids could still be required and so it is also proposing to specify the following principle of good market behaviour.

New principle of good market behaviour 1 (reasonableness of assessments)

- 4.7 As described in paragraphs 3.14-3.16 above, generators will have to make a number of assessments when deciding whether or not GTC costs would form part of their plant's SRMC and, if so, at what value. Generators may be called upon to provide reasoned explanations and supporting evidence for any such assessments¹⁰. To help ensure that the scope and incentives for generators to formulate misleading bids are further decreased (and so support transparent pricing and the consumer interest), the SEM Committee is proposing to specify a principle of good market behaviour.
- 4.8 That principle would be that generator assessments must be 'reasonable'. This will mirror the existing provision within the BCOP for risk to plant and equipment¹¹. It will also continue to allow generators the full flexibility which they currently have under Condition 15/17 to compete with each other and find the lowest cost way of procuring and using GTC, which the SEM Committee considers would be in the consumer interest.
- 4.9 Where the amount which a generator would pay or receive is not known in advance, the SEM Committee considers that 'reasonable' assessments will reflect the specific circumstances for a generator on any day. In particular those assessments should be informed by factors such as:
- 4.8.1 the general availability of GTC;
 - 4.8.2 the anticipated availability of GTC on the particular trading day in question; and
 - 4.8.3 the timescale within which GTC would have to be bought/sold (recognising that, unlike fuel and other costs GTC products only apply to particular trading days and so only have a value until the end of that trading day).

New principle of good market behaviour 2 (penalties principle)

- 4.10 Finally, it has been suggested that penalty charges which generators may incur are also costs which should be included within generators' bids. This point has been raised with the SEM Committee in the context of this GTC matter and separately and the Committee plans to consider it in more detail. Meantime, it notes that there are a variety of such charges which

¹⁰ An obligation contained in paragraph 9 of Condition 15/17.

¹¹ In paragraph 8(iii) of the BCOP.

may be incurred at different times and for different reasons. In relation to GTC, the most likely charges are 'overrun' or 'unauthorised flow' charges which are levied on generators that do not acquire sufficient GTC for their needs and take gas from the gas network without having the corresponding capacity. The SEM Committee does not accept that penalty charges are necessarily 'costs' for the purposes of Condition 15/17 or would fall within a generator's SRMC.

- 4.11 The SEM Committee also notes that penalty charges are generally designed to incentivise behaviour which is important for the overall efficacy and safe running of either the gas or electricity networks. It would consider it perverse if such charges were 'costs' and fell within a generator's SRMC, as it would undermine the important system incentives and raise the prospect that consumers paid for generator behaviour which jeopardised the overall efficiency and safe running of the electricity or gas systems. In any event, the SEM Committee does not consider it 'good market behaviour' to incur any such charges and so is proposing a general principle of market behaviour which would require generators to bid on the basis of an expectation that they would not unreasonably be exposed to such charges. This principle would apply in relation to overrun or unauthorised flow charges as well as other similar charges.
- 4.12 These are the three enduring changes which the SEM Committee proposes to make at this time. In considering these changes the SEM Committee has considered the various incentives which may exist for generators to take greater risks with their capacity holding, buying and selling more within a trading day in order to include that capacity within their bids. The SEM Committee expects generators to act in competition with each other and to seek to keep their bids as low as possible in order to stand a greater chance of being called upon to generate. It will continue to monitor generators' behaviour and may propose further action as appropriate.

5 CONSULTATION QUESTIONS & NEXT STEPS

5.1 Do you have any comments on the information, reasons and provisional decisions set out in SEM-13-039?

5.2 Do you have any comments on the reasons and proposed decision set out in this paper? In particular, do you agree that the SEM Committee should:

5.2.1 Make enduring provision for the treatment of GTC through modifications to the BCOP and consolidated guidance including:

- (i) Specifying the alternative valuation principles described in paragraphs 4.2-4.6 above;**
- (ii) Specifying the first principle of good market behaviour (the reasonableness of assessments principle) described in paragraphs 4.7-4.9 above; and**
- (iii) Specifying the second principle of good market behaviour (the penalties principles) described in paragraphs 4.10-4.11 above.**

5.3 If you do not agree that the SEM Committee should make such enduring provision, why not?

5.4 Do you think there are any other steps or modifications which the SEM Committee should take or make?

5.5 Any responses to these questions or other comments should be sent to:

Joe Craig

Utility Regulator

14 Queen Street

Belfast

BT1 6ED

joe.craig@uregni.gov.uk

Stakeholders have already had opportunity to provide comments to the SEM Committee in relation to the treatment of GTC costs but the SEM Committee recognises the relative complexity of this subject and the fact this consultation falls over the summer holiday period. Given that the good cause determination set out in SEM-13-039 is in place, providing the necessary clarity on a provisional basis, the SEM Committee will therefore consult on these proposals, together with SEM-13-039, for 8 weeks, i.e. by the 26 September 2013.

5.6 Once it has considered any comments received, the SEM Committee will make a final decision on how the licence and BCOP apply as regards GTC costs and what, if any, further action it should take. That action may include making directions that amend the BCOP.

Status of SEM-13-039

- 1.1 A number of stakeholders asked for clarity as to the status of SEM-13-039, its place in the overall consultation process and what further stages the SEM Committee planned prior to making a final decision.
- 1.2 SEM-13-039 contains provisional guidance and a provisional good cause determination. These applied with immediate effect and the Committee expects generators to construct their bids on the basis of them. They apply unless and until they are explicitly revoked or updated.
- 1.3 The SEM Committee would welcome any further comments on SEM-13-039 as well as on this consultation by 26 September 2013. Once this consultation has closed, the RAs, acting through their SEM Committees will consider all comments received and make a final decision on how the licence and BCOP apply as regards GTC costs and what, if any, further action they should take.

Flawed, discretionary, interpretation

- 1.4 It has been suggested that the view expressed in SEM-13-039 is fundamentally flawed because it involves a level of SEM Committee discretion in interpreting the licence and the BCOP which is inconsistent with the Supreme Court ruling in the carbon revenue levy case. In particular, it has been suggested that the SEM Committee is conducting an unlawful interpretation of the licence and BCOP because it allows generator trading strategies and generator expectations to influence whether or not GTC costs fall within SRMC.
- 1.5 The SEM Committee again acknowledges that in considering how Condition 15/17 and the BCOP apply to GTC, its interpretation of those documents is limited to reaching a view on what their stated terms mean. By explaining that view the SEM Committee can provide regulatory certainty and any discretionary action which the SEM Committee then takes should be taken in light of its view of what the stated terms of Condition 15/17 and the BCOP mean, i.e. its interpretation.
- 1.6 The SEM Committee's view remains that a generator must, as a matter of fact, submit its bids on the basis of an expectation as to the costs which would or would not be attributable to its plant on any trading day and that that expectation must be informed by the particular circumstances of each plant, i.e. the generator's trading strategy. It considers that view to be supported by the facts that (a) generators' bids (i.e. their Commercial Offer Data or 'COD') have to be submitted in advance of a trading day and (b) Condition 15/17 defines SRMC by reference to the costs which 'would' be attributable were a plant to run or not. In those circumstances the SEM Committee considers an expectation as to the costs which would or would not be attributable to that particular plant on any given day to be the only basis on which bids could be formed.

- 1.7 However, the SEM Committee acknowledges that the BCOP may operate such that the opportunity cost value which is placed on any such costs is different from the actual cost to the generator. Nonetheless, given the primacy of Condition 15/17 over the BCOP, the SEM Committee does not consider it possible for the notion of opportunity cost to be applied in a way which allows the price components of a generator's COD to include costs items which would not fall within the definition of SRMC. The SEM Committee is not aware of any previous decisions which are inconsistent with this view.

BCOP values must be objective

- 1.8 It has also been suggested that the SEM Committee's approach is flawed because it requires an element of subjectivity in the valuation of cost items, which is not possible because BCOP valuations must always be objective.
- 1.9 The SEM Committee has acknowledged that it is easier to monitor generator bids where the BCOP defines opportunity cost by reference to particular, objectively set, prices, e.g. the spot price for gas. However, it does not consider anything within either Condition 15/17 or the BCOP to require such an approach to the valuation of costs and, as was explained in SEM-12-089 and SEM-13-039, it is not possible in relation to GTC.
- 1.10 Nonetheless, the SEM Committee has reflected on these comments and is proposing to modify the approach to valuation in any enduring arrangements. Paragraphs 4.2-4.6 above provides further details of that proposed change.

The existence of RAGATM

- 1.11 It has been suggested that the SEM Committee cannot make a good cause determination without first reaching a firm conclusion on whether or not a RAGATM for both primary and secondary capacity exists.
- 1.12 The SEM Committee does not agree. Indeed, as was stated in SEM-13-039, the fact that there is evidently dubiety as to whether or not the arrangements under which either primary or secondary capacity can be acquired can be characterised as 'recognised and generally accessible trading markets' is, in itself, a good cause to disapply the general principles in paragraphs 8(i) to 8(iii) of the BCOP.

Distinctions between primary and secondary capacity

- 1.13 It has also been suggested that there is no distinction to be made between primary and secondary GTC and therefore that the SEM Committee's conclusion that primary products are not a suitable replacement for secondary is flawed.
- 1.14 In this regard, the SEM Committee notes the various submissions which have been made to it, emphasising the differences between primary and secondary capacity. It also reiterates the reasons it gave in SEM-13-039, in particular paragraph 4.17, as to why it considers the

differences between the products to mean that they should be considered to be different products for valuation purposes.

Flawed good cause determination

- 1.15 It was also suggested that the provisional good cause determination set out in SEM-13-039 was flawed (because of issues such as those noted above) and, in any event, any good cause determination had to respect the primacy of the generation licence and not allow a generator's bid to be anything other than cost-reflective.
- 1.16 The SEM Committee agrees that the Supreme Court judgement has clarified that Condition 15/17 and its definition of cost-reflectivity has primacy over the BCOP. It considers the terms of its provisional good cause determination and the proposals in this consultation paper to be consistent with that position but would welcome any more detailed comments as to any inconsistency with the principle of cost-reflectivity as defined in Condition 15/17.

Penalty charges

- 1.17 Finally, it has also been suggested that penalty charges which generators may incur are also 'costs' which should be included within generators' bids. The SEM Committee's response to this suggestion is noted in paragraphs 4.10 and 4.11 above.

This is a copy of the Bidding Code of Practice which illustrates how the modifications proposed in this consultation could be implemented. The terms of any final direction amending the BCOP may differ from the illustrative amendments shown below.

INTRODUCTION

1. This Bidding Code of Practice (**this Code**) is published jointly by:
 - a. the Northern Ireland Authority for Utility Regulation (**the Authority**), in accordance with paragraph 5 of the following conditions of licences in Northern Ireland:
 - (i) Condition 17 of each electricity generation licence; and
 - (ii) Condition 57 of the public electricity supply licence granted to Northern Ireland Electricity plc under Article 10(1) of the Electricity (Northern Ireland) Order 1992 under a licence document dated 31 March 1992 and transferred to NIE Energy Limited; and
 - b. the Commission for Energy Regulation (**the Commission**), in accordance with paragraph 5 of the following conditions of licences to generate electricity in the Republic of Ireland:
 - (i) Condition 17 of the interim electricity generation licence granted to the Electricity Supply Board on 21 April 2006;
 - (ii) Condition 16 of the electricity generation licence granted to Synergen on 31 July 2002; and
 - (iii) Condition 15 of electricity generation licences granted to all other licensed generators of electricity.
2. For the purposes of the licence conditions under which it is made (**the relevant conditions**), this Code defines the concept of Opportunity Cost, makes provision for the calculation of cost-items and sets out other principles of good behaviour in the Single Electricity Market.
3. In accordance with paragraph 6 of each relevant condition:
 - a. electricity generators are required to comply with the provisions of this Code in submitting Commercial Offer Data under the Single Electricity Market Trading and Settlement Code, whether by themselves or through Intermediaries; and

- b. the Power Procurement Business of NIE Energy Limited is required to comply with the provisions of this Code in submitting Commercial Offer Data under the Single Electricity Market Trading and Settlement Code.
4. This Code aims to facilitate the efficient operation of the Single Electricity Market by ensuring that:
- in combination with the Capacity Payment Mechanism established under the Single Electricity Market Trading and Settlement Code, generators are appropriately compensated for making available their generation sets or units (as appropriate) and for generating electricity in the Single Electricity Market;
 - generators cannot exercise market power in the generation of electricity on the island of Ireland or any part thereof; and
 - the Power Procurement Business cannot exercise market power by virtue of generation sets or units contracted to it under long term power purchases agreements in Northern Ireland, in respect of which it has been appointed an Intermediary.
5. **Words and expressions used in this Code and not defined shall, unless the context otherwise requires, have the same meaning as when used in the licences containing the relevant conditions or (where appropriate) in the Single Electricity Market Trading and Settlement Code.**

DEFINITION OF OPPORTUNITY COST, VALUATION OF COST-ITEMS AND PRINCIPLES OF GOOD MARKET BEHAVIOUR

General Principles

6. When calculating the Short Run Marginal Cost of a generation set or unit in respect of a Trading Day, constituent cost-items are to be valued at their Opportunity Cost, and so that a reasoned explanation of the calculation of that Opportunity Cost is capable of being given to the Authority or the Commission (as appropriate) on request.
7. The Opportunity Cost of any cost-item shall comprise the value of the benefit foregone by a generator in employing that cost-item for the purposes of electricity generation, by reference to the most valuable realisable alternative use of that cost-item for purposes other than electricity generation.
8. Save as otherwise provided in this Code, in calculating the value of the benefit foregone in employing a cost-item for the purposes of electricity generation, the

following principles shall, unless it can be demonstrated to the satisfaction of the Authority or the Commission (as appropriate) that there is good cause not to, be applied:

- (i) where there exists a recognised and generally accessible trading market in the relevant cost-item, the Opportunity Cost of that item should reflect the prevailing price of the cost-item, which may be for immediate or future delivery or use as appropriate to the circumstances of the relevant generator, having regard to:
 - (a) costs the relevant generator would incur in offering that cost-item for sale, or acquiring that cost-item, on a recognised and generally accessible trading market;
 - (b) reasonable provision for the variability of the prevailing price of a cost-item on a recognised and generally accessible trading market;
- (ii) where no recognised and generally accessible trading market exists in the relevant cost-item the Opportunity Cost of that item should reflect the costs which would be incurred by the relevant generator in replacing that cost-item; and
- (iii) reasonable provision for increased risks to plant and equipment as a result of the operation of a generation set or unit may be included.

9. Subject to paragraph 12, all Commercial Offer Data submitted in respect of a generation set or unit are to reflect the costs relating to that generation set or unit when considered on a stand-alone basis.

Start-Up and No Load Costs

10. Start-up and no load costs should reflect the actual start-up and no load costs of the generation set or unit unless it can be demonstrated to the satisfaction of the Authority or the Commission (as appropriate) that the scheduling algorithm and associated software operates in such a way that the bidding of actual start-up and no load costs would distort the true economics of the generation set or unit.

Energy, Emissions or Time Limited Units

11. Where there is a constraint on:
 - a. the total time a generation set or unit may run, or
 - b. the total emissions a generation set or unit may emit over a period of time, or

- c. the total amount of energy available to a generation set or unit for a period of time,
bids should reflect the Opportunity Cost of the generation set or unit over that period of time.

Co-Generation

12. Where the generation of electricity is associated with additional processes other than generation, the Opportunity Cost of generating electricity for delivery to the Single Electricity Market should reflect the value of the use of electricity, or heat used to generate electricity, or both, in those associated processes.

Gas Transportation Capacity Costs

12A. To the extent that the price components of the Commercial Offer Data (COD) submitted by a Licensee in respect of a Trading Day are required by the relevant conditions to reflect the gas transportation capacity (GTC) costs relating to a generating unit, the provisions of paragraphs 12B and 12C shall apply.

12B. Where this paragraph applies the value of the benefit foregone in employing GTC for the purposes of electricity generation by reference to the most valuable realisable alternative use of that GTC for purposes other than electricity generation, shall:

- (i) to the extent that the relevant COD reflects GTC not yet held by the Licensee in respect of the Trading Day, correspond to the amount which the Licensee would pay to purchase sufficient additional GTC within the Trading Day; and
- (ii) to the extent that the relevant COD reflects GTC held in respect of the Trading Day, correspond to the amount which the Licensee would realise by disposing of the unused GTC within the Trading Day.

12C Where this paragraph applies, any assessment as to whether the price components mentioned in paragraph 12A are required to reflect GTC costs and any assessment of an amount under paragraph 12B must be reasonable.

Exposure to penalties etc

12D. A Licensee's COD should reflect an expectation that it will act so as to avoid unreasonable exposure to the following:

- a. charges (known as overrun charges in Ireland and unauthorised flow charges in Northern Ireland) associated with the removal of gas from the relevant system without capacity; and
- b. any other penalties or charges of a similar nature.

CHANGE MANAGEMENT

13. In accordance with paragraph 5 of the relevant conditions, this Code may, following consultation with the holders of generation licences and such other persons as the Authority or the Commission (as the case may be) consider appropriate, from time to time be amended by direction.

ANNEX 3 GENERIC TEXT OF GENERATION LICENCE CONDITION 15/17: COST REFLECTIVE BIDDING IN THE SINGLE ELECTRICITY MARKET*¹²

1. *The Licensee shall ensure that the price components of all Commercial Offer Data submitted to the Single Market Operation Business under the Single Electricity Market Trading and Settlement Code, whether by the Licensee itself or by any person acting on its behalf in relation to a generation [unit/set] for which the Licensee is the licensed generator, are cost-reflective.*
2. *For the purposes of this Condition, the price component of any Commercial Offer Data shall be treated as cost-reflective only if, in relation to each relevant generation [unit/set], the Schedule Production Cost related to that generation [unit/set] in respect of the Trading Day to which the Commercial Offer Data submitted by or on behalf of the Licensee apply is equal to the Short Run Marginal Cost related to that generation [unit/set] in respect of that Trading Day.*
3. *For the purposes of paragraph 2, the Short Run Marginal Cost related to a generation [unit/set] in respect of a Trading Day is to be calculated as:*
 - (a) the total costs that would be attributable to the ownership, operation and maintenance of that generation [unit/set] during that Trading Day if the generation [unit/set] were operating to generate electricity during that day;*
 - minus*
 - (b) the total costs that would be attributable to the ownership, operation and maintenance of that generation [unit/set] during that Trading Day if the generation [unit/set] was not operating to generate electricity during that day,**the result of which calculation may be either a negative or a positive number*

¹² * Text shown in square brackets appears in some licences but not all generation licences in the SEM.

4. *For the purposes of paragraph 3, the costs attributable to the ownership, operation and maintenance of a generation [unit/set] shall be deemed, in respect of each relevant cost-item, to be the Opportunity Cost of that cost-item in relation to the relevant Trading Day.*
5. *The [Commission/Authority] may publish and, following consultation with [the holders of Generation Licences/generators] and such other persons as the [Commission/Authority] considers appropriate, from time to time by direction amend, a document to be known as the Bidding Code of Practice, which shall have the purposes of:*
 - (a) defining the term Opportunity Cost;*
 - (b) making provision, in respect of the calculation by the Licensee and other generators of the Opportunity Cost of specified cost-items, for the treatment of:*
 - (i) the costs of fuel used by generators in the generation of electricity*
 - (ii) the value to be attributed to credits issued under the Emissions Trading Scheme established by the European Commission;*
 - (iii) variable operational and maintenance costs;*
 - (iv) start-up and no load costs; and*
 - (v) any other costs attributable to the generation of electricity; and*
 - (c) setting out such other principles of good market behaviour as, in the opinion of the [Commission/Authority], should be observed by the Licensee and other generators in carrying out the activity to which paragraph 1 refers.*
6. *The Licensee shall, in carrying out the activity to which paragraph 1 refers, act so as to ensure its compliance with the requirements of the Bidding Code of Practice.*
7. *The [Commission/Authority] may issue directions to the Licensee for the purposes of securing that the Licensee, in carrying out the activity to which paragraph 1 refers, complies with [this licence/ the requirements of this Condition] and with the Bidding Code of Practice, and the Licensee shall comply with such directions.*

8. *The Licensee shall retain each set of Commercial Offer Data, and all of its supporting data relevant to the calculation of the price component of that Commercial Offer Data, for a period of at least four years commencing on the date on which the Commercial Offer Data is submitted to the Single Market Operation Business.*
9. *The Licensee shall, if required to do so by the [Commission/Authority], provide the [Commission/Authority] with:*
- (a) a reasoned explanation of its calculations in relation to any Commercial Offer Data; and*
- (b) supporting evidence sufficient to establish the consistency of that data with the obligations of the Licensee under this Condition.*
10. *In any case in which Commercial Offer Data are submitted to the Single Market Operation Business which are not consistent with the Licensee’s obligation under paragraph 1 of this Condition, the Licensee shall immediately inform the [Commission/Authority] and provide to the omission a statement of its reasons for the Commercial Offer Data submitted.*
11. *[The Licensee shall by 1 June in each year submit to the Authority a certificate, signed by at least one director on behalf of the board of directors of the Licensee, to confirm that during the period of twelve months ending on the preceding 31 March:*
- (a) It has acted independently in relation to all submissions of Commercial Offer Data that have been made, by it or on its behalf, under the Single Electricity Market Trading and Settlement Code; and*
- (b) no such submissions made by it or on its behalf have been co-ordinated with any other submissions made by or on behalf of any other party to the Code.]*
12. *In this Condition:*

“Bidding Code of Practice”

means the document of that title published by the [Commission/Authority] in accordance with paragraph 5, as it may be

	<i>amended from time to time;</i>
“Commercial Offer Data”	<i>has the meaning given to it in the Single Electricity Market Trading and Settlement Code [as it may be amended from time to time];</i>
“Opportunity Cost”	<i>shall have the meaning set out in, and the value calculated in accordance with, the terms of the Bidding Code of Practice;</i>
“Schedule Production Cost”	<i>has the meaning given to it in the Single Electricity Market Trading and Settlement Code [as may be amended from time to time];</i>
“Short Run Marginal Cost”	<i>means certain costs attributable to the ownership, operation and maintenance of a generation [unit/set], as calculated in accordance with paragraph 3 of this Condition;</i>
“Single Market Operation Business”	<i>has the meaning given to it in the [licence granted pursuant to section 14(1)(j) of the Act / market operator licence for Northern Ireland]; and</i>
“Trading Day”	<i>has the meaning given to it in the Single Electricity Market Trading and Settlement</i>

Code [as it may be amended from time to time].”

Energy Regulation Act 1999 - Sections 9BC & 9BD

Principal objective and functions of Minister, the Commission and SEM Committee in carrying out their functions in relation to the Single Electricity Market

9BC.—(1) The principal objective of—

(a) the Minister in carrying out his or her electricity functions in relation to matters which the Minister considers materially affect, or are likely materially to affect, the Single Electricity Market,

(b) the Commission in giving effect to any decision of the SEM Committee, and

(c) the SEM Committee in carrying out its functions under section 8A(4), is to protect the interests of consumers of electricity in the State and Northern Ireland supplied by authorised persons, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the sale or purchase of electricity through the Single Electricity Market.

(2) The Minister, the Commission and the SEM Committee shall carry out their respective functions referred to in subsection (1) in the manner which each considers is best calculated to further the principal objective, having regard to—

(a) the need to secure that all reasonable demands for electricity in the State and Northern Ireland are met,

(b) the need to secure that authorised persons are able to finance the activities which are the subject of conditions or obligations imposed by or under this Act or the Internal Market Regulations or any corresponding provision of the law of Northern Ireland,

(c) the need to secure that the functions of the Minister, the Commission, the Authority, and the Department in relation to the Single Electricity Market are exercised in a coordinated manner,

(d) the need to ensure transparent pricing in the Single Electricity Market, and

(e) the need to avoid unfair discrimination between consumers in the State and consumers in Northern Ireland.

(3) The Minister, the Commission and the SEM Committee may, in carrying out any of the functions mentioned in subsection (1), have regard to the interests of consumers in the State and Northern Ireland in relation to gas.

(4) Subject to subsection (2), the Minister, the Commission and the SEM Committee shall carry out the functions mentioned in subsection (1) in the manner which each of them consider is best calculated—

(a) to promote efficiency and economy on the part of authorised persons,

(b) to secure a diverse, viable and environmentally sustainable long-term energy supply in the State and Northern Ireland,

(c) to promote research into, and the development and use of—

(i) new techniques by or on behalf of authorised persons, and

(ii) methods of increasing efficiency in the use and generation of electricity.

(5) Subject to subsection (2), in carrying out any of the functions mentioned in subsection (1) the Minister, the Commission and the SEM Committee shall have regard to—

(a) the effect on the environment in the State and Northern Ireland of the activities of authorised persons, and

(b) the need, where appropriate, to promote the use of energy from renewable energy sources.

(6) In carrying out any of the functions mentioned in subsection (1) the Minister, the Commission and the SEM Committee shall not discriminate unfairly as regards terms and conditions—

(a) between authorised persons, or

(b) between persons who are applying to become authorised persons.

(7) In this section—

‘authorised person’ means the holder of a licence or exemption under a provision of this Act relating to electricity or under any corresponding provision of the law of Northern Ireland;

‘electricity functions’ means—

(a) functions under this Act, and

(b) functions under the Internal Market Regulations,

relating to electricity;

‘environmentally sustainable’ includes the need to guard against climate change;

‘renewable energy sources’ has the same meaning as in Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC1.

Performance of functions relating to Single Electricity Market

9BD.—The Minister, the Commission and the SEM Committee shall have regard to the objective that the performance of any of their respective functions in relation to the Single Electricity Market should, to the extent that the person exercising the function believes is practical in the circumstances, be transparent, accountable, proportionate, consistent and targeted only at cases where action is needed.

**The Electricity (Single Wholesale Market (Northern Ireland) Order 2007
Articles 9 & 10**

Principal objective and duties of Department, the Authority and SEM Committee in relation to SEM

9.

(1) The principal objective of—

- (a) the Department in carrying out its electricity functions in relation to matters which it considers materially affect, or are likely materially to affect, the SEM;
- (b) the Authority in carrying out its functions under Article 3 (b) the Authority in giving effect to any decision of the SEM Committee;

(c) the SEM Committee in carrying out its functions under Article 6(2), is to protect the interests of consumers of electricity in Northern Ireland and Ireland supplied by authorised persons, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the sale or purchase of electricity through the SEM.

(2) The Department, the Authority and the SEM Committee shall carry out those functions in the manner which it considers is best calculated to further the principal objective, having regard to—

- (a) the need to secure that all reasonable demands for electricity in Northern Ireland and Ireland are met; and
- (b) the need to secure that authorised persons are able to finance the activities which are the subject of obligations imposed by or under Part II of the Electricity Order or the Energy Order or any corresponding provision of the law of Ireland; and
- (c) the need to secure that the functions of the Department, the Authority, the Irish Minister and CER in relation to the SEM are exercised in a co-ordinated manner,
- (d) the need to ensure transparent pricing in the SEM;
- (e) the need to avoid unfair discrimination between consumers in Northern Ireland and consumers in Ireland.

(3) The Department, the Authority and the SEM Committee may, in carrying out any of the functions mentioned in paragraph (1), have regard to the interests of consumers in Northern Ireland and Ireland in relation to gas.

(4) Subject to paragraph (2), the Department, the Authority and the SEM Committee shall carry out the functions mentioned in paragraph (1) in the manner which it considers is best calculated—

- (a) to promote efficiency and economy on the part of authorised persons;
- (b) to secure a diverse, viable and environmentally sustainable long-term energy supply in Northern Ireland and Ireland; and
- (c) to promote research into, and the development and use of—

- (i) new techniques by or on behalf of authorised persons;
- (ii) methods of increasing efficiency in the use and generation of electricity.

(5) Subject to paragraph (2), in carrying out any of the functions mentioned in paragraph (1) the Department, the Authority and the SEM Committee shall have regard to—

- (a) the effect on the environment in Northern Ireland and Ireland of the activities of authorised persons, and
- (b) the need, where appropriate, to promote the use of energy from renewable energy sources.

(6) In carrying out any of the functions mentioned in paragraph (1) the Department, the Authority and the SEM Committee shall not discriminate unfairly—

- (a) between authorised persons; or
- (b) between persons who are applying to become authorised persons.

(7) In carrying out any of the functions mentioned in paragraph (1) in accordance with the preceding provisions of this Article, the Department, the Authority and the SEM Committee shall have regard to—

- (a) the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed;
- (b) any other principles appearing to it to represent the best regulatory practice.

(8) In this Article—

"authorised person" means the holder of a licence or exemption granted under Part II of the Electricity Order or any corresponding provision of the law of Ireland;

"electricity functions" means —

- (a) functions under Part II of the Electricity Order;
- (b) functions under the Energy Order relating to electricity;
- (c) functions under Part IV of the Electricity Order 1992 (Amendment) Regulations (Northern Ireland) 2005 (SR 2005/ 335); and
- (d) functions under this Order;

"environmental sustainability" includes the need to guard against climate change; and

"renewable energy sources" has the same meaning as in the Directive.

(9) In relation to any time after the coming into operation of Article 3 but before the establishment of the SEM Committee, this Article has effect as if for paragraph (1)(b) there were substituted—

" (b) the Authority in carrying out its functions under Article 3;"

Exemptions from the general duties

10

(1) Article 9 does not apply in relation to the functions of the Department under

- (a) Article 39, 40, 58, 59 or 60 of the Electricity Order; or
- (b) Article 61 of the Energy Order

(2) Article 9 does not apply in relation to anything done by the SEM Committee in taking a decision as to the exercise of any function of the Authority-

- (a) which relates to the determination of disputes;
- (b) under Article 46(3) of the Electricity Order; or
- (c) under Article 8 of the Energy Order;

or to anything done by the Authority in giving effect to that decision.

(3) The SEM Committee may nevertheless, when taking a decision as to the exercise of any function of the Authority under Article 46(3) of the Electricity Order, have regard to any matter in respect of which a duty is imposed by Article 9 if it is a matter to which the Office of Fair Trading could have regard when exercising that function.

(4) The duties imposed by Article 9 do not affect the obligation of the Authority or the Department to perform or comply with any other duty or requirement (whether arising under this Order or another statutory provision, by virtue of any Community obligation or otherwise).