Power NI Energy Limited
Power Procurement Business (PPB)

Gas Transportation Capacity Costs

Consultation Paper on BCoP Modification Directions

SEM-13-051

Response by Power NI Energy (PPB)

Power Procurement Business

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Introduction

Power NI Energy – Power Procurement Business ("PPB") welcomes the opportunity to respond to the consultation paper which seeks views on the BCoP Modification Directions in relation to Gas Transportation Capacity Costs.

General Comments

Since the beginning of Single Electricity Market (SEM) generators have been adhering to Condition 15/17 of their Generating Licence and the Bidding Code of Practice (BCoP) when constructing their Commercial Offer Data (COD). PPB agrees with the SEMC that, where a change is necessary, the most appropriate document to modify would be the BCoP. As paragraph 8 of the BCoP deals with calculating the value of the benefit foregone in employing a cost-item for the purposes of electricity generation and as Gas Transportation Capacity (GTC) cost is a cost-item PPB is of the opinion that, if anywhere, paragraph 8 is the most appropriate place for any relevant changes. However, for the reasons set out in response to the specific questions, PPB does not see the need for any formal variation to the BCoP.

The SEM is a day ahead centrally dispatched market and generators, when bidding in their short run marginal cost (SRMC), must submit bids without regard to how they may be scheduled in the market or dispatched by the TSO. At present generators formulate their CODs reflecting published spot prices for both fuel and carbon, even though these prices are likely to have changed by the time they are dispatched. The fundamental premise of the SEM is to ignore long term contracting decisions and to seek efficiency of short term scheduling by scheduling on the basis of SRMC.

It would be perverse to expect generators to automatically commit to purchasing GTC when their load factor is low and indeed it is arguable that the overall energy market would be inefficient if all generators required (and the gas market constructed) capacity to supply every gas user's peak demand when the actual aggregate peak demand may be only half of the sum of the individual maximum possible demands. The RAs each have duties to promote efficiency and economy and to ensure a secure and viable supply and requiring gas users to book their maximum possible capacity on a long term basis would likely contradict these duties.

It is therefore perfectly legitimate to expect that gas fired generators will take different decisions in relation to the GTC they require. However, the SEM is a day-ahead, centrally dispatched market and hence the generator must provide fully flexible, cost reflective bids to the market which will then be used by the TSOs to determine actual dispatch. This means that contractual positions are generally ignored (unless they were entered into prior to SEM and there is good cause not to require the use of short term prices). In relation to GTC, there is a regulated published tariff for gas capacity and there is no valid reason for generators not to use this short term tariff as the index for GTC costs within their bids (particularly as any debate over whether the costs of secondary prices should be used seems redundant given the decision to remove secondary traded capacity as an option).

In relation to the point that generators should not be incurring penalty charges and hence should not bid any such charges into the market, it must be noted that generators are centrally dispatched in SEM and therefore have no control over the amount of gas or GTC that they may require during a trading day. It is therefore possible that generators may incur penalties or charges due to changes in dispatch and such penalties/charges may be unavoidable and are a legitimate cost of central dispatch in the SEM and therefore should be recoverable through the COD.

These points will be addressed further in the next section that responds to the specific questions set out in the consultation paper.

<u>Response to the specific questions asked in the consultation paper</u>

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

PPB does not agree with the Guidance provided in the SEMC's paper and considers the reasoning is not wholly justified. PPB is also concerned that the decisions appear not to be based on the proper determination of what are legitimate marginal costs but are being adopted to overcome wider flaws in the pricing of gas capacity products. Any such approach undermines the efficient operation of the SEM and risks creating a perception of an irrational regulatory environment which will not be in the long term interests of consumers.

SRMC and valuation of capacity

PPB's welcomes the decision that gas transportation capacity costs can be included in generator bids. However, PPB does not agree that a generator's trading strategy in relation to the procurement of capacity should influence whether a cost is marginal or not. This may be a legitimate argument in a self commitment market but is clearly not the case in the SEM which (i) is based on centralised scheduling and dispatch, (ii) requires generators to provide bids reflecting the cost of operating at any level of output from zero to full load without condition, and (iii) has explicitly rejected allowing trading strategies interfering in bid formulation for other commodity purchases (e.g. gas), except we understand, where those contracts were in place prior to the commencement of the SEM and where there is good cause to use prices arising from those contracts. Hence our view remains that all RoI capacity (since at present there are no daily products in NI) must reflect short term capacity costs in their commercial offers.

Further, PPB does not accept that Secondary market prices should be used to value short term capacity products. The Poyry analysis concluded that the Secondary market cannot be regarded as being "recognised and generally accessible" and hence they concluded the primary gas capacity price is the correct opportunity cost. Use of the Secondary prices lacks any transparency and makes overall price transparency virtually impossible and similarly would make market price forecasting for market participants very difficult. Again our view remains that the only consistent price that should be used is the regulated daily capacity price. This would ensure a consistent approach would be adopted by all generators and has the further benefit of not complicating the market monitoring function. In any event, we understand that there has been a recent decision in RoI to remove Secondary products and hence the debate now appears to have been superseded and our understanding is that the only short term price that will be available will be the primary product.

Do you have any comments on the reasons and proposed decision set out in this paper?

GTC Valuation principles

PPB agrees that the SEM Committee could make enduring provision for the treatment of GTC through modification of the BCoP to provide clarification although we do not believe it is really necessary and that clear guidance on the matter, sitting alongside the existing licence and BCoP obligations, should be sufficient.

We continue to see no good cause not to apply the provisions of paragraphs 8(i) and 8(ii) of the BCoP since short term GTC costs are no different to many other costs that generators are required to bid and any disapplication would mean that a generator who does procure short term gas transportation capacity would not be recovering the marginal costs it would be incurring when it is called upon to generate and this would clearly result in the generator generating for revenues that would be less than its short run marginal/avoidable costs.

Paragraph 3.12 of the consultation document notes that the BCoP already makes specific provision for the valuation of start up and no load costs and therefore contends that it is acceptable to include new paragraphs for the valuation of GTC. However, start up and no load costs are distinct cost elements of the COD whereas GTC costs represent only one element to be taken in to consideration when calculating the PQ pairs and we consider that paragraph 8 of the BCoP already provides the principles for such costs.

PPB does not agree with the alternate valuation principles as described in paragraphs 4.2 – 4.6 of the consultation document. In addition, it is not clear in paragraph 4.5 how the removal of "*expectation"* from the valuation principle and the introduction of "*would*" will aid transparency and help monitoring of those bids. For example, one interpretation of the definition of "would" relates to willingness and in such context, a party would be willing to pay any level for a product where it can recover that cost in an onsale. This proposal therefore adds no clarity or transparency in relation to the interpretation of any valuation. In any event, it appears that as there is no longer to be a secondary market in GTC in the RoI, in which case the proposals would appear to be largely redundant. As we have already indicated, there remains a regulated published tariff for gas capacity and this therefore represents the only viable valuation of GTC costs that RoI generators can use within their bids. This simplifies matters and will ensure a consistent approach for all RoI generators and also simplifies the market monitoring function.

New principle of Good Market Behaviour 1 (reasonableness of assessments)

PPB does not consider there is any requirement for the proposed principle in relation to Good Market Behaviour. It is not clear that any decision a generator will make in relation to GTC is any different to decisions it currently make in relation to other components of its commercial offer data. For example while the basis of gas prices may be the current spot market index, these prices are often not reflective of actual purchase costs within a day when gas is being purchased to enable generation in line with the TSOs' dispatch instructions. Commodity prices are volatile and inevitably differ from the price used in the submission of the COD and, for example, we have recently seen within day gas price movements in excess of 10p/therm. Hence generators currently take account of and reflect such volatility in their COD. Even if the SEMC were to persist with its GTC proposals, the uncertainty around GTC prices is no different to the uncertainty that is taken into account for other aspects of the COD and hence there is no need for a specific good behaviour requirement for GTC. The whole underpinning of the BCoP is that generators much reflect actual costs and therefore reasonableness is already inherent within the BCoP.

The intent to remove secondary GTC products from the RoI gas market further confirms that any such requirement would be superfluous. Similarly, adoption of the regulated tariff for the valuation of GTC costs would also negate the requirement to introduce the proposed first principle of good market behaviour. Additionally, the proposals create ambiguity arising from the scope for different interpretation by generators of what is "reasonable" and therefore use of a common tariff would set a level playing field for all generators.

New principle of Good Market Behaviour 2 (penalties principle)

PPB disagrees with the second principle of good market behaviour as described in paragraphs 4.10 – 4.11 of the consultation document. As generators are not self dispatching they have no control over the amount of gas or GTC that they may require during a trading day. It is therefore possible that generators may incur penalties or charges due to late changes in dispatch of marginal plant, notwithstanding that they may otherwise have been perfectly in balance. Hence these penalties/charges are a cost of generating in the SEM and should be recoverable through the COD.

As is noted in the consultation, imbalance costs can be incurred for a variety of reasons, often because the flexibility afforded to the TSO in the SEM to allow it to determine the dispatch of generators is largely unfettered even though it is not matched by equivalent flexibility in the gas system (e.g. the TSO re-dispatch of increased gas generator output between the hours of 2am and 6am cannot be matched with re-nominations in the gas market which can result in charges under the gas codes). It would therefore set a very dangerous precedent to seek to disallow the recovery of such costs (and given the Supreme Court decision, it is likely to be deemed illegal in any event).