SEM/13/051

GAS TRANSPORTATION CAPACITY COSTS
CONSULTATION ON BCOP MODIFICATION DIRECTIONS

SSE RESPONSE TO SINGLE ELECTRICITY MARKET COMMITTEE CONSULTATION PAPER

SEPTEMBER 2013

INTRODUCTION

I am responding on behalf of SSE to the SEM Committee's consultation paper on Bidding Code of Practice (BCOP) Modification Directions. SSE participates in the Single Electricity Market, and owns around 1500MW of generation capacity, including 500MW of renewable generation capacity. We are also constructing a 460MW combined cycle gas turbine power plant at Great Island which will be fully commissioned in 2014.

As we stated in our previous response, we believe the Treatment of Gas Capacity Costs in the SEM is an important issue for the market, as it is not currently possible for generators to recover the costs of gas transportation capacity (GTC). We also believe that the structure of any marginal gas transport costs should not result in over-remuneration of the infrastructure owner, or undue impact on electricity customers.

From the two papers released to date, it appears that the SEM Committee acknowledges that gas transport capacity costs do constitute a Short Run Marginal Cost (SRMC) and that generators would therefore be obliged to include these costs in their offers to the market.

Since the publication of the ***SEM/13/051*** consultation, the Commission for Energy Regulation (CER) has made a number of substantial changes to Gas Transmission Access Tariffs in ***CER/13/191, Access Tariffs and Financing the Gas Transmission System***. The paper decided to:

I. Remove secondary capacity transfers at the exit.
II. Remove within day purchases of short term capacity at the exit to 9:00 at D-1.

These two changes, once implemented in the Gas Code of Operations, effectively make much of the consultation paper issued by the SEM Committee irrelevant. Our consultation response is therefore limited to comments on the principles behind the BCOP changes included in the paper.

If would like any further detail on the points included in our response, please don't hesitate to contact Connor Powell at connor.powell@sserenewables.com.

COST REFLECTIVE BIDDING AND OPPORTUNITY COST

As the consultation paper notes in its introduction, all generators are required under their generation licences to 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."

Commercial Offer Data is defined as cost reflective if it is equal to the SRMC related to that generation set in respect of that Trading Day. SRMC is defined[1] as the difference between the total costs attributable to ownership, operation and maintenance if the generation set was operating and if the generation set was not operating.

GTC Costs would therefore constitute a Short Run Marginal Cost as long as daily capacity is available, and as such, in accordance with the judgement of Hardiman J in ***Viridian Power v Commission for Energy Regulation***[2] generators would be obliged to include it in their bids. The daily cost is directly linked to the generation of electricity and would have a linear relationship with the quantity of electricity offered to the market. As long as a choice between purchasing a daily GTC product and not purchasing a daily GTC product exists, then a generator has an opportunity cost equivalent to the cash used to purchase that product.

This consultation paper and ***SEM-13-039*** are correct in noting that generators in the Republic of Ireland also currently have an alternative to choosing to purchase or not purchase GTC, offered through bilateral transfers in a secondary market for GTC. Various purchasing strategies for GTC exist, some of which would mean that the cash used to purchase the product would be SRMC as defined by the BCOP, and some of which would mean that the costs could not be defined as SRMC.

SSE expected that the ***Guidance to market participants on formulation of Commercial Offer Data, Provisional 'Good Cause' Determination & Outline of Next Steps*** paper would effectively clarify how this cost item would be valued. The language of a generation licence prohibits a generator from bidding at a price which either exceeds, or is lower than its SRMC.

However, as a generator can choose different purchasing strategies for many of the variable cost items that make up SRMC, the

[1] In basic terms
[2] Supreme Court Reference 285/11; Judgement of 23/2/2012

generation licence establishes the publication of a BCOP and defines what a BCOP may contain. The BCOP effectively establishes common principles for the valuation of elements of SRMC when constructing Commercial Offer Data (COD). The consultation paper notes that:

"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."

For cost items which could otherwise be determined by reference to contractual terms or trading strategies (such as the cost of fuel inputs), this means that the BCOP operates in such a way as to preserve the fundamental market design of the SEM: merit order dispatch reflective of underlying costs.

Through the GTC modification proposed to the BCOP, the SEM Committee appears to be seeking to move away from this fundamental design principle. SSE would agree that the notion of opportunity cost should not be applied in such a way that allows price components of a generator's COD to include cost items that would not fall within the definition of SRMC. The reverse is also true, the notion of opportunity cost should not be applied in such a way that allows price components of a generator's COD to exclude cost items that fall within the definition of SRMC.

MARKET POWER MITIGATION AND SEM HIGH LEVEL DESIGN

This paper therefore appears to signal a worrying shift in thinking from the SEM Committee. The BCOP is one of the market power mitigation measures that protect smaller participants (i.e. those without a portfolio) and new entrants from the effects of market dominance.

While GTC are not, and will hopefully never be such a substantive cost item that merit order dispatch could be significantly distorted[3], marginal plant could effectively decide whether or not one of the costs they incur in generating should be included in their offers. This is true regardless of whether valuation is done by reference to costs that a generator 'would' or 'would expect' to incur. Both would remain expectations of cost.

Introducing an element of interpretation into the BCOP that allows a generator to exclude cost items that would fall within the definition of SRMC from its COD necessarily creates a risk that participants might structure their bids to the detriment of customers or other market participants.

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[3] As would be the case if fuel costs could be subjectively determined by reference to trading strategies

Similarly, allowing bids on the basis of expectations of cost (where a number of different strategies are available to participants) makes the job of the Market Monitoring Unit (MMU) substantially more difficult, even if this is true for only one cost item. The mapping between GTC and monotonically increasing PQ pairs in the bid would be central to ensuring compliance with the BCOP. It will be difficult for the MMU to provide effective oversight of how a marginal generator might structure its GTC purchases and how that might impact upon its PQ pairs.

UNREASONABLE EXPOSURE TO PENALTY CHARGES

The second modification to the BCOP is less controversial. SSE would agree that a general principle of market behaviour that generators should bid on the basis of an expectation that they would not be unreasonably exposed to penalty charges is fair, and that the phrasing within the ***Indicative Modified BCOP*** seems appropriate.

We would assume that by setting an expectation that generators will act so as to avoid unreasonable exposure to penalty charges that generators can appropriately account for risk if penalty charges are a central and unavoidable part of the purchase of a cost item.

CONCLUDING REMARKS

In our original response to ***SEM-12-089*** on ***Treatment of Gas Transportation Capacity Costs in the SEM*** we expressed concern about the inclusion of GTC on suppliers and consumers and asked that the Regulators might look at the structure of gas transmission tariffs.

The CER has revised the means through which the gas transmission system is financed in ***CER/13/191*** by substantially restricting the flexibility available to all customers of the gas transmission system in Ireland. SSE does not believe that this restriction of flexibility will encourage the efficient use of or planning of the gas transmission system in Ireland. The imposition of an arbitrary cost allocation on every customer of the gas network will also lead to a narrower customer base[4] for the system in the long run.

On the basis of the changes introduced by the CER, the modifications proposed within consultation paper ***SEM/13/051*** now appear to require substantial revision. However, SSE would like to express concern that the determination and guidance papers published by the SEM Committee appear to disregard both the merit order dispatch and market power mitigation pillars of SEM High Level Design.

[4] DM and LDM customers whose demands fit the single preferred product (annual gas capacity) will be well served. Any other DM or LDM customers will be increasingly poorly served.

While GTC, fuel or a number of other purchases sit within a generators commercial strategy, the Generation Licence and BCOP have been designed in such a way that the benefit and risk associated with ‘outperforming’ or ‘underperforming’ relative to what they are obliged to bid sits entirely with the generator rather than customers or other market participants.

The SEM Committee should fully evaluate the changes implemented in ***CER/13/191*** and consider whether making enduring provision for the treatment of GTC in the BCOP is still necessary or desirable. SSE believes that the modifications proposed in the paper undermine the SEM High Level Design. The primary justification appears to be cost, and that the inclusion of GTC might over reward some generation units.

A generator can choose to incur irrecoverable costs or irrecoverable gain[5] if it so chooses, but the licence and BCOP set out the basis through which the market must value the generation of electricity. Ensuring that all avoidable costs of generation are recoverable underpins a transparent, open market, and protects both customers and generators better than the GTC changes proposed to the BCOP.

[5] We would note that taxation means that risk/reward is asymmetric.