BGE response to CRM Locational Issues

SEM-16-052

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Introduction

System constraints have always been a real issue in the energy market and industry has repeatedly highlighted the negative impacts that they have on market outcomes and prices. The significant delays in transmission infrastructure development have prevented many of these constraints from being resolved and as a result, it is proving to be a real risk for market stability as we transition to I-SEM. While we understand that a market design should not undermine the safe and secure operation of the electricity system, we do not believe that the market design should be dictated by the deficiencies of the system.

As a starting point, we understand there is an immediate issue to ensure that there is adequate capacity on the system in areas where there are locational constraints. This is not a market issue in our view but a system issue and therefore should be addressed through incentives on the TSO to manage system constraints in an efficient manner which does not distort either the energy or capacity markets. At this point we wish to stress that locational constraints should not determine the overall capacity market design. Instead they should be managed through specific temporary rules that will fall away once the locational constraint has been resolved. Obligations and incentives should be placed on the TSO targeting these constraints to minimise their costs on customers and impact on the market.

Recognising that the main objective of this Consultation is to ensure that locational constraints are addressed in the capacity market, we believe there a number of important principles and issues that must be considered. Specifically these are the following:

i. Distortions to the market outcome must be minimised

Through the number of other Consultation Papers relating to the capacity market that have been issued and discussed over the past number of months, the Regulatory Authorities (RAs) have stated on numerous occasions that the objective of the capacity market is to procure a MW of capacity – it is not the objective of the capacity market to distinguish between providers of MWs. In our view, this Consultation Paper completely undermines this principle and looks to provide capacity contracts on the basis of where a MW is located. This in our view distorts the market outcome in terms of both entry and exit signals.

Any interference with the market must be temporary and minimised. On that basis, **the market must clear on an unconstrained basis**. This would provide an accurate and true value of capacity which will be necessary for encouraging new entries into the market. It is also consistent with the design of the energy market.

ii. Transparent and robust process

We believe the locational issues should be dealt with on a rules-based approach and that any rules are defined by the TSOs are done on an ex-ante basis to provide transparency to the market and confidence that the market outcomes are accurate.

iii. Locational market power

We are concerned that the proposals to simply reward out-of-merit units on a pay-as-bid basis will provide these units with the incentives and ability to increase their bids. We believe that a transparent and robust regulatory process is needed for monitoring bids and to provide the right incentives to ensure that bids are provided on a fair and reasonable basis such that it mitigates the range of market power concerns in the market. This process is outlined in detail in answer to question 5.1.1 below.

iv. Finding a balance between controlling consumer costs and preventing "inefficient exits"

We understand that the costs of meeting locational constraints may result in higher consumer costs compared with the costs of an unconstrained market and that it may be a necessary imposition in the short-term. It is clear that there are consumer benefits to not rewarding (or compensating) the so-called "in-merit losers", i.e. those who are beneath the marginal price but are displaced due to locational constraints and thus do not receive a RO contract. However, when choosing a compensation mechanism (i.e. go/no-go compensation), the RAs should be mindful of the types of exit they are creating. In the short-term, it may be beneficial to not pay these in-merit losers, but if they choose to exit the market as a result, the long-term effects (when the locational constraints are removed) may be negative since the more expensive and inefficient units will still be running, thus driving up costs for the consumer.

BGE's first preference would be that the issue of locational constraints are not 'dealt with' through the capacity market. We do not believe that this is the appropriate mechanism to drive locational signals and instead they should be addressed through system operator obligations and incentives relating to grid development and constraint management.

Notwithstanding that and combining the concerns outlined above, within our response to the consultation questions below we outline what we believe to be a reasonable alternative solution (based on an adaptation of the RAs' proposals) to best manage locational constraints on the system, while minimising the impact on the overall market outcome.

Outline of issue and proposed solution

2.6.1 Do you agree with the assessment of the potential for exit and lack of new entry during the transition period set out in this section, and do you think that the potential for exit creates a security of supply issue given locational constraints?

The CRM was designed to provide both entry and exit signals. While we recognise the problem of locational constraint issues outlined by the RAs, we are concerned that in addressing this problem, the solution will send inefficient exit signals and the wrong entry signals. While it is true that the risk of exit creates a security of supply concern, the persistence of these locational constraints adds significant costs to customers. Therefore it is necessary that a balance must be met in ensuring that security of supply is managed while not providing market power to units and inherently hiding the costs of constraints.

We also believe that a robust monitoring and incentives process is put in place to manage system constraints and ensure that they are remedied in a timely and cost effective way.

2.6.2 Do you agree that locational constraints should be incorporated in the CRM? Please elaborate your rationale in your response.

While we recognise the RAs' concerns of locational issues, we are concerned about the distortions they can potentially create in the market should they be managed inappropriately. Since locational constraints are a short-term issue (i.e. until either grid improvements are made or greater competition is available), we do not think the market design should be driven by locational constraints, as per the RAs' options A (constrained market) and D (combinatorial auction). Rules to mitigating locational

constraint issues should only be applied on a temporary basis and the market should first and foremost be designed to reflect as closely as possible the market under normal conditions.

BGE does not believe that locations issues should be managed outside of the market through bi-lateral contracts either. Between the energy, ancillary service and capacity markets, there is sufficient flexibility to provide the right signals to energy providers and investors to meet both customer and system demand. Any signals should be sent through one or more of these markets and not opaquely through "out-of-market" bi-lateral contracts.

2.6.3 Feedback in relation to the specific Grid Code requirements are sought in respect of the following:

- ***The extent to which the Grid Code requirements can be relied upon to manage exit of plant which does not obtain a Reliability Option;***

Although the Grid Code provides for a 3-year notice period for units exiting the market, this does not mean that a unit will make itself operationally available if the market signals are not providing positive revenue streams. There is therefore a distinction between exiting the market operationally and exiting the market administratively. If a unit wishes to exit the market operationally, it can do so at any point in time (by declaring itself unavailable). However, if a unit wishes to exit the market completely (i.e. operationally and administratively), we believe that the 3-year notification period as required through the Grid Code is appropriate as it provides sufficient notice to the system operator for the purposes of system planning and ensures the assumptions made about unit retirements in capacity auctions are consistent/reliable.

- ***Whether it is appropriate to provide assurances that generators which do not obtain a Reliability Option in the transitional auctions (which happen on a T-1 basis) be released from their obligations to give 3 years notice in accordance with the Grid Code; and***

As per our response to part 1 of this question, we believe that a 3-year notification period to exit the market is appropriate. This is for two reasons:

i. The system needs adequate time for planning.

The TSOs conduct their adequacy forecast statements for a 10-year outlook. If a plant who is normally available to the market is planning to exit, there should be an appropriate amount of time (i.e. 3 years) to allow the TSOs to reassess their plans and safely manage the exit of this capacity from the system from a system adequacy and security perspective.

ii. Exiting the market immediately will obscure the basis on which market prices were actually cleared

A capacity auction will clear with reference to the de-rated capacity requirement. This capacity requirement will be calculated 4 years in advance based on expected available capacity on the system. If a unit that was included as part of the capacity requirement calculation was to exit the market, it would undermine the premise under which the market was cleared.

For these reasons we do not believe that units should be released from their obligations to give 3 years notice to exit the market. To the extent that they do not want to participate in the markets, they can operationally declare themselves unavailable.

- ***Whether the Grid Code requirement should be extended from 3 years notice, to say 3 years 6 months to align with T-4 auction timings.***

We do not believe there would be any benefits from increasing the notification time from 3 years to 3 years 6 months. If anything, units would typically require an amount of time after an auction result clears to make a final decision on exiting the market if the auction results force them to do so.

2.6.4 Do you agree with the key principles proposed for any locational capacity framework within the CRM?

BGE is not in favour of locational constraints thwarting the capacity market outcome in the long-term. This is a system issue and should be addressed through system planning and development. From a fairness and efficiency point of view, as well as considering the issue of getting state aid approval for this measure, BGE is concerned that all of the options proposed in the Consultation Paper will result in sub-optimal outcomes.

Notwithstanding the above, where locational constraints are to be considered within the capacity market, we agree with the RAs' key principles proposed in the consultation such that the process for identifying constraints should be simple, transparent and only relate to energy constraints. To aid transparency, we believe that the process should be determined and outlined ex-ante and outputs should be verified independently.

2.6.5 Do stakeholders agree that clear and large existing capacity delivery constraints should be reflected within the CRM auction, for example limiting this to the North-South constraint and the Dublin area constraint?

First and foremost, BGE does not believe that locational constraints should be accounted for within the capacity market. As outlined in our introduction, the RAs have stated on numerous occasions that the aim of the capacity market is to procure capacity on a level playing field – i.e. not provide any signals as to what type of capacity is required. This should hold for both technology neutrality as well as locational neutrality. We therefore believe that the issue of locational constraints as described in the Consultation Paper should be identified and provided for by the TSO to ensure system security and integrity but that they would be better resolved through obligations and incentives on the TSO to develop the grid in a timely and cost effective manner.

To the extent that locational constraints are required in the CRM, we would agree that they only consider large locational issues related to energy constraints on the island (and not ancillary constraints). In the immediate future, we agree that these constraints should be limited to the North-South constraint and the Dublin area constraint. However we understand that constraints will continue to develop where new constraints may replace old constraints (i.e. a locational issue may develop when Moneypoint exits the market). Obligations and incentives should be placed on the TSO to manage these constraints on a timely basis as opposed to allowing them to thwart the capacity market. In our view, the proposals in this consultation abdicate the TSOs of a very important responsibility. With that in mind, on top of more explicit TSO obligations relating to constraints, there should be a clear oversight in the process of approval constraints to be accounted for in the capacity market. Where constraints could have be planned and managed more efficiently there is a case to exclude them from the capacity auction to minimise the market distortions and provide real incentives to the TSO.

2.6.6 Do stakeholders agree with the high level proposed solution for dealing with locational capacity issues?

We have two principal issues with the high level proposal. It gives market power to those behind the constraints and it sends out signals to plant who in the absence of the constraints would provide more efficient energy to customers. We do not believe that the RAs' proposals appropriately address these issues and we therefore do not agree with their high level proposed solution. Furthermore, there is nothing within the proposals outlining the incentive mechanisms that will be put in place to minimise the size and timeframe of constraints. In essence, the proposals put 100% of the risk of constraints on generators without recognising that to a large extent they cannot resolve the issue.

While we recognise both the RAs' immediate concerns on locational issues and the need to address them, it is equally as important that the design chosen does not leave the market susceptible to parties exercising market power. Any out-of-merit plants who are allowed to enter into RO agreements as specified under the CRM mechanism should be paid a price which is set through a transparent regulatory process which minimises the incentive and ability for parties behind constraints to game the market and maximise their contract price. This would essentially involve a 3-step process, which we discuss in more detail in our answer to 5.1.1, but can be summarised as:

- All parties are obliged to bid into the capacity market at their specific 'Net Going Forward Cost'.
- The RAs (or a regulatory appointed monitor) assesses these bids for potential market power abuse, this may include asking the parties to demonstrate the basis behind their bids;
- Where the RAs are not satisfied with the bid justification they can either a) remove the party from the auction (in the case that they are not must-run) or b) where a unit is a must-run unit, this unit will be awarded a contract at a regulatory determined estimate of their Net Going Forward Cost.

We believe that this process will be critical to ensure parties bid competitively into the market, thereby protecting the integrity of the market outcome and the cost of the mechanism being implemented.

2.6.7 If you do not agree with or have further view any of the proposals or assessment set out in this section, please outline why and where relevant suggest alternatives.

At the risk of over-repeating our position, BGE believes that a key principle of the CRM design is to allow the market to clear on an unconstrained basis, such that the contracts awarded and the price provided gives a clear approximation of the long run marginal cost of capacity required to meet demand. The aim of the capacity market is to provide a value for a universal MW on the system – as the RAs have stated on numerous occasions this should be technology neutral and in our view should also be locationally neutral. An unconstrained and un-altered market outcome should provide efficient signals to the market – to existing and new investors. It should also incentivise all parties as best as possible to compete in the market on level terms.

With respect to the proposals put forward by the RAs, we have a concern relating to how it views market power across parties in the market. In recognising the market power of must-run units, the Consultation Paper recognises the market power of out-of-merit must run units, however, it overlooks the market power of must-run units who would under normal system conditions be in-merit. The proposals put forward by the RAs would incentivise these parties to manipulate their bids upwards to get a contract outside of the market at a price above the clearing price.

BGE believes that its proposal outlined in answer to question 2.6.6 above and further detailed in answer to question 5.1.1 below addresses this concern and should be considered if the RAs are resolute in implementing a form of the options presented in the Consultation Paper.

Auction design framework

3.6.1 Which option do you prefer for the Auction Design Framework and why?

Overall we believe that none of the proposed options in the consultation will deliver the best solution for managing locational constraints and exit signals on the system. Apart from our point that the capacity market should not be used for addressing locational constraints and that signals need to be provided to oblige and incentivise the TSO to properly manage and fix constraints on the system, it is important that the design of the CRM avoids the abuse of localised market power, controls consumer costs and provides a robust process which provides transparency to the market such that it gives confidence in the market outcomes. On the basis of meeting these additional objectives, we would consider an adaption to the unconstrained heuristic option to be the most appropriate mechanism) for dealing with short-term locational issues. To be clear, we do not support Option C as presented in the Consultation Paper. We discuss our adapted proposal of Option C below along with our positions on the other options.

Option A – ex-ante identification of "must-not-exit" units

The CRM should be designed in such a way that encourages new builds to enter the market to displace older, inefficient plants. By dealing with "must-not-exit" units outside of the capacity market, it prevents the necessary long-term investment signals for new builds in two ways:

i. It reduces the total capacity requirement, which in turn dampens the market clearing price, undermining the value of capacity and sending false, artificial signals to all market participants.
ii. It removes some of the expensive, inefficient units from the market mechanism, dampening exit signals and therefore entry signals for new builds ;

For these reasons, we believe that Option A is not a suitable approach for designing the CRM.

Option B – Additional capacity

We believe there is merit to this proposal from the perspective of running the auction in an unconstrained way. As outlined above, we are concerned that any option which results in a constrained market price will cause inefficient market signals. However, in providing contracts to both cleared and un-cleared must-run units this option will add considerably to consumer costs in the short term and could give rise to issues with EU approval for the I-SEM CRM relating to ensuring that the CRM only compensates on the basis of "need". On that basis, we do not believe that option B is a viable solution for the market.

Option C – Heuristic approach

BGE has 2 concerns relating to Option C and as a result, we do not support this as a solution to addressing locational constraints. Firstly, as with all of the other options proposed, we are concerned that "must-run" units will have significant market power if simply awarded a 'pay-as-bid' price when out of merit. Secondly, we are concerned that the option will force efficient plant that are marginal in the capacity auction to exit the market, leading to higher prices in the long-term when locational constraints are removed.

There are some merits to Option C however, namely the application of an unconstrained market run to set the market price for in-merit capacity contract holders and the provision of a clear set of ex-ante rules outlining the process by which locational constraints will be identified and applied.

With these concerns and merits in mind, BGE proposes that as a short-term solution to locational constraint issues, an amended version of Option C could be implemented. The below points summarise our proposed alternative:

- The capacity market should first and foremost be run on an unconstrained basis, such that the market clearing price is set by reference to an unconstrained market run. This will identify a market clearing price that would not be distorted by locational issues and will provide the true capacity price for long-term investment signals.
- A set of rules should be provided on an ex-ante basis, set be the TSOs, outlining how locational constraints and "must run" plants are identified.
- The rules should also outline that all units are obliged to offer into the market on the basis of a legitimate estimate of their Net Going Forward Costs.
- A Market Monitor (possibly the Auction Monitor) assesses whether offers are in line with expected Net Going Forward Costs.
- If the RAs/Market Monitor are not satisfied that the offers submitted are reflective of expected Net Going Forward Costs, they can either exclude the offer from the auction (in the case that they are not "must run" units) or where they are "must run" units, replace their bids with an independently determined value of the unit's Net Going Forward Costs.
- After the unconstrained market run, any "must run, out-of-merit" units, i.e. those that have not cleared in the auction but are required as per the ex-ante set of heuristics provided by the TSO, are awarded contracts at their pay-as-bid price.
- To avoid inefficient exits, or the exit of otherwise efficient marginal units from the market, BGE believes that a "balancing test" should be applied to assess whether the longer-term cost of "constraining off" efficient units outweighs the cost of keeping excess capacity online. This will determine whether excess capacity should be purchased i.e. whether some of the so-called "in-merit losers" should actually receive contracts.

On this last point, BGE does not believe that it is reasonable or practical to offer all "in-merit losers" and "must-run, out-of-merit" units contracts, as per option B. From the point of view of managing consumer costs, providing exit signals and State Aid approval we think this isn't feasible. However, we are concerned that in "constraining off" equal MWs of "in-merit losers" to those "must-run, out-of-merit" units "constrained on", consumer welfare will be negatively impacted in the longer-term. For instance, given that locational constraints are only supposed to be temporary, it may be more efficient in the medium to long-term to pay for excess capacity to avoid sending premature exit signals and paying higher energy costs once the constraint is remedied. The "balancing test" we suggest in the last bullet above aims to assess this trade off and ensure the most efficient market outcomes in the longer-term.

Option D – Combinatorial approach

Due to the complexity of the combinatorial auction, the lack of transparency in the process and the issues we have seen to date with regards the DS3 auction design, we firmly believe that option D should not be implemented.

In addition to this complexity, this combinatorial design approach suggests that locational issues will always exist in the CRM which will not be the case assuming grid developments are incentivised and

completed to address system constraints. Therefore we do not believe that the design of the CRM should be over-complicated for the sake of dealing with what should be temporary locational issues.

Option E – Ex-post TSO system security analysis to identify must-not-exit units

We believe this Option E has very similar characteristics to Option C, however we would dismiss this approach from being chosen on the basis that it is an ex-post adjustment to the market which does not provide the same level of transparency to the market as Option C. This type of intervention should be unnecessary in the market design, especially given the clear and obvious nature of where locational issues exist and the extent to which they exist.

3.6.2 Should the capacity price be set equal to: a) the highest-priced bid accepted in the unconstrained merit order; or b) the highest-priced bid which is both: accepted in the unconstrained merit order; and selected as a winning bid after lumpiness and locational considerations have been resolved?

We believe the capacity price should be set equal to the highest-priced bid accepted in the unconstrained merit order for reasons discussed in detail below.

The unconstrained merit order marginal price reflects a more efficient investment price signal

We firstly agree with the RAs that a marginal price set as the highest priced bid accepted in the unconstrained merit order is a better approximation to the long run marginal cost of capacity. The alternative (the highest priced bid accepted after lumpiness and locational considerations have been resolved) would produce prices that are artificially low and would therefore be an obstruction to long-term investment signals. This would undermine the objectives of the CRM to send exit signals to expensive, inefficient plant while sending entry signals to new, efficient units.

An unconstrained market price would retain a level of the original market operation while also providing transparency

We believe that the CRM should seek to retain as much of the original market design as possible to deliver the entry and exit signals that it purported to achieve and that an unconstrained market clearing price should be applied. This would also provide transparency to the market which will provide confidence to the process and market outcomes.

3.6.3 Should a bidder that would have been accepted in an unconstrained auction but which is not awarded an RO receive a "constrained-off" payment in the CRM? If yes, how should the "constrained-off" payment be determined, and why?

Payments made to capacity that is "constrained off" will ultimately be funded by consumers. Any such payments ought therefore to be justified by some form of associated consumer benefit.

If compensation payments to "constrained off" plant are to be completely untied to any further obligation on the part of the "constrained off" plant, and are therefore unlikely to provide any additional consumer benefit, the RAs favoured position to provide no compensation would seem to be reasonable.

However, BGE recognises the efficiency concerns raised in paragraph 3.4.2 of the consultation document that by "constraining off" in-merit plant, the CRM may trigger the premature exit of relatively efficient capacity that could usefully be deployed in later periods when locational constraints differ. We also recognise that the implied inefficiency in exit signals may be detrimental to consumers in the long term, by locking the power system into the use of comparatively inefficient capacity.

At the heart of the long-term efficiency concerns raised by "constraining off" plant lies the fact that auction outcomes today may have persistent effects on the structure of the market and therefore on future auction outcomes. Consequently, while it is clearly optimal in the immediate term to "constrain off" any capacity not immediately required, this may result in the longer term in a less efficient plant park, with potential implications for future capacity and energy costs.

In considering whether or not to compensate 'constrained off' plant, the key question for the RAs is whether or not the longer-term cost of "constraining off" capacity outweighs the costs associated with keeping excess capacity online today. This is an analytical question that we have not attempted to answer. We simply acknowledge that there is a theoretical case to avoid sending potentially premature exit signals to in-merit plant. In reality, consumers may or may not benefit from keeping excess capacity online in the near-term.

If consumers do face higher longer-term costs as a result of premature exit, it is important to note that these longer-term costs are only alleviated to the extent that capacity is successfully kept online to participate in future auctions.

Because of this, we do not think that untied compensation is an appropriate solution to this efficiency problem. Compensation alone gives consumers no guarantee that capacity will be kept online. Even if "constrained off" capacity is provided a level of compensation that is more than sufficient to cover its costs of remaining online in the interim, there is nothing to stop this plant from taking the money and exiting the market anyway, with no benefit to consumers. Indeed, if the relevant generator owns a portfolio of plant, this approach may actually be optimal, since the portfolio owner will still stand to gain from higher CRM prices in later periods.

In the event that the RA's determine that consumers are better off if "constrained off" plant do not exit the market, then a more appropriate response to this efficiency issue could be to partially over procure by scaling back the mechanism used to "constrain off" in-merit plant. This would result in more in-merit capacity being awarded an RO contract. As with compensation, this would have a near-term cost to consumers, but at least in this case consumers would be guaranteed enhanced security of supply, through the availability of additional capacity, and entitled to difference payments under the RO contract.

There are a wide variety of methods by which the mechanism used to "constrain off" plant could be scaled back. Examples include:

- Exempting the last X **MW** of in-merit capacity that would otherwise be "constrained off";
- "Constraining off" in-merit capacity at a ratio of less than 1:1; and
- Exempting the last X **units** that would otherwise be "constrained off".

3.6.4 How should local capacity deliverability constraints be defined?

The capacity requirement for the system is calculated in **MW** and we therefore believe that so too should the locational capacity constraints. As per our answer to 2.6.5, we agree that locational issues should be limited to large existing constraints such as the North-South division and Dublin area. Given that these locational issue areas are known, the size of their capacity constraints should be relatively simple to determine. By defining constraints in MW, it also encourages competition among units in locational constrained areas since the TSOs will select the units in order of cheapest bid price.

Longer term issues

4.4.1 Should the inclusion of locational capacity delivery constraints in the CRM occur in T-1 auctions, T-4 auctions, or both?

Notwithstanding the fact that our preference is that locational issues are not addressed through the capacity market, if the issue is to be addressed through the market we think it should be addressed in the T-4 auctions as opposed to the T-1 auctions.

When considering whether locational constraints should be included in T-1 and/or T-4 CRM auctions, it is important to realise the potential impacts on system security if they were not included. If constraints are not addressed in the T-4 auctions, there is a risk that must-run units may exit the market and there would be insufficient capacity available in these locational constrained areas to meet demand. We therefore believe that locational capacity should be included in the T-4 auctions. The issue of units exiting the market in T-1 auctions is not relevant as the units will not be able to exit the market completely at that point..

If locational constraints were to be included in T-4 auctions, it would be unnecessary to include them in T-1 auctions since any "must-not-exit" plants will have already received ROs for that year. Therefore, we believe that locational constraints should be excluded from enduring T-1 auctions (note, we believe they are necessary in the transitional (or interim) T-1 auctions).

4.4.2 What circumstances or criteria should be considered in relation to the T-4 auctions being conducted without explicit consideration of locational capacity delivery constraints?

The premise of this question is not very clear. To reiterate BGE's first point, we do not believe that the capacity market should be used to address locational issues in the long-term. Locational constraints are a system issue and should be dealt with elsewhere and specifically through obligations on the TSOs to manage and plan for system constraints in a timely and efficient manner. This is best managed through grid development planning and ancillary services. The issue of locational constraints should be removed from consideration in the capacity market in the long-term.

4.4.3 Are there any further considerations that should be taken account of regarding the longer term management of locational capacity delivery constraints? If so please detail your rationale for these.

We have highlighted in our response that over time, existing locational constraints will fall away (i.e. the North-South interconnector should remove the North-South constraint) while new locational constraints will emerge (i.e. when Moneypoint plants decommission). The TSOs have ample foresight of these types of pending constraints and should be obliged to address these on a timely basis. If the capacity market is to account for locational constraints, it should only account for those short-term and unpredictable/unmanageable constraints that arise from time-to-time. Therefore the design of the capacity market should be sufficiently flexible (while retaining the required transparency) such that it evolves with the market and the system over time. The proposal we provide as an alternative to Option C should allow for the dynamic evolution of the system while ensuring that market distortions are minimised.

Local security of supply and market power

5.1.1 Do you believe that the suite of market power controls set out in CRM Decision 3 are sufficient to address any additional market power issues raised by local security of supply considerations? If not, what additional measure would you propose, and why?

BGE believes that the market power measures decided on in CRM Decision 3 (SEM-16-039) should be complemented by a set of further measures designed to provide additional safeguards against the exercise of market power in the presence of locational constraints.

As noted in paragraph 5.1.2 of the consultation document, the controls imposed on all generators in CRM Decision 3 were assessed with reference to potential market power concerns on an all-island basis. They did not address the risk that network constraints could lead to localised market power. In order to deal with this risk, it is appropriate that further measures to prevent the exercise of market power are implemented.

On top of the market power concerns raised in the Consultation Paper, BGE has a further concern that units in locationally constrained areas, who would otherwise be competitive and in-merit in a capacity auction ('in-merit, must-run' units), may be incentivised to bid up their offer price in the knowledge that they would be eligible for a contract above the market clearing price on a pay as bid basis.

To address this amongst the other market power concerns relating to 'out-of-merit, must-run' units and portfolio players with marginal plants, we believe that the following process should be implemented.

- All bids should be required to be consistent with a bidder's Net Going Forward Costs. Furthermore, bidders should be able to demonstrate the consistency of their bids with their own estimates if asked to do so by the RAs. Moreover, the bidders should be in a position to demonstrate that their estimates are evidence-based and made on the basis of reasonable assumptions.
- The RAs should examine bids for any indication of potential market power abuse. This examination should focus on those bidders most likely to be in a position to exercise market power (including plants that must clear as a result of locational constraints). Where the RAs identify a potential abuse of power, the RAs should require the relevant bidder to justify its bid. The RAs should also have the power to audit the bidder as necessary to determine whether or not the bid submitted was consistent with the bidder's internal estimate of its Net Going Forward Costs, and whether that bid was evidence-based and made on the basis of reasonable assumptions.
- Where the RAs are satisfied with the bidder's justification, the submitted bid will stand and no further action will be required. However, if the RAs are not satisfied, the relevant bid will be excluded from the determination of the clearing price. In cases where the associated unit is not required for system operation, the associated generating unit will effectively be excluded from the auction and will not receive an RO. In the event that the plant must be kept online for reasons of system operation, the unit will instead be awarded an RO at a price equal to the RA's independent determination of the plant's true Net Going Forward Costs.

Note that the same process would be applied to both existing and new plant.

The proposed approach has the advantage of minimising the administrative burden on the RAs while nevertheless dissuading abusive behaviour. Specifically:

- A thorough examination of an individual bid would only be required in the event that the RAs had cause to believe that the bid was abusive in the first place; and
- Even in the event that a detailed investigation was required, the obligation to justify each bid lies with the bidding party.

The approach also allows scrutiny to be targeted on those plants that give rise to the greatest concern, allowing additional focus to be placed on plants behind locational constraints. It also ensures that all parties bid competitively and helps address BGE's concern re 'in-merit, must-run' units and the RAs' theoretical concern, noted in paragraph 3.3.9 of the consultation document, that a portfolio player might attempt to affect the clearing price by inflating the bids of units likely to "constrained off", since these bids will also be subject to the scrutiny described above.

Finally by tying bidding behaviour and any regulated settlement to the concept of Net Going Forward Costs, this approach is consistent with the RAs' existing decisions on bidding caps and capable of providing must-clear plant with appropriate returns even in the event that their bid is abusive.