Thomas Quinn
The Commission for Regulation of Utilities
Belgard Square North
Tallaght
Dublin 24

Karen Shiels
The Utility Regulator
Queens House
14 Queens Street
Belfast
BT1 6ED

12th July 2019

Dear Thomas and Karen,

RE: Response to Consultation on Balancing Market and Capacity Market Options

We note and appreciate the Regulatory Authority's (RA) willingness to understand and respond to issues with the market in a timely manner. The Consultation Paper provides a very detailed and clearly explained overview of the issues at hand supported by detailed analysis.

Please see below our answers to your specific questions raised as part of this Consultation process

1 Simple NIV Tagging

To be fair to all interested parties in the market, we are still trying to fully bed-in and grapple with the new market. This is leading to trading parties altering trading strategies and learning by doing. We must recognise that this can be the cause of volatility and notably we have seen a significant drop off in volatility over the past few months as people have become more familiar with the market and the implications of its design.

In reviewing this consultation, BGE is also keenly aware of one of the fundamental principles which guided the design of the I-SEM – to provide market signals to influence behaviour in terms of market entry and exit as well as unit availability. In particular the market design wanted to incentivise parties to take a balanced position into the balancing market via ex-ante trades to ensure liquidity remained in those markets – and therefore was sufficiently liquid to support long term forward market liquidity. To that end, Bord Gáis Energy (BGE) is comfortable that the overall market should retain a level of volatility between the DAM and Balancing Market (BM), so long as it is intuitive and in line with reasonable market expectations. To that end, BGE is currently of the view that we take some time to allow the market settle further before making any significant changes to the original design at this stage. We would propose that we leave this consultation open for another 8-12 months, during which time we conduct further analysis on the volatility and pricing outcomes of the market, and reconsider the questions and concerns raised by the CRU as part of this consultation. Bearing in mind that 70,000 of the first 73,000 pricing periods are subject to material disputes and repricing, it may be more reasonable and prudent to conduct this analysis and make this decision once the market prices are confirmed.

1.1 Do you support this Simple NIV tagging option and its implementation in the SEM?

At this time, BGE does not support changing the market processes to introduce Simple NIV tagging. BGE has been engaged in the development and implementation of the I-SEM market design for a number of years and has supported the intent of introducing pricing signals between markets as a means of incentivizing market behavior and market entry and exit. We would be concerned that implementing change at this time, while the market is still in its infancy and parties are bedding in new and complex systems and processes would have unintended consequences that will be difficult to undo.

For now, BGE believes that it is best to take a 'wait and see' approach, to allow the market to settle further and to provide more time to understand if the market is fundamentally flawed in how it has allowed for volatility. The volatility we have seen in the new market has reduced over the past number of months and we think it would be more prudent to observe how it changes or stabilizes over the next number of months before implementing further change at this time. If the evidence suggests that the market volatility is too extreme – unmanageable and unintuitive – then perhaps there may be merit in implementing Simple NIV tagging. In short, BGE is not in principle against Simple NIV tagging as a concept, but for now we are not sure that the balance of evidence would suggest that it is required for the market and/or that it will deliver a better market outcome in line with the original market design objectives.

As an alternative, we would suggest that an audit and review is conducted of the wider tagging and flagging process to ensure that the process is delivering as intended and that the systems that were designed are supporting the outcomes expected. This would in our view, give confidence to the market that all of the systems and processes underpinning the market are working appropriately and are in order. Considering the teething issues we have had with the market systems, it would be sensible in our view to have an independent review of the systems outside of the market but which are equally critical in delivering the market outcomes.

1.2 Do you have any concerns regarding moving to Simple NIV tagging in the Balancing Market, including the risk of unintended consequences? If so, please explain these concerns.

As outlined above, BGE has been supportive of the ISEM market design as a means of incentivising the right type of trading and operational behaviour of generation and demand on the Irish system. We would be concerned that changing the market rules to dampen the price differential effect between the DAM and BM may disincentivise some from ex-ante trading, thereby affecting liquidity in those markets and perhaps accentuating the unintuitive price differential between the markets.

BGE also has concerns that the dispatch balancing costs may increase as a result of the proposed change on the basis that the majority of actions will be paid for at a lower energy market price under the proposed Simple NIV Tagging.

1.3 *Do you agree or disagree that Simple NIV tagging meets the I-SEM High Level Design, the I-SEM Detailed Design and the I-SEM market power mitigation decision? If you disagree, please explain why*.

It is our understanding that Simple NIV tagging already exists within the ISEM design in that the tagging and flagging process defaults to Simple NIV tagging where there is not an energy action to form the price. To that end, BGE does not think there is a principled objection to Simple NIV tagging. The question that we think is more important to answer at this time is whether the tagging and flagging process is working correctly and ensuring that Simple NIV tagging is being triggered when it is necessary and appropriate.

1.4 Do you agree or disagree with SEM Committee's assessment that the pricing outcomes under Simple NIV tagging are preferable, given market fundamentals? If you disagree, please explain why.

For now, BGE is not convinced that the pricing outcomes are preferable. As we noted above, BGE is in favour of price volatility between prices as a means of incentivising appropriate trading behaviour. We understand that in the months following market implementation there were instances of extreme prices, which were unintuitive, however, this type of volatility has dampened in recent months. Therefore, it is not clear to us that the extreme volatility that arose previously was because of a fundamental flaw in the market design as opposed to some outlier events reflective of a market 'learning by doing'.

BGE appreciates the expediency of the RAs in reviewing the cause of the extreme volatility in the market but at this time, we believe it may be premature to take definitive action. It will be difficult to undo the action in future and the fundamental data to support a decision to do so would not exist. We therefore think that the most appropriate and reasoned path for now is to review the tagging and flagging process and systems, and consider the evidence in the whole in a further 8-12 months.

2 <u>Removal of Difference Charges where Operational Constraints are binding</u>

2.1 Do you support this Capacity Market option and its implementation in the SEM?

The high-level design of the ISEM provided for a capacity mechanism to address a generation adequacy risk on the basis that it was proven that an energy only market in Ireland would result in a 'missing money problem', which would likely give rise to a security of supply concern. The original design was based on giving the TSO “the right to call on the option holder to provide energy at a pre-determined strike price” as per the I-SEM High Level Design Decision Paper. There are two parties to this contract – one who controls the availability of its generation unit and another who controls the availability of the system which enables that generation to export and flow.

To the extent that the option/RO holder cannot deliver its power at the pre-determined strike price because of a system issue, this is not something that the RO holder can control, nor should they be expected to absorb the risk of. On the other side of that, the TSO controls the systems’ ability to take power from the units that it has agreed to connect to the grid, and as the counterparty to the option, they should not call on a party who they know cannot deliver their contractual obligation because of an issue on the system. Therefore, in terms of reasonableness of contract, we do not think it is fair for the RAs to expect and the TSOs to enact a term of a contract when it knows that the counterparty is encumbered through the actions (or inactions as the case may be) of the party itself. With that in mind, we think it is reasonable to implement the removal of difference charges where operational constraints are binding.

2.2 Do you have any concerns regarding the removal of Difference Charges where Operational Constraints are binding, including the risk of unintended consequences? If so, please explain these concerns.

We understand the RAs concerns that the removal of difference charges where constraints are binding may provide an investment signal to parties to invest in constrained areas of the network to minimise their RO exposure. However, in the overall considerations of an investment case, this signal (i.e. the effective cost of a strike event) is not significant enough to determine an investment case. The ability to get access to the grid, to sell power into the energy market and to minimise the negative effects of TLAFs & GTUoS are far more material determinants of a unit’s location when making an investment case. We therefore do not believe that removing the difference charge where operational constraints are binding will practically have a material impact on locational signals.

2.3 Do you consider this proposed change is in keeping with the broader CRM detailed design? Please explain your view.

As outlined in answer to question 2.1 above, we do think that the intent of the CRM detailed design is still being retained and that the proposed change provides a level of reasonableness between the two contracting parties.

2.4 Do you have any views on this option from a consumer perspective?

BGE does recognise that this will likely increase the cost of the socialisation fund, which will impact customer prices, however we believe that it should also dampen capacity market risk and prices, which is also a cost borne by the customer. In the round therefore, we believe that the customer should not be materially negatively affected by this change.

2.5 Do you have a strong view regarding an alternative option which could be implemented, i.e. preferably requiring only a configuration change rather than a system change?

BGE has no alternative proposal at this time.

Please do not hesitate in contacting me if you would like to discuss anything outlined above in more detail.

Yours sincerely,

Jill Murray
{by email}