

Feedback Summary

Executive summary

Before you read this document, please familiarise yourself with the explanatory document included with this consultation. The document gives further context and explains the methodology behind the concepts involved in developing the Pricing Proposal.

As part of drafting and developing the Pricing Proposal, we have sought feedback from industry on our plans. We have attended various industry forums in order to provide updates on our progress and take questions and comments onboard. Two webinars were held, the first to discuss and introduce the proposal, and a second to walk through the first draft of the document. Gaining this feedback has been an important part of the process and had been valuable to understand the viewpoints of valued stakeholders. A table of engagements is listed below.

Engagement Event	Dates
Joint European Stakeholder Group (JESG)	June, July, August, September, October, November, December 2021
First industry webinar - introduction	7th September 2021
Bi lateral conversations with 6 stakeholders	W/C 14th September 2021
Second industry webinar - walkthrough of document	8th October 2021
Further bi-Lateral conversations with stakeholders	W/C 11th October 2021

The ESO have also regularly shared drafting with Ofgem as part of this process.

The feedback has proved to be very useful and constructive. Several key themes have emerged as part of this feedback, and for the purpose of transparency and clarity, this document has been produced as part of the consultation to outline some frequently addressed issues within this feedback.

Key feedback themes and Questions

Why is the default position for new products Pay as Cleared?

First and foremostly, the regulation states that such products must be settled as Pay as Clear, as per Article 6(4) of Regulation (EU) 2019/943, as retained in GB Law through STATUTORY INSTRUMENTS 2020 No .1006).

Pay as Cleared will be used for new products if the economic criteria outlined in the PP can be met. An assessment will determine whether the market criteria are present for Pay as Cleared to be more efficient or an alternative (e.g Pay as Bid) would be more efficient. Following this, a Cost Benefit Analysis (CBA) will be conducted, and if this is positive, it means that Pay as Cleared is the most efficient outcome for that product. If the economic criteria cannot be met, or the CBA is not positive, then Pay as Bid may be the more efficient settlement mechanism at that time and may be utilised.

Generally accepted economic theory shows us that both Pay as Bid (PAB) and PAC produce similar results, but PAC is slightly more efficient when certain market condition exist. PAC is where all providers receive the most expensive bid that has been accepted, whereas PAB is where all providers who are accepted receive the price they have bid. Economic theory suggests that whilst the results overall are similar, PAC markets are

slightly more efficient than PAB markets as they incentivise providers to bid at a price closer to the marginal price, and operate closer at their Short Run Marginal Cost, when there are three key elements in place¹:

i) Homogeneity: The product cannot be distinguished from other products by different providers.

ii) Perfect Information: All information for the market in which the product is available is correct, transparent and available to all parties.

iii) Competition: The market in which the product is in has competition and is not distorted by a single or dominant participant is competitive and not distorted

Economic theory shows when these three key elements are not in place, a move to PAC results in a more expensive outcome for consumers. When developing this Pricing Proposal, we have used the economic theory as the basis of our assumptions but have received feedback that the criteria themselves should be amended or rethought. As such the quantitative measures and the definitions have been updated to reflect valuable feedback

Homogeneity

Why do you feel that >4 technology types result in homogeneity?

Following this feedback from the webinars and bi-lateral calls with stakeholders, we have since updated the wording to be more reflective of the criteria; updated to encompass rigidity of the technical parameters. For example, TERRE is extremely homogenous due to the fact that the parameters limit the market to few types of generation. The original thinking behind this measure was different technology types have different marginal pricing, therefore the impact in a PAC market is that it results in higher costs for the consumer.

Why is technical capability not used as a parameter?

We have updated the criteria for homogeneity to cover the flexibility of technical capability. This now includes, but is not limited to the location, speed of delivery, duration of service and recovery periods. This better reflects the principle of the criteria in that the more flexible these parameters, the less homogenous the product is.

We would also welcome any supporting evidence regarding technical capability and will continue to take this into consideration.

Are you confusing factory with product in this case?

There was feedback given that factory may have been confused with product in terms of homogeneity when developing the market criteria, as outlined in the explanatory document. It was also highlighted to us that different technologies can provide different services – and that homogeneity should be measured on the ability to provide the service. We have now updated the market criteria for homogeneity to reflect this.

We encourage industry to share any ideas they may have with us on thresholds so we can take these into consideration.

Market Information

Will it be possible to get perfect information in any market? How do we quantify "all information"?

Perfect Information was an aspect of the criteria which prompted frequent questioning as part of the engagement activity. We explain this within the explanatory document. Much of the feedback highlighted that it was potentially difficult to define and quantify what perfect information for a market would look like. Our use of perfect information as a criteria is based upon economic theory. Some stakeholders we engaged with

¹ The criteria, associated definitions and quantitative measures are available in Section 2 of the Pricing Proposal.

suggested that we could instead use a parameter that was "close to" perfect information, something we examine within the consultation itself by asking questions on this.

One stakeholder did state their opinion that in situations where there is (hypothetically) scarcity, prices rise, and subsequently participants will try to put bid and offers in a competitive range to be accepted under a PAB scenario, somewhere around where the marginal price will be. If a market wasn't to have perfect information, PAC can overcome this limitation.

Following feedback from parties, we changed Perfect Information to "All Information".

We are looking to industry to provide further ideas on thresholds which we would take on board as feedback and consider as part of this consultation process.

Competitive Market

The Herfindahl-Hirschman Index is a good way to measure competitiveness - do we have an up to date HHI rating?

The feedback centring on the Competitive Market criteria was largely positive, recognising that the Herfindhal Hirschman Index (HHI) was an established method to measure the competitiveness of the market.

The index "is calculated by squaring the market share of each competing firm in the Industry and then summing the resulting numbers, where the market shares are expressed as fractions or points. The result is proportional to the average market share, weighted by market share. As such, it can range from 0 to 1.0, moving from a huge number of very small firms to a single monopolistic producers. Alternatively, if whole percentages are used, the index ranges from 0 to 10,000 "points". For example, an index of .25 is the same as 2,500 points.

A low degree of concentration means that the industry is closer to a perfect competition scenario, where many firms of more or less equal size share the market. Increases in the Herfindahl index generally indicate a decrease in competition and an increase of market power, whereas decreases indicate the opposite" (Eurostat, 2022)

Markets are not static; they change and evolve over time. Hence, moving forwards we would need to periodically ascertain the HHI of a market as part of the market assessment.

We welcome any views on an appropriate length of time to review the market conditions. Part of this will include competitiveness.

Scope of the Pricing Proposal

Can the scope of this document, and which products are in scope, be made clearer?

The definitions of standard and specific products are outlined in Section 2 of the document in line with the regulation. The ESO also agreed to undertake a mapping exercise in order to show clearly which products were in and out of scope of the Pricing Proposal. This was updated for the final draft outlined in the consultation. This is inclusive of stability products such as pathfinders. This mapping exercise is available in the explanatory note accompanying this consultation.

A move to PAC is a fundamental change to the Electricity Market Design. The opposite move was undertaken under NETA. Will this cause market impacts?

The Pricing Proposal allows the ESO to carry out an assessment to see whether implementing and running PAC is the most economically efficient remuneration method. Where it is not, the Pricing Proposal allows an alternative method to be used instead. In addition, products that have been developed prior to the Pricing Proposal can remain as they are, without the need to revisit the market conditions. This will ensure that focus remains on developing new products that are fit for purpose.

We are aware that this shift from PAB to PAC is a fundamental shift in the way the market currently operates. Most GB products which are within scope of this currently operate on a PAB basis. The Pricing Proposal will use the generally accepted economic theory which suggests that if the market criteria set out within the proposal is correct, the PAC results in the best economic outcome for the consumer.

If you have information to suggest that this change will impact your organisation in any way, please let us know as part of this consultation.

Balancing Mechanism

How will the BM be treated? Will BM BOAs be Pay as Bid or Pay as Cleared?

During the process we received feedback that the Proposal needed more clarity in regard to the treatment of the Balancing Mechanism.

Some market participants have assumed that all BM BOAs (Bid Offer Acceptances) will remain PAB, whereas others have assumed that some BM BOAs will be PAC (such as those used to instruct new reserve services). This appears to be because BM BOAs are a 'legacy product', but they are the mechanism by which BMUs will offer any new reserve service. We have re-worded 3.10 of the draft Pricing Proposal to try and offer some clarity on BM BOAs and their treatment moving forwards, as the previous wording had been somewhat vague. However there are currently two options, and NGENSO would appreciate industry feedback on which of the options are the most suitable (more information available in the Explanatory Document):

1. BM BOAs will always only be PAB. This means that BMUs can only ever be settled PAB.
2. Some BM BOAs will be settled PAC, if they are used to activate a reserve product that is currently settled PAC.

Assessment/General Principles

How will the Assessment procedure be created? This is not clear.

Feedback from bi-lateral conversations and webinars indicated that the assessment procedure needed more clarity. We have developed an economic assessment form within the Pricing Proposal. This should be included within the Article 18 process of product development. We are conscious that the assessment process should consider stakeholder feedback at the earliest available opportunity, ideally within the product development stage, when we consult on any new product under EBR Article 18.

Why are the ESO keeping legacy products as Pay as Bid? What are the benefits of keeping legacy products of this approach?

ESO analysis has indicated that moving legacy products to PAC would lead to an increase in costs for end consumers, and so have recommended that they remain PAB. This will allow us to focus on developing new products and have outlined a clear methodology for assessing the right settlement mechanism.

How will it be possible to stop units gaming two different settlement mechanisms?

The ESO recognises that one of the downsides to this approach is that, for providers looking to maximise revenue, the most viable commercial decision may be to regularly switch between markets – depending both on settlement approach (PAB vs. PAC) and wider factors. This could require significant market redesign to manage this risk whilst ensuring providers have sufficient freedom to make appropriate commercial decisions. Further information can be found in the Explanatory Document; more detail will need to be developed with industry on this point, and on many other points above.

Why are some capacity payments able to be PAC, but utilisation is not?

Analysis on the capacity payments shows that it meets the market criteria for PAC to result in a better outcome than PAB for some products

Please see the explanatory document, Capacity vs. Utilisation section, for further information.