Capacity Remuneration Mechanism (CRM)

Early Delivery Incentives

Decision Paper

SEM-24-037

2 May 2024

Table of Contents

1. Introduction

Following engagement with industry, including both the Senior Stakeholder Forum on 26 January 2024 and reflection on written responses from market participants received to SEM-24-012, the SEM Committee stated its intention to hold the T-4 2028/29 auction with incentives for the early delivery of successful projects (SEM-24-017).

The SEM Committee has expedited this workstream so as to develop an appropriate early delivery incentive policy and communicate this policy in sufficient time for the upcoming T-4 auction.

At the conclusion of a consultation period, which closed on 15 April 2024, the SEM Committee received eight consultation responses. The SEM Committee appreciates the feedback provided by industry and, following analysis of this feedback, has now reached a decision on the design of the early delivery incentive mechanism.

2. Summary of Consultation Proposals

SEM-24-024 sets out the proposal for introduction of early delivery incentives into the CRM and its design.

The proposal includes the following points:

- **Restriction of early delivery payments to multi-year New Capacity**

  The SEM Committee states it is minded to limit early delivery payments to multi-year New Capacity to prevent the possibility of Existing Capacity or already contracted New Capacity to renege on already awarded contracts and go into a T-4 auction to obtain a high price. This is expected to target incentive payments on projects which are making significant investments and have the most challenging delivery lead times, and to limit gaming potential.

- **Limits on early delivery and gaming incentives**

  To further limit gaming potential, the SEM Committee proposes allowing early delivery payments to start no more than a year before the start of the capacity delivery year for the auction in question to prevent incentivising capacity to terminate and come into the T-4 auction in the expectation of being paid higher prices for early delivery. Limiting early delivery payments to one year is expected to limit unintended consequences such as units joining later auctions knowing they will have the option to get paid if they deliver early anyway.

- **Payment multipliers**

  The SEM Committee notes it is minded to pay capacity for early delivery at the same rate as the price for the awarded capacity. However, the SEM

Committee seeks feedback on the option to employ upward multipliers (greater than 1) to payments during the early delivery period to provide extra incentives to deliver early and seasonal multipliers to reflect the differing values of capacity to consumers at different times of the year (greater than 1 in the winter and less than 1 in the summer). Introduction of multipliers could, however, introduce further potential for gaming and complexity.

- **Changes to qualification processes**

  The SEM Committee notes that it does not foresee the need for changes to Qualification or Exception Application processes, including Implementation Plans. An applicant for the 2028/29 T-4 does not need to declare whether the CMU can deliver early or not as part of its Qualification or Exception Application.

- **Applicable auctions**

  The SEM Committee states that it is minded to apply early delivery incentives to all auctions until further notice (including T-1 auctions) and that it will review this position once it is confident that sufficient capacity has been secured to meet the target reliability standard without the need for early delivery years incentives.

3. Summary of Consultation Responses

The SEM Committee received eight responses to the consultation (SEM-24-024), one of which was marked as confidential. The non-confidential responses were from:

- Bord Gáis Energy (BGE)
- Demand Response Association of Ireland (DRAI)
- Energia
- EP UK Investments (EPUKI)
- ESB Generation and Trading (ESB G&T)
- Kilshane Energy Ltd (KEL)
- SSE

Of the respondents, the majority supported the proposals. Some respondents had slightly different views towards the implementation of the early delivery incentives (EDIs) but there were no strong objections against the introduction of EDIs and the overall design of the proposal.

The overall proposal was supported by KEL, ESB G&T, SSE, EPUKI, DRAI and BGE. Energia argued that reviewing the functioning of T-1 Auctions for early delivery is a better option than introducing EDIs. However, ESB G&T raised the risk of participating in a T-1 Auction for early delivery and incurring potential termination fees.

Clarifications were sought from SSE and Energia regarding interaction of this proposal with Intermediate Length Contracts (ILC) for delivering refurbishment early.

Other proposals for incentivised early delivery were mentioned, such as issuing Directions to other government departments to prioritise projects (KEL), holding auctions further in advance and longer duration contracts (ESB G&T) and reducing the Performance Security Requirements since DRAI argue it is disproportionally high for single-year New Capacity.

Some respondents commented further on certain aspects of the proposals, which are outlined in more detail in the following paragraphs.

3.1 Overall design of the early delivery options

Support of overall design of the EDI

Most respondents (KEL, ESB G&T, SSE, EPUKI, DRAI and BGE) welcomed and supported the overall design of the EDI options and most confirmed that this proposal will provide an incentive for investors to deliver early where possible since it does not introduce an additional risk.

ESB G&T described that the only current early delivery option is to participate in a T-1 Auction, but this option carries a risk associated with meeting the long-stop date (LSD) of the T-1 auction and potential termination fee if the LSD is not met. EPUKI also welcomed the proposal of introducing EDIs since this would not erode the length of the original capacity contract. EPUKI supported the overall design of triggering Capacity Payments from the date that a project achieves Substantial Completion (or Minimum Completion).

Need for early delivery of capacity

All respondents were in broad agreement about the need to deliver additional capacity early to alleviate the capacity margin deficit following a failure to meet capacity requirements in the T-4 2027/28 Auction and agreed with the reasoning behind this proposal.

Implementation of the EDI proposal and additional comments

Energia expressed concerns with the implementation of EDIs and argued that EDIs are not the best option to incentivise early delivery. Instead, Energia argued that early delivery payments can be provided through entering a T-1 Auction instead as they have done before for Energia’s Castlereagh Battery Energy Storage System (see 3.7).

3.2 Eligibility restrictions for early delivery payments to multi-year New Capacity

Most respondents had no objections to restricting EDI payments to multi-year New Capacity, but some proposed to extend the incentive to single-year capacity, New

Capacity that has already been contracted and Intermediate Length Contracts (ILC) for refurbishments.

Energia, BGE, EPUKI and SSE had no objections against restricting to multi-year New Capacity. However, DRAI strongly objected to restricting EDI payments to multi-year New Capacity as it is of the view that there is no difference between single-year and multi-year capacity in terms of contribution to adequacy and restricting EDI payments to multi-year New Capacity would limit the ability to procure sufficient volumes. DRAI was of the opinion that sufficient provisions exist for preventing gaming behaviour in the implementation progress report submitted by a participant with awarded new capacity (CMC J.4.2) but suggested that one option could be to restrict EDI to six months in single-year contracts.

KEL and DRAI requested that this incentive also applies to New Capacity that has already been contracted but has not yet been delivered, which they argue would incentivise early delivery instead of considering termination of their existing contracts. DRAI made the argument that modular technologies can supplement their existing capacity with new capacity.

SSE and Energia argued these incentives should also apply to ILCs for delivering refurbishment early. SSE was of the opinion that there is strong likelihood of these projects achieving early delivery.

3.3 Limits on early delivery and gaming incentives

All respondents agreed or had no objections to allowing early delivery payments to start not more than a year before capacity delivery year.

Energia agreed the risk of gaming would be greater if the payments were not limited to one year but was of the opinion that the consultation does not propose sufficient mitigations to gaming and the risk still exists. It pointed out that section J.6.1.10 of the Capacity Market Code (CMC) explicitly allows terminated projects to re-enter auctions and commented on previously terminated projects re-entering the CRM at higher prices in the past. Energia argued that, if these proposals are introduced, it will be even more important that the SOs rigorously assess whether proposed timelines for the delivery of New Capacity are realistic, according to section E.7.5.1 of the CMC which requires the SOs to reject applications from New Capacity where implementation plan dates are unachievable.

In contrast, EPUKI is of the opinion that the time limit together with Termination Charges associated with previously Awarded Capacity mitigates the risk of potential gaming but propose introducing a time restriction on allowing a project to re-enter the Capacity Auction after terminating a project.

3.4 Employment of payment multipliers for early delivery

There were different views on the implementation of multipliers for early delivery. Three respondents (Energia, DRAI, BGE) agreed that using multipliers would add complexity and are not needed.

BGE instead proposed payments to be set at the greater of the T-1 auction clearing price for the early delivery year or the T-4 auction price that the unit cleared in the auction for the expected delivery year. However, it noted the need to ensure that the party does not game qualification in order to push up the T-1 price to its own benefit.

Implementation of upward multipliers

EPUKI and KEL supported using upward multipliers. KEL argued that the cost to the developer and benefit for early delivery is greater than 1 and noted the difficulty in delivering a project any amount of time early, so strongly objected against not using upward multipliers. EPUKI argued that early delivery provides a benefit to the consumer compared to capacity procured outside the market and that feasibility of early delivery is unclear within current capacity market timelines, but multipliers would be a strong incentive and positive investment signal for new capacity. EPUKI recommended a multiplier of 1.25 to capacity payments received in advance of the beginning of the relevant Capacity Year, up to a maximum of one-year in advance, which would represent the offset of increased cost in the procurement and activation of TEG (temporary emergency generation).

Seasonal multipliers

No respondents supported using seasonal multipliers.

BGE objected against making any distinction between whether a project delivers in the winter or summer before its expected year since they argue the real incentive is the length of the additional payment on top of the 10-year capacity contract. KEL argued that since the capacity year begins in October, a higher multiplier in winter would skew the incentive and considers it unfair to have to be more than 6 months early to receive the benefit. EPUKI disagreed with the statement that the value of capacity to consumers in the summer is less than the value of capacity in the winter based on the timing of scarcity events in recent years and trend of lower wind capacity / scheduled outages in summer months.

Downwards multipliers

Respondents objected against using downwards multipliers. EPUKI argued that negative multipliers would reflect a negative market signal and DRAI commented that this could discourage early delivery.

3.5 Changes required to Qualification and Exception Application rules or processes

Most respondents did not have any comments (SSE, ESB G&T) or agreed that no changes are required (KEL, Energia, DRAI) to Qualification and Exception Application rules. Energia only commented on the implementation plans for additional gaming mitigation arguing that, if EDIs are introduced, a more rigorous assessment will be required of whether implementation plan dates for New Capacity are achievable (referred to in section 2.3).

EPUKI responded that no changes are needed to the Exception Application rules but argued that changes may be required to the Qualification process for accelerated delivery of projects.

BGE proposed amendments to the Qualification process by undertaking a check on project implementation plans at the T-1 Qualification to assess whether multi-year capacity holders should be competing at T-1 Auction.

3.6 Early delivery incentives to all auctions until further notice

Most respondents (KEL, SSE, DRAI, EPUKI, ESB G&T) agreed or did not object to applying EDI to all future auctions until further notice. KEL noted that participants should be provided with notice of any change, no later than the publication of the Initial Auction Information Pack (IAIP).

In contrast, BGE was of the opinion that there could be potential unintended consequences and EDIs should only be applied to the upcoming T-4 auction and could be consulted upon along with general parameters consultations, but not as an obligation on all auctions.

EPUKI sought clarification on how many additional auctions the SEMC envisions under the existing State Aid approval for the Capacity Remuneration Mechanism since current approval is due to expire and the SEMC 2024 workplan included a review of CRM design and renewal of approval.

Energia requested clarity on applicability only to auctions yet to come, not to awarded capacity in concluded auctions and it objects to retrospective changes.

3.7 Any other incentives that may be appropriate to promote early delivery of capacity

Some respondents raised additional proposals for promoting early delivery of capacity.

Review T-1 Auctions

Energia was of the opinion that a better approach would be to review how T-1 auctions can be scrutinised on a case-by-case basis to incentivise early delivery, which would prevent termination of already awarded capacity to re-enter T-4 auctions. Energia noted a previous example of this on Energia's Castlereagh Battery Energy Storage System.

Energia noted that modification CMC_03_23, which allowed the RAs more flexibility in setting the Long-Stop Date for T-1 auctions, achieved the de-risking of delivery of New Capacity at T-1 auctions. Furthermore, Energia argued that historically, T-1 prices have been higher than at T-4 auctions, so a new clearing price should not present a barrier to delivering early via a T-1. Energia was also of the opinion that it would be appropriate for participants to be unable to secure a contract if there is insufficient requirement at T-1 auction.

Issuing Directions to prioritise projects

KEL was of the opinion that modifications to the Capacity Market will not lead to early delivery alone and raised the issue of delays related with the planning system. KEL proposed issuing Directions to Government Departments to prioritise projects such as issued by DECC for procuring temporary emergency generation.

EPUKI also argued that Directions should be issued and noted previously issued Directions by the CRU to electricity and gas grid operators to instruct that connection offers be issued to projects which have been successful in Capacity Auctions. According to EPUKI, these Directions should prioritise delivery of these connections above all other workstreams in the interest of Security of Supply and the consumer benefit.

Incentive mechanism for system operators

EPUKI proposed introducing an incentive mechanism for system operators to deliver connections for new capacity. SSE also commented that early delivery is dependent on strong incentives on the TSO, so project milestones must be sufficiently flexible so that required deliverables outside the control of a project development are recognised.

Hold auctions further in advance and longer duration contracts

ESB G&T proposed holding auctions further in advance, such as T-5 or T-6 that would be reflective of real-world programme timelines of major infrastructure projects, and longer duration contracts for capital-intensive projects, such as CCGTs, as proposed by EY.

Reduce Performance Security Requirements

DRAI proposed reducing the Performance Security Requirements to reduce barriers for single-year New Capacity since they claim this measure is disproportionally high for these capacity projects.

Impact on capacity requirement for T-1 auction

SSE commented that the potential for early T-4 projects should not impact how the TSO/RA access the capacity needs for a T-1 auction, i.e. the capacity requirement for a T-1 auction should not make provisions for potential early delivery of T-4 projects.

4. SEM Committee Responses

The SEM Committee would like to thank respondents for taking the time to consider the proposals outlined in the consultation paper and provide feedback. The SEM Committee has considered the feedback and would like to make the following comments in response:

- The SEM Committee notes that the majority of respondents supported limiting eligibility for early delivery payments to multi-year New Capacity and remains of the view that targeting this capacity with early delivery incentives is the correct approach as such projects tend to have the most challenging delivery lead times, whilst projects with shorter lead times can enter via a T-1 auction, and, in addition, this approach would limit gaming potential.
- The SEM Committee remains concerned at the potential for projects which have won in previous auctions to profit by paying termination fees and coming back into the 2028/29 T-4 at higher prices and earning income for delivering in earlier years. The SEM Committee notes that limiting early delivery payments to one-year of early delivery will limit the gaming potential, and the RAs will scrutinise plans and notes the general prohibition against market manipulation within the CMC. However, the SEM Committee will continue to monitor the situation and assess whether there is evidence of gaming, and whether other provisions may be appropriate.
- The SEM Committee notes comments made regarding the interaction with intermediate length contracts and agrees that it is appropriate that such capacity would be incentivised to deliver early. However, as outlined below, this will apply to incremental capacity only.
- The SEM Committee notes that respondents agreed that early delivery payments should not start more than one year prior to the capacity delivery year.
- Regarding the payment of multipliers, the SEM Committee agrees that using multipliers would add unnecessary complexity and considers that proceeding without multipliers is the best option, being simple, providing clear incentives and limiting gaming potential.
- Regarding State aid, the current State aid approval commenced with the start of I-SEM entering into force, in October 2018, and allows for auctions to take place for the following ten years. As noted by a respondent, the SEM Forward Work Plan includes an action to commence the next phase of the CRM/new State aid application.

- The SEM Committee notes that the CRU has previously issued Directions to EirGrid, ESB Networks and GNI prior to recent T-4 auctions and understands that such Directions are due to be issued and published prior to the upcoming T-4 auction.
- Regarding feedback in relation to the reduction of Performance Security Requirements for single-year New Capacity, the SEM Committee notes the recent CMC Modification Proposal submitted on this topic, which is currently open for consultation (SEM-24-027).

5. SEM Committee Decisions

The SEM Committee has decided to progress with the introduction of Early Delivery Incentives and introduce the mechanism in line with the following design decisions:

i. Multi-year New Capacity and incremental multi-year ILC capacity will receive payment for early delivery at the same price as its awarded capacity in the 2028/29 T-4 auction, i.e. there will be no additional multipliers to the contract price.

ii. The early delivery incentive will apply to all auctions until further notice (including T-1 auctions). The SEM Committee will review this position once it is confident that sufficient capacity has been secured to meet the target reliability standard without the need for early delivery years, at which point the cost of early delivery payments to consumers may exceed the savings in terms of incremental reduction in the value of lost load.

iii. The early delivery incentive will not apply to auctions which have already taken place, i.e. the T-4 2028/29 is the first auction to which this incentive will apply.

iv. To limit gaming potential and interactions with earlier year auctions, early delivery payments will commence no more than one year before the start of the capacity delivery year for the auction in question. For instance, if multi-year New Capacity enters the 2028/29 T-4 auction, and achieves Substantial Completion on 1 January 2028 (nine months prior to the start of the 2028/29 capacity year), its payment will:
   a. Commence on the date it achieves completion, in this example 1 January 2028; and

   b. Conclude on the date the contract was originally expected to end, in this example 30 September 2038.

v. Any multi-year New Capacity or incremental multi-year ILC capacity being paid for early delivery would also be subject to the same Reliability Option

Difference Payments and the same Stop-Loss limits as any other capacity operating in the CRM, from the date payments start.

vi. For incremental multi-year capacity (including New Capacity and incremental ILC capacity), the capacity can get paid for early delivery of any incremental capacity only and not the Existing Capacity, i.e. the capacity that is already contracted.

For instance, in the 2028/29 T-4 auction, if a unit had capacity of 100MWd pre-refurbishment, it would likely have been contracted for 100MWd in the 2027/28 T-4 as Existing Capacity. If it then won an ILC for 110MWd in the 2028/29 T-4, it could not get paid under the early delivery incentive for the 100MWd in 2027/28, but it could get paid under early delivery incentive on the incremental 10MWd which was not contracted in the 2027/28 T-4, provided it also delivered the 100MWd contracted in the 2027/28 T-4.

vii. It is anticipated that the capacity would be expected to achieve Substantial Completion to be paid, but the provisions of Mod CMC 13_23 would apply, which, as per CMC J.6.1.4A, allows a unit to get paid on Minimum Completion, if it does not expect to achieve Substantial Completion.

6. Next Steps

The SEM Committee is publishing this decision today, to coincide with the TSOs' publication of the IAIP for the 2028/29 T-4 auction and provide investors with the confidence to enter the upcoming auction knowing that they will be rewarded for early delivery of capacity.

Following the publication of this decision paper, the SEM Committee will work to propose the required implementing modifications to the CMC, and any necessary charges to the Trading & Settlement Code.