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RE: Capacity Remuneration Mechanism, Detailed Design, Consultation Paper SEM-15-044

Dear Brian, Thomas

Bord Gáis Energy ("**BGE**") welcomes this opportunity to respond to the SEM Committee ("**SEMC**") first consultation on the Capacity Remuneration Mechanism, Detailed Design ("**the Consultation**").

1. Introduction

Recognising that the current capacity mechanism in the Single Electricity Market ("**SEM**") has delivered both capacity adequacy and competition into the market, BGE nonetheless supports the initiative to move to a more market based approach to rewarding capacity as proposed in the Integrated Single Electricity Market ("**the I-SEM**") High Level Design. Within the context of a market with increasing renewable generation and a need for more efficient and less carbon intensive **thermal** capacity which must be adequately remunerated; the new capacity mechanism must deliver both efficient exit and entry signals in the wholesale market. It must also work alongside both the ancillary service market and the energy market, which collectively should incentivise the right **level** (through the RO), **type** (through the ancillary service market) and **timing** (through the energy market) of capacity respectively.

BGE is concerned that there are a number of elements of the proposed Reliability Option (**"RO"**) design which could have negative implications for both the energy and capacity market outcomes and these concerns heavily influence BGE's views on the appropriate design of the RO. The key design decision concerns include primarily:

i. The choice of reference market: BGE believes that the day-ahead market ("**DAM**") should be the RO market reference price. Using a balancing market ("**BM**") related price as part of the RO design will in BGE's view drive liquidity into the BM to the detriment of DAM liquidity. This in turn will have knock on implications for forward market liquidity and cross border trading raising EU concerns around Target Model compliance. Whereby the split market option proposed in the consultation paper attempts to mitigate some of this risk, BGE believes that this option would drive down dynamic pricing signals in the energy market (affecting entry signals for flexible generation) and may have wider policy implications in effectively introducing a price cap, potentially raising EU concerns on internal market harmonisation. BGE's view on the DAM choice is however predicated on an expectation that adequate market power mitigation measures will be implemented in the balancing market;
ii. The proposal for inclusion of explicit penalties and administered scarcity events: need to avoid adding unnecessary risk into the RO before the successful operation of the design is given a chance, at the consequential risk of increasing prices to consumers (as that additional risk will be factored into capacity providers' RO auction bids). The provisions for penalties and administered scarcity events are premised on the assumption that parties will not react to market signals and will not make their capacity available during periods of tight capacity margins. Given that the balancing market will be a mandatory market, that the Regulatory Authorities ("**RAs**") are committed to develop and implement a robust market power mitigation strategy for I-SEM, and that commercial entities will be naturally incentivised through dynamic pricing to make their capacity available at times of tight margins, BGE believes that these

proposals are unwarranted and only add risk to the participating generators and therefore cost to the procurement of capacity by suppliers and customers. Experience of the mechanism's operation in a market such as I-SEM is necessary and such decisions should not be made based on design failures in overseas markets. The competitive auction process together with strict de-rating factors that should act as "minimum standards" to which all units of a particular technology must abide will drive efficiencies and ensure that capacity that can physically and economically adjust to market changes is available to the market. To be clear, where a robust de-rating factor approach is applied, BGE does not believe that explicit penalties are required and such penalties would instead add unnecessary risk to the market and increase consumer costs;

iii. The need for a liquid secondary market to enable trading out of outage risk: The Consultation does not recognise or provide for the design of a secondary market for the trading of ROs. A liquid secondary market will be important for generators with ROs to reduce risks related to planned and forced outages and it would therefore act to put downward pressure on capacity prices. BGE is concerned that there is potential for market power to be exercised in this market and therefore urges the RAs to consider the design and implementation of a transparent and liquid secondary market alongside the auction design;

iv. The need for a tighter security standard to ensure the suppliers' RO hedge is not undermined: In its assessment of a security standard for the island, the RAs' minded to position gave insufficient credence to important elements of the TSOs' capacity adequacy analysis and, in BGE's view, ignored the benefits (to a small island system with growing levels of intermittent generation) of a tighter security standard. As a supplier, who will pay for and rely on the RO to provide a hedge above the strike price, BGE is concerned that a failure to recognise this benefit and therefore to procure sufficient capacity through the capacity auction will expose suppliers to price spikes and undermine their customer offerings and prices.

It is with these principled concerns in mind that BGE has developed its response to this consultation. The remainder of this response deals with the sections of the Consultation Paper sequentially. Our summary and conclusion on positions completes our response.

2. Capacity Requirement

As outlined in the introduction above, the RO will play an important role in fixing the lack of exit signals in the current capacity payment mechanism but a balance must be struck between signals that encourage the exit of the correct (inefficient) plant and signals that result in "over" exit (i.e. inadvertent exit of efficient plant). In this context, BGE's views on the questions posed on the capacity requirement are put forward below.

2.1 Capacity Requirement Questions

2.1.1 Feedback on SEMC minded to position to retain the all-island security standard of 8 hours LoLE

BGE does not agree with the SEMC's minded to position to retain the all-island security standard of 8 hours LoLE and submits that the LoLE standard should be reduced to 3 hours LoLE.

The LoLE should necessarily move to 3 hours, for the following main reasons:

a. To take account of the EU internal energy market objectives to harmonise energy trading arrangements and optimise cross border flows. GB and France are part of the region that I-SEM forms part of in the EU Target Model context. Both countries have a LoLE of 3 hours creating disparity between them and the Irish system and arguably frustrating the move to full harmonisation of the European electricity market on a region by region basis;

b. To take account of the growing renewable resources on the system, and the concurrent increasing risk that electricity markets will be unable to deliver sufficient generation capacity to meet demand at all times. Ireland is a forerunner in renewables installation levels in Europe. It seems contradictory to have the highest ambitions for renewables installation but one of the lowest EU LoLE standards comparatively. Increasing renewables implies a need to at least

review the increased likelihood of insufficient capacity to meet high demand periods, the probability of which has certainly changed since the early 1990s when the current 8 hour LoLE standard was adopted;To recognise the island's unique characteristics in terms of its island status, low interconnection levels, and high levels of intermittent generation. The benefit of a tighter standard is greater for a market of such characteristics than those markets with higher interconnection and lower renewable volumes;

c. To recognise the increasing importance of an increasingly reliable security of electricity supply from a Foreign Direct Investment ("FDI") perspective as recognised by the recent EY paper. The Irish economy is portraying strong growth which is predicted to continue for some time. It is generally recognised that as economies grow in wealth, so too does the reliance on an increasing higher quality electricity supply. While recent Irish FDI decisions were based on the current standard, the effect of the recently adopted 3 hour LoLE decision in BETTA has not yet been seen thus the Irish economy is putting itself at risk of losing out on FDI in favour of our closest neighbours.

A tighter standard undoubtedly introduces an element of additional cost but these costs should not be looked at in isolation of the benefits. One very important element under the RO is the fact that suppliers and customers are paying for capacity and should therefore receive the full hedge benefit of the RO. They should not be potentially exposed to a situation, e.g. capacity under-procurement, that undermines this benefit. Where the benefit of a measure outweighs the cost to the consumer, it warrants in BGE's opinion significant consideration. In the Consultation, the RAs have arbitrarily chosen aspects of the TSOs' analysis to support the RAs' preferred position of retaining an 8 hour LoLE standard. The TSOs' analysis warrants consideration beyond that raised in the Consultation Paper. As outlined below, BGE believes that the cost are lower than the higher benefits of moving to a 3 hour LoLE standard and that there is therefore clear rationale for moving to a tighter LoLE standard.

An additional 220MW of capacity is noted as the amount needed to adequately maintain security of supply if moving from 8 to 3 hours LoLE. The RAs note the low-high cost range for an additional 220MW of capacity as between €14.4m - €19.2m, based on the lowest – highest BNE costs seen since SEM's inception. The RAs must recognise that a competitive auction structure is core to the process of the new RO mechanism and it will ensure a competitive outcome and procurement of efficient capacity. Taking the auction design element of the RO into account, and using the GB capacity auction parameters as proxies,[1] the real cost of an additional 220MW is likely to be closer to €5.8m[2]; or worst case scenario based on the GB 2014 capacity auction BNE for a CCGT, €14.7m. However, on the basis that the SEM capacity mechanism has used an OCGT as its proxy BNE since inception in 2007, the real cost of an additional 220MW in an auction type mechanism is arguably closer to €8.7m based on GB's OCGT BNE price. The correct range of the cost of moving from 8 to 3 hours LoLE based on the TSO analysis is in BGE's view therefore €5.8m-€8.7m. The fact that the GB system security margins are at an all-time low as compared to the SEM's level of capacity, implies that the cost to I-SEM of an additional 220MW is likely to be closer to the lower end of this cost range.

As mentioned above, the cost of this change cannot be looked at in isolation of its benefits and BGE is strongly of the view that the benefits must outweigh the cost. In this instance, they arguably do. Again based on the TSOs' analysis an additional 220MW would reduce unserved energy volumes by 1500MWh/year. Despite the difficulty in accurately valuing VoLL the current SEM VoLL standard remains instrumental in informing the generation adequacy standard for the island. Taking the TSO analysis, the value to the consumer of moving to 3 hours LoLE is €16m. This is based on the current estimate of VoLL in SEM, which has not been reviewed since 2008. Using the recent evidence from the BETTA market which reviewed VoLL based on actual consumers' value of retaining supply, the value/ benefit of moving to a 3 hour LoLE is €35m. Irrespective of the SEM or BETTA VoLL level being used, the evidence is that the benefit of moving to a 3 hour LoLE standard outweighs the cost of the added 220MW. **BGE reiterates that applying a high de-rating factor as a "minimum standard" will be important in ensuring that current, and the potential additional 220MW of, capacity will deliver their full value to the market and consumer.**

[1] Given the lack of comparable competitive market price proxies for SEM/ I-SEM
[2] Using the GB auction clearing price as a proxy

Taking the ranges of costs and benefits of moving to 3 hours LoLE coupled with the rationale outlined above, BGE urges the RAs to consider reducing the LoLE hours to 3.

2.1.2 Comments from respondents as to their preferred method of accounting for unreliability of capacity in determining the capacity requirement, along with reasons behind their preference

BGE believes that the determination of the capacity requirement is a critical aspect of ensuring the success of the RO mechanism – its inputs, assumption, parameters and models must necessarily be further consulted upon.

Consideration will be required as to the interrelationship between the approaches to determine the capacity requirement and to determine the level of MWs that can be bid by capacity providers into the RO auction, to ensure from a consumer perspective that the protection of the RO hedge is not undermined. Any risks to the protection of this hedge must be mitigated insofar as possible in order to optimise the benefits of the RO mechanism.

2.1.3 Feedback on the options presented in relation to accounting for demand forecast uncertainty, along with rationale behind any position

BGE supports option 3: the optimal scenario approach for accounting for demand forecast uncertainty in determining the demand requirement, subject to the caveat that a "worst case scenario" is one of the scenarios assessed in the optimal approach in determining the "least regret cost".

BGE believes that the single average scenario is not broad enough to capture outcomes where demand might be uncharacteristically high or low and there is a risk that insufficient MWs would be procured through the auction with the single average scenario which risks the protection of the RO hedge for suppliers (e.g. if insufficient RO contracts exist and the reference price > strike price, there will be an insufficient number of capacity providers paying back this price difference, leaving suppliers exposed to the residual market price). The worst case scenario is considered insufficient of itself as a proxy and could lead to over procurement and consequently increase supplier payments towards RO contracts. Finally the stochastic model appears to be an opaque approach the outputs of which would be very difficult to predict and verify which BGE is not in favour of and it would also bring us out-of-line with the methodologies employed by our European neighbours.

The "optimal scenario" can cater for examining the cost of extremes as well as "single average" and "worst case" approaches, determining the best solution for the market and ultimately the most cost-effective procurement of capacity from the consumers' perspective. BGE requests that consultation on the inputs and assumptions to this approach occurs.

2.1.4 Feedback on minded to position to base the capacity requirement for the CRM on a single capacity zone

BGE agrees with the minded to position to base the capacity requirement for the CRM on a single capacity zone. Procuring the capacity on an all island basis is similar to how it is done currently and best mitigates market power as the island is considered too small to break into more than one capacity zone without resulting in a likely benefit to one or two particular plants which would of itself increase the regulatory burden in terms of market power mitigation. The existing physical constraints are anticipated to be a short-term issue and a single zone approach would ensure the most efficient use of capacity in the I-SEM to serve all of load on the island.

As discussed in the following answer, BGE is not in favour of side contracts believing that they can lead to efficient market outcomes.

The suggestion of applying locational price adjustment through adjustment of individual capacity bids is not only complicated but is potentially subject to unpredictable regulatory intervention and would compound the bidding strategy for market participants bidding into the auction. BGE is not in favour of this.

BGE therefore urges continuance of the single all island approach to procurement without an option for unilateral bid adjustment by the RAs.

2.1.5 Detail of any other considerations respondents felt should be taken into account when determining the capacity requirement for the CRM

The Consultation Paper makes reference to "adjustment of the capacity requirement" as there will be more than one auction per capacity year and that a different amount will have to be procured in each. Reference is also made to the strong link between this and eligibility requirements. As discussed further below, BGE believes that all market participant types should be eligible to compete in the capacity auction. There should be no special rules for any plant type as this could inadvertently favour one technology type over another depending on the timing of the auction ahead of the capacity delivery year. BGE is in favour of the new competitive market based approach to capacity procurement and believes that all market participants should have equal eligibility in terms of auction participation regardless of the auction timing, the contribution of which capacity will inevitably be controlled by pre-qualification requirements and the risk appetite of market participants in terms of delivering capacity committed through auction.

As the reliability standard is very sensitive to inputs when it comes to setting the capacity requirement, the assumptions that feed into this assessment are critical. The setting of the capacity requirement for example is central to determination of the demand curve in an auction which is critical for investors who require certainty and transparency of inputs, assumptions and models. The slope of the demand curve (if any) must be consulted upon and consideration should be given to the application of a price floor at least on a transitionary basis which will contribute towards achieving the aforementioned balance between exit signals for inefficient plant while maintaining efficient plant on the system. BGE requests confirmation that the RAs /TSOs will consult on at least these particular aspects of the capacity requirement as they arise?

BGE is not in favour of side contracts for the construction or operation of critical capacity outside the CRM auction. All capacity should be procured centrally through the RO auction to ensure that, through the capacity, energy and ancillary services markets the most efficient capacity is available through the right market signals. BGE requests clarification as to how existing contracts will be accounted for within the context of the RO.

Notwithstanding that contract duration is to be consulted on in the second RO consultation later this year, it is anticipated that new market participants will be offered longer contract durations than existing units to support financing and BGE urges the RAs to consider how the additional risk longer term contracts impose on the RO Counterparty may be accounted for. BGE is concerned about how the different value of short and long term contracts will be accounted for and understands that this issue is being considered in the GB context which may be instructive for the RO mechanism.

Finally, reference is made in the Consultation to using GTUoS charges to sharpen locational signals. **BGE reiterates its discontent with the current GTUoS methodology – it is an opaque, unpredictable mechanism which is unsuitable as a locational tool. BGE believes that any viable locational tool must be predictable and verifiable.**

3. Product Design

As discussed in the section 1 introduction above, the RO mechanism provides an excellent opportunity to fix the main weakness of the current mechanism being the lack of exit signals. A number of elements of the RO design will contribute to ensuring effective exit signals. These include the competitive element of the auction process as well as strict de-rating factors that act as "minimum standards" (discussed further in section 4 below).

While elements of the product design will also have a role in exit signals, it is critical that decisions around the product design (i) do not negatively impact liquidity undermining in particular forward hedging opportunities, and; (ii) do not introduce unnecessary, unmanageable, unquantifiable risk into the market, both of which concerns would increase prices and reduce the value of the RO hedge to customers.

3.1 Product Design Questions

3.1.1 The approach to setting the RO Strike Price:

- ***Should a floating/indexed strike price apply?***
- ***What should the reference unit for the strike price be?***
- ***Should the strike price reference unit be grandfathered in long contracts?***

BGE believes that the chosen strike price should be indexed to flex in line with fuel costs. Despite the noted volatility that would be expected with an indexed strike price, such an approach to fixing a strike price is considered more realistic of market outcomes and is conducive to reducing risk for peaking plant which will become increasingly necessary in a system with increasing levels of renewables. An indexed strike price approach will also align with the SEMC's preference for a peaker reference unit to set the strike price whose risk should be mitigated insofar as possible. Finally, from a consumer perspective, the volatility of indexed strike prices can be effectively managed provided there is sufficient counterparty liquidity in the market up to the strike price.

The reference unit used to set the strike price should be a hypothetical "peaker" unit (i.e. a hypothetical marginal BNE unit on the system including e.g. generation and demand side). That unit should in BGE's view be a BNE as opposed to the actual marginal unit on the system. The use of the actual marginal unit risks the outcome that year on year, given the lack of experience in the operation of the RO in a market the size of I-SEM, the marginal unit on the system may not be either successful in the subsequent auction and/ or exit the market entirely meaning that year on year the parameters for setting the strike price could be markedly different and heighten capacity market uncertainty for investors, and costs for consumers alike. The use of a hypothetical BNE marginal unit provides greater stability and transparency than an existing plant choice. Importantly however, market participants must have confidence in the process of choosing a reference unit and strike prices should be objective, fair, transparent and verifiable. As well as consultation on the inputs and parameters (including costs of the reference unit) as and when the reference unit might change, BGE believes that an independent auditor should be used to verify the chosen BNE reference unit and that auditor should be accountable to both the RAs and market participants.

The discussion around whether the reference unit should or should not be grandfathered for long-term contracts is heavily related to BGE's concern around how long and short term contracts for capacity can be accounted for side by side. It is essential that there is no discrepancy in the value/ benefit of the RO hedge for customers. For example, if different reference units (and thus different strike prices) apply to long and short term contracts respectively, this will introduce administrative complexity in determining the RO paybacks to suppliers and could also result in a breakdown in the supplier hedge whereby varying volumes of payback apply to varying volumes of strike price/ reference price differentials, adding cost to the consumer. This risk to the RO hedge must be avoided.

It is also important that inconsistent scarcity signals for different units of the same technology (by virtue of applying different strike prices to new and existing units), undermining the usefulness of this element of the RO mechanism, do not materialise. Short term contract holders and long term contract holders should not be comparatively disadvantaged and the study on-going in BETTA on this issue may prove instructive for the RO detailed design.

3.1.2 The Implementation of scarcity pricing in the I-SEM Balancing Market

BGE believes that the proposal of a scarcity price adder to the spot market price is assuming a market failure in the RO before it is even designed. The SEMC should not underestimate the potential of the RO to drive competitive outcomes that should result in a balance of plant on the system that is available to respond to peak/ scarcity periods as and when required – the elements of the RO that will help realise this potential include:

- a competitive capacity auction with defined parameters;
- the exposure to the RO paybacks (occurring when the reference price > strike price);
- the rules around eligibility and strict de-rating permissions.

BGE is not in favour of adopting an administered scarcity price in pre-emption of failure of RO signals for the following key reasons:

i. the addition of a price that might apply in certain, mostly unpredictable, scarcity scenarios adds more complexity to the RO, the risk of which market participants will have to factor into RO auction bids with the likely effect of increased auction clearing prices at cost to the consumer;
ii. any MWs that are not RO committed that are thus capable of earning the administered price (without exposure to RO payback requirements), arguably renders the protection of the RO hedge for suppliers inoperable for those MWs (for which the full administered price will have to be paid for by customers), exposing suppliers to unpredictable risk which will have knock on negative impacts on consumer prices;
iii. an administered scarcity price further blurs the delineation between reserve shortage and capacity shortage. One of the foci of the DS3 project is to ensure sufficient short term reserve on the system whereas capacity shortage is a longer term adequacy issue, within the auspices of the RO capacity mechanism. Application of a scarcity price to a spot price also heightens the risks of double payment in a market with capacity and ancillary service revenues;
iv. it interferes with the operation of the BM.

BGE believes that the scarcity price would only be of benefit to those outside of the RO (i.e. would only be earned, and not be subject to the hedge payback element of the RO, by those outside the RO). This benefit can however be effectively dealt with through optimal use of the de-rating element of the RO mechanism as discussed under section 4 below.

Finally, issues of imbalance pricing are best dealt with under the Energy Trading Arrangements workstream and should not be pertinent in the RO detailed design decisions.

3.1.3 The choice of market reference price options from amongst the options presented and consistency with key objectives

BGE is a long standing advocate of the need to delineate between capacity adequacy and flexibility. The purpose of the CRM – the long term "adequacy" objective is to ensure that sufficient plant remains on the system long term to be able to respond on a continuous and sometimes enduring basis to "back up" gaps in intermittent generation. BGE assumes that from a consumer perspective, the RAs want plant on the system able to respond to long term requirements for "back up" that are not limited to peaker generators given the high cost of running such generators over any period longer than ~2 hours. The role of the BM and DS incentives is short term reserves/ flexibility. DS3 should ensure that there is sufficient reserve on the system at the DAM gate closure and the balancing market should ensure that the market signals are created which appropriately incentivise short term availability and flexibility during peak times.

An array of options has been put forward for market reference prices in the Consultation but BGE limits its discussion here to the DAM, BM and split market option. A number of pros and cons are evident in each of these three options and ultimately in the context of the discussion outlined in the introduction to this section 3.1.3, **BGE is in favour of the day ahead market ("DAM")**. In leading to this decision, BGE has considered the benefits and drawbacks of the split and BM options also.

The split option in our view appears to ensure a balance of liquidity, and hence good consumer protection through the RO hedge, across both the DAM and BM. It raises solid concerns however around state aid compliance as the option effectively caps the energy market price across the spectrum – while this issue may be dealt with by allowing the RO to be voluntary, given market power concerns in I-SEM we do not believe this to be an appropriate solution. The option also dampens BM signals and the ability for flexible plants to maximise revenues affecting an appropriate market driven balance of fleet on the system. BGE is also concerned around the hedging complexities of this option and the potential for the dilution of much needed forwards liquidity.

The BM option provides a good hedge on the supply side against balancing risk. It will likely however drive liquidity in the BM to the likely detriment of DAM liquidity. Using the BM as the reference market would also undermine forwards CFDs which will be based off DAM reference prices. Given the higher scheduling risk of participating in the BM than the DAM in the context of a heavily constrained system,

the risk appetite of hedging counterparties to reference the BM can only be considered as being much lower than referencing hedges off the DAM. Given that market coupling will happen through the DAM, driving liquidity to the BM undermines the objectives of the EU Target Model and efficient interconnector flows. The BM would also no longer be a "residual" market; rather it becomes the reference market/ market of first resort for trading. As a reference market the BM option would blur the line between DS3/ BM objectives (in incentivising flexibility) and RO objectives (incentivising adequacy) again to the detriment of ensuring an appropriate balance of fleet on the system to cater in a cost-effective manner, for the adequacy and flexibility gaps inevitable in a renewables heavy market. Finally, BGE would welcome clarity as soon as possible on whether the balancing price and imbalance price will both include uplift or whether only one of these prices will, as this has a major bearing on the appropriate market reference price from an integrated portfolio perspective and the need to avoid basis risk.

Finally, BGE's preferred DAM option is heavily subject to the caveat that measures around market power and liquidity are adopted such that the exposure for suppliers to high BM prices is mitigated insofar as possible.

The below table outlines the performance of BGE's preferred DAM option as against the RA criteria:

Key Factor	BGE Assessment of preferred option
Security of supply: incentivise availability at times of system stress	The RAs must recognise the delineation between the incentives of the RO (capacity adequacy) and DS3/ BM prices (flexibility/ short term reserves). The DAM, unlike the split and BM options, avoids raising concerns around dampening the potential of the BM to incentivise flexible generation in tandem with the incentives of the DS3 project. The DAM option ensures sufficient plant on the system to cost effectively fill gaps in capacity reserve
EU Internal Market: Optimisation of interconnector trading	The DAM option best helps ensure DAM liquidity which is positive for cross border trades (given that market coupling will occur on a DAM basis) and forward market liquidity. It rightly ensures the BM is a market of last resort.
Efficiency: Accessibility	DAM scheduling while risky is less risky than BM scheduling and encouraging DAM liquidity should better attract forwards hedging counterparties assisting forwards liquidity. RO participants are also more likely to be willing to compete in a RO auction with a DAM reference increasing liquidity and competitive outcomes of RO auctions as well as optimising the use of the existing capacity in the market.
Competition: Promotion of wider liquidity objectives	DAM liquidity will be promoted and not diluted or eroded as would be expected under the split or BM option. BM liquidity will be assisted by the mandatory nature of the market and should remain the market of last resort
Competition: Market Power Controls	It is critical that market power and liquidity measures are adopted in the BM if the DAM is the reference market to protect suppliers from BM price exposure

3.1.4 Whether the RO volume and/ or the additional performance incentives should be load- following

Where a single reference market price is chosen, BGE agrees with the load-following proposal for RO volumes. This will ensure suppliers are hedged while simultaneously not undermining investor certainty and potentially driving inefficient exit of plant ultimately to the detriment of the consumer in terms of the costs of replacing such plant. Not adopting load-following for RO volumes will be viewed as additional risk by certain capacity providers that have uncertainty of scheduling and dispatch levels (confidence is required of being in receipt of the reference market price for the full volume of their RO contract). This risk would be factored into their RO auction bid price increasing the cost to the consumer of RO option fees. ***This view is however subject to the caveat that, from a supplier/ consumer perspective, if the split option is chosen as the reference market then load-following should not apply as given the danger of shortfalls in the supplier RO hedge, the additional money received if the load obligation is not load-following, would be needed to fill the potential shortfall.***
BGE is not in favour of additional performance incentives/ penalties for reasons outlined in the next answer and thus the concept of load-following in performance incentives is considered moot.

3.1.5 The requirement for, and design of additional performance incentives, including:

The RAs should not design the RO mechanism with a view to the RO attributes not working effectively. The RO is being implemented in tandem with DS3 and a balancing market. In BGE's view, these 3 markets shroud collectively ensure the availability of the correct volume, type and availability of capacity on the I-SEM system. **We do not believe that additional penalties are necessary believing instead that they will only add cost to customers**.

The proposal to introduce penalties presumes a market failure before the market is fully designed and implemented. Should it become apparent after experience of the RO in I-SEM that shortcomings are materialising, it is only at that stage that amendments to the pure RO should be made. The risk otherwise of incorporating many performance incentives into the mechanism may outweigh potential rewards given that it unnecessarily adds complexity, additional risk hedging considerations and increases costs which undermines investor confidence and complicates consumer pricing.

Should performance incentives still be considered, the additional risk they introduce which will be reflected in auction prices should be minimised insofar as possible and capped/ floored as relevant. BGE is not in favour of the RAs' proposal to treat different technologies differently in terms of performance incentives. If these incentives are adopted, the RAs must necessarily treat all technologies equally. The risk any unit poses to the system should be reflected in all relevant elements of the RO design so not to inadvertently appear to favour one technology type over another which raises state aid considerations.

3.1.6 Detail of any other considerations respondents feel should be taken into account when determining policy in relation to product design

4. Eligibility

At a high level, BGE submits that subject only to minimum standard de-rating factors per technology; there should be no restrictions on market participants that want to compete in the RO auction regardless of technology type or participation via an aggregator.

To restrict eligibility and competition would undermine:

a. the competitiveness of the RO auction which misses the opportunity to optimise the benefits of the new capacity procurement approach;
b. the EU requirement for non-discrimination between technologies, and;
c. the need to avoid the perception of state aid to certain technologies,

It is BGE's view that suitably strict pre-qualification requirements; transparent, objective and realistic technology based de-rating factors, and; the implicit penalty risks under RO contracts for those bidding into the RO auction (which should ensure realistic reliable capacity offers are made through the RO auction), should together suffice to provide comfort to the RAs as to the soundness of capacity committed in the RO auctions.

4.1 Eligibility Questions

4.1.1 Options presented in relation to the eligibility of plant supported through other mechanisms

BGE's preference is for Option 3 in the consultation: all market participants whether supported or not should be eligible to participate.

As outlined in the introduction to this section 4 of the response, BGE does not believe that it is appropriate to discriminate between plant supported or not supported or on a scheme by scheme basis. All technology types regardless of supports outside the RO mechanism should be entitled to bid into the auction if they see fit to and to the extent that they deliver reliability to the system and ultimately the customer.

Allowing all potential capacity providers to participate in the RO auction will eventually reduce reliance on out of market supports moving towards a more market based solution to capacity procurement for the ultimate benefit of the consumer.

From a consumer perspective, allowing participation by relevant participants should reduce the need for supports to neutralise their revenues were they excluded from the RO. Excluding those with RoCs in NI appears arbitrary and unfair whereas allowing their participation would enable them to take a commercial view on the extent to which they can participate and provide capacity thereby mitigating to an extent their potential loss of revenues given that their subsidy would not automatically increase to revenue-neutralise them akin to the RoI supports.

Regarding those in receipt of DS3 payments, it is anticipated that potential DS3 revenues would inherently be factored into RO auction bids helping the competitiveness of the RO auction price outcome, ensuring the right type of capacity is sufficiently rewarded, and reducing the risk of double payments by consumers. BGE emphasises the fact that the auction rules for both the DS3 auctions and RO auctions both need to be published well before either auction occurs so that parties can reflect their commercial efficiencies in each and thus ensure optimal outcomes in both mechanisms for the market and customer.

4.1.2 Options for eligibility of demand side and storage providers

BGE is in favour of option 1: DSUs do not receive an energy payment for foregone consumption (but continue to avoid paying energy payments due to reduced consumption), and are subject to the same RO paybacks and any physical performance incentives as others.

In terms of demand side units ("**DSUs**"), the treatment of DSUs should not change from their current treatment in terms of payments. Subjecting DSUs to RO payments and any incentives should be on a par with all other technologies to avoid the risk of discriminatory treatment and ensuring as level a competitive playing field as possible.

Storage and energy limited technologies should also be permitted to participate and exposed to the same paybacks and incentives as all other technologies. The de-rating factor and commercial decisions on risk exposure under the RO mechanism by relevant technologies will help ensure only sound bids for committing capacity are made by such technologies. Given the critical role of de-rating in the RO mechanism, the de-rating process should be open to consultation.

4.1.3 Technology vs. Plant specific approaches to de-rating

BGE strongly believes that de-rating should occur on a technology by technology basis as opposed to on a plant specific basis. That de-rating factor should act as a "minimum standard" below which standard no unit should be permitted to bid into the RO auction.

Determination of a de-rating standard on a technology, as opposed to plant by plant basis, is considered the most fair, objective and transparent method as it places all units of the same technology on an even footing provided the calculation used to measure the standard is explicit and consulted upon. A plant specific approach on the other hand introduces an element of subjectivity in the parameters used to determine an appropriate de-rating factor considering for e.g. that certain confidential information to the plant may not be revealed in calculations publically which is opaque and not conducive to a competitive market. A plant by plant approach also allows plant on the system of providing little benefit to capacity adequacy to maintain their status quo to the detriment of more efficient plant and customer costs. The centralised technology de-rating approach addresses market power, sets a standard that is deemed efficient for the market and in so doing contributes towards providing efficient entry and exit signals.

The de-rating factor should be a "minimum standard" which standard market participants must at least meet when bidding and committing MWs of capacity into the RO auction. This minimum standard per technology will drive technologies to be efficient and continuously invest in efficiency to maintain the standard and minimise its risk under the RO, which is positive not only for competition, reliability and consumer costs but from an exit signal perspective also.

Under no circumstances should a plant in a technology grouping be permitted to self-de-rate below the minimum standard; if the plant is unable to meet the standard and is not willing to invest to do so, it should rightly exit the market.

Consideration should however be given to the fact that there may be capacity providers voluntarily able and willing to offer capacity into the auction above the stated de-rating factor/ standard for their technology. Capacity providers willing to do so will make such decisions on an informed commercial basis, and given the exposure to the RO paybacks, the RAs can be confident that only the most efficient plant would take on such self "up-rating" risk. This provides comfort to the RAs in this regard but also incentivises increases in the efficiency of plant on the system to the benefit of adequacy, reliability and consumer costs.

This suggested minimum standard, with an "up rate" only option, approach would have the effect of encouraging continued investment in plants of a particular technology to ensure that they can meet the de-rating standard set for the technology which will overall contribute to a more efficient fleet of plant on the system and more reliable and competitive outcomes from a consumer perspective.

The approach also in BGE's view erodes the need for a plant by plant assessment – such individual assessment arguably discourages investment in maintaining and/ or improving plant capabilities which could ultimately lead to a need for new plant to replace them which will be a more costly outcome (than continued investment in existing plant) for the consumer.

Finally, this approach will mitigate potential gaming opportunities within portfolios where for example a lower percentage of capacity for a number of units could be offered in the RO auction with a view to maintaining capacity revenues for inefficient plant at a level that is just sufficient to stay open while not being exposed to a high number of payments for a high number of MWs. This risk would be to the detriment of other more efficient plants and would undermine the usefulness of the exit signal provided by the de-rating design aspect of the RO.

4.1.4 Historic, projection or hybrid approaches to de-rating

The setting of the de-rating standard should be based on historical availability within the technology in question.

A historical approach is and should be predictable from year to year as a reliable assessment of what a technology's actual capability should be. The assessment should be carried out over an appropriate period of years such that unexpected outages do not distort the de-rating factor for a particular technology.

Given the importance of this element of the RO mechanism, BGE strongly believes that further stakeholder engagement and consultation on the issue is required.

4.1.5 Grandfathering of de-rating factors

Regardless of the choice of the technology or plant-by-plant approach, de-rating factors should be grandfathered/ remain static for the duration of the RO contract in question with no option for a reducing profile. De-rating factors are minimum standards that should be achievable by all units of the technology regardless of the age. A static standard will incentivise continuous investment during a plant's lifetime whereas reducing it year on year would dis-incentivise investment to the detriment of maximising the usefulness of the mix of plant on the system or looking to enter the market.

4.1.6 Options presented with respect to non-firm generation

BGE is in favour of Option 1: non firm generators eligible to bid and subjected to the same de-rating factors as firm generators of the same technology. As stated in the introduction to this section 4 of this response, BGE believes that all efficient and capable generation should be permitted to participate in the RO auction should they so desire. As non-firm generators could help in certain situations of system stress and relieve the prices to the consumer by contributing to the RO hedge, they should not be

precluded from doing so in the same way that they are eligible to participate in the energy market. The RO auctions are expected to be held 3 to 4 years ahead of the capacity delivery year and not all generators bidding into that auction can expect to have full firm capacity confirmed at that early stage. Non-firm generators will make the decision themselves as to the cost of and their ability to enter RO auctions depending on their firm access and ability to be market scheduled during stress events. It is therefore likely that a non-firm generator will factor in the risk of non-firm access into their bids and that the RO auction will be priced accordingly balancing the increased risk associated with non-firm generation with the benefits of new and efficient market entry that can contribute to capacity adequacy.

4.1.7 Evidence an aggregator should be required to show physical backing

The major concern around the need to show physical backing is that all capacity providers (not just aggregators) will bid into the auction but when it comes to delivery, they will be unable to reliably deliver on their commitments to the detriment of security of supply and at a potential cost to the consumer.

This question and the following three questions are in BGE's view heavily related. BGE's full view on the evidence that should be provided by all capacity providers including aggregators is further discussed in answer 4.1.10 below. Provided all capacity providers submit appropriate pre-qualification evidence, to include evidence of physical backing, then the risk outlined at the beginning of this answer should be largely mitigated. It is crucial that the pitfalls seen in the GB 2014 capacity auction whereby despite strict credit risk requirements, certain plants cleared in the auction that it turns out may not be able to deliver, risking the capacity margin while simultaneously keeping other arguably more efficient plant out of the auction, which may increase capacity procurement costs must be avoided. Furthermore, new plants in GB were given lower thresholds of proof than older plants which did not help the situation that outturned so it is necessary that the same levels of proof apply to both new and old plant in the I-SEM's RO auction.

As well as the additional pre-qualification criteria outlined in answer 4.1.10 below, BGE agrees that PPA contracts should be shown by PPA aggregators as evidence of MWs of deliverability.

4.1.8 Maximum size of unit that can be bid into RO auction via an aggregator and what threshold should apply

BGE believes that there should be no maximum size of an aggregator but that there should be a maximum size of unit that can participate in the RO through an aggregator. The commercial market-based nature of the RO should be permitted to operate such that aggregators should be allowed to bid in whatever level of MWs they are commercially comfortable bidding into the RO auction in the context of the implicit exit signals/ performance incentives in the RO mechanism. Aggregators should also be subject to the same de-rating rules per technology as all other market participants. It is necessary that aggregator participants are capable of being measured and metered for their capacity contribution. It is critical that aggregation should be done on a technology by technology basis only, for transparency purposes as well as to avoid gaming and exploitation of portfolio benefits. E.g. wind should be aggregated separately to DSUs etc.

4.1.9 Minimum size below which a capacity provider may not bid directly into the RO auction and must bid via an aggregator and what threshold should apply

BGE believes that there does not need to be a minimum size that an aggregator should be or that there should be a minimum size of a unit that can participate through an aggregator. The commercial market-based nature of the RO should be permitted to operate such that aggregators should be allowed to bid in whatever level of MWs they are commercially comfortable bidding into the RO auction in the context of the implicit exit signals/ performance incentives in the RO mechanism. Aggregators should also be subject to the same de-rating rules per technology as all other market participants. It is necessary that aggregator participants are capable of being measured and metered for their capacity contribution.

4.1.10 What pre-qualification criteria should be applied?

It is critical that appropriate pre-qualification criteria apply to all RO capacity provider bidders, such that the situation in GB whereby capacity that may not now be able to deliver for the capacity obligation

period clears the auction. The following is a non-exhaustive list of what BGE believes should be required, from new and existing capacity bidders alike, in the pre-qualification stage:

a. contracts backing up the bidder's physical capacity capability (e.g. PPAs), (new and existing);
b. expert evidence/ confirmation of ability of a bidder to deliver MWs it seeks to bid into the RO auction (new plant); historic data to support bidders seeking to bid into the RO (existing plant);
c. business plans including planning permissions etc. to support a bidder's claim to operational reliability on time for the capacity delivery year (new plant);
d. Financial commitments e.g. bonds, parental guarantee, should be submitted in a way that ensures payments will be made even in cases of bankruptcy (ensuring priority creditor status for the RO auction administrator), (new and existing);
e. Implementation agreements are also required for new capacity – please see further discussion in answer 6.1.3 below.

Finally, the MW capability that market participants submit as part of their pre-qualification information should be monitored at RO auction time to ensure that RO auction bid volumes at least match the pre-qualification criteria. This is a role that in BGE's view could be carried out by the independent NEMO as the independent auction administrator. Institutional arrangements are discussed further under section 6 below.

4.1.11 Any other considerations respondents feel should be taken into account when determining policy in relation to eligibility

Regarding the discussion in the Consultation around mandatory vs. discretionary participation for eligible bidders, BGE believes that in the context particularly of market power abuse concerns, all existing generators should be mandated to participate in the auction. This will prevent unilateral discretion as to what capacity will be bid in by capacity providers which would be of most benefit to a large portfolio player who could unpredictably game their portfolio to maximise revenues from DS3, energy and capacity payments not necessarily in the interests of the consumer. Making participation mandatory also reduces the need for the CRM administrator to quantify and de-rate capacity not participating in the auction before deriving the demand curve for the auction simplifying their role and removing any subjectivity concerns in terms of plant de-rating. A comment is made in the paper that downward adjustment of the amount of capacity bought if a generator expected to contribute decided not to bid will be used for renewable generators that are ineligible or choose not to bid. BGE believes that the de-rating approach if carried out appropriately should erase the potential for any existing generator, including renewable generators, to have the option not to bid. If mandatory participation for existing participants is adopted, it should be mandatory for all technology types including renewables and DSUs, placing all market participants on a level competitive playing field. If it is evidently not commercial for a plant to succeed in a RO auction given its cost-recovery requirements, if such plants can justify their bids they should be permitted to bid as such and result in being outside the auction if that is the competitive outcome.

BGE's position is that participation should be mandatory for all existing generators. BGE requests confirmation that critical decisions as to who may and may not be mandated to participate in the auction is further consulted upon given the implications this can have in terms of market power abuse and importantly the price consumers pay for capacity provision.

If subsequent to the RO auction it materialises that certain committed plant will not be able to deliver, the RAs should retain the right to re-run the auction if it emerges that the gap left by the plant now unable to deliver can only be filled by plant that is under the same ownership as the initial plant that is failing to deliver. This is a market abuse concern and if the auction is not re-run, the plant able to fill the gap may be able to receive higher payments to the detriment of plant that may have bid in good faith to the earlier auction but not been able to obtain an RO contract (or obtained an RO contract but at a lower price than would have out-turned if it was known at auction time that some of the committed plant would not deliver).

Regarding the de-rating standard, BGE urges the RAs to consider that if a unit cannot meet a standard then this is an efficient exit signal and this aspect of the RO design should be maximised. However for efficient plants that can unexpectedly become unavailable (e.g. extreme unplanned outages), it is

critical that secondary trading is available in the market to ensure against disorderly exit of efficient plant to the overall detriment (cost) to the consumer.

Notwithstanding that interconnector issues will be dealt with in the second consultation later this year, BGE believes that particularly if interconnector participation occurs on an interconnector owner basis, that de-rating must reflect not only the risks to the interconnector's technical capacity but also the risk of coincident stress in the other market of interconnection.

5. Supplier Arrangements

5.1 Supplier Arrangements' Questions

5.1.1 Whether the recovery of CRM option fees from Suppliers should be on a flat, profiled, or focused basis?

BGE believes that a flat fee per MWh should apply/ be charged to suppliers. That flat fee should be calculated at the start of the year (i.e. when the results of the auction and amount of payments to be made to generators will be known) on a €/MWh aggregated forecast demand basis. This charge should then be applied to suppliers on a monthly basis in accordance with their consumption during that particular month which should also help to reduce resettlement volumes.

While there will be 12 monthly fees to be paid, the re-settlement to account for under/ over consumption by suppliers vs. their forecast consumption should occur at the end of the 12 months as opposed to re-settling each month which would be a more volatile outcome and potentially negatively impact on tariff setting.

This approach places all suppliers regardless of customer portfolio on a level playing field. It will also better enable predictability and hence stability in pricing/ tariffs as compared to a volatile profiled approach. BGE is strongly opposed to a profiled approach as this is ultimately targeted at residential customers, who do not have the ability to change their behaviour or react to price changes. It also penalises suppliers with residential heavy portfolios in favour of those with balanced wider customer portfolio, which in the main is the incumbent supplier, Electric Ireland. In BGE's view, the preferred flat fee approach will also mitigate the existing accruals issue seen in the SEM whereby delays in the publication of amounts payable each month require suppliers to estimate monthly accruals, which can lead to inaccuracies and cashflow issues.

In terms of payment of option fees to capacity providers successful in the RO auction, suppliers' charges should largely match capacity providers' receipts month on month (i.e. reflecting higher capacity payments to providers in months where higher consumption by suppliers is expected).

With regard to the options for passing back difference payments and incentive payments to suppliers, BGE favours those payments being passed back to suppliers in proportion to their demand at the time when the difference (and/ or incentive payments if applicable) arises. While there will be an element of complexity and validation difficulties with this, the option is fairest and logical and retains the value of the RO hedge and in so doing provides best protection for suppliers consuming during the peak periods when the spot exceeds the strike price. The other option could result in spikey payments in the month of refund which is difficult to predict and not conducive to stable tariffing.

BGE however requests stakeholder involvement in how the flat fee/ MWh is calculated and smoothed such that the predictability benefits noted above can be realised.

Finally, SEMO charges similar to now should continue for the administration and settlement of the RO. A single independent administrative body should insofar as possible be running all I-SEM markets as this will reduce the multiple bodies parties have to deal with (and reduces the burden and cost of administration).

5.1.2 *Whether the Supplier credit cover arrangements for the I-SEM CRM should be broadly similar to those under the SEM, and whether / what credit cover arrangement should be introduced for capacity providers?*

Suppliers' credit cover requirements should apply in a manner akin to the current capacity mechanism. BGE also agrees that capacity providers should provide credit cover given the exposure market participants face in case of non payment of RO payments or incentives by another participant. Credit cover should be provided in a method similar to how it is provided for SEM trading arrangements currently. The credit cover requirements should not however be prohibitive such that it negatively affects liquidity in the RO.

BGE urges continuance of the provision that generator and supplier credit risk can be netted off and this should apply across all markets – capacity, energy, ancillary services.

BGE would welcome early confirmation of how participants will be notified of credit cover requirements going forward and when they will be able to determine (e.g. via formulae) how much financial security will have to be posted considering capacity providers' risk is likely to be very volatile and difficult to forecast.

The SEMO market help desk is considered very useful and we urge its maintenance going forward into I-SEM. We would however like to see improved efficiencies in the downloading of credit cover requirement information from the All Island Markets website as the current digital certification and regular outages experienced render it quite cumbersome.

Finally, BGE requests that in light of the additional credit cover requirements required under I-SEM, consideration be given to the range of credit cover provision options available in the market such as letters of credit, parent company guarantees as well as cash collateral alternatives.

5.1.3 *Whether the costs of exchange rate variations (arising from differences in the €/£ exchange rate at the time capacity is procured and its subsequent delivery) should be borne by capacity providers or mutualised across the market?*

Based on BGE's understanding of how the exchange rate ("**FX**") risk is dealt with currently in the SEM energy trading arrangements (i.e. it is paid in one currency but the risk of FX is mutualised so all participants bear a portion of the risk), BGE seeks retention of that approach. Parties should however use best endeavours to minimise costs of FX risk.

6. Institutional Framework

BGE refers the RAs to its response to the I-SEM Roles and Responsibilities paper on 17th April this year. In that paper BGE highlighted its desire that synergies should be maximised wherever possible in terms of bodies designated to operate/ oversee elements of the market such as the RO mechanism. These synergies should not however be implemented at the cost of enabling conflicts of interest to impinge on competitive outcomes in the market ultimately to the consumer's detriment.

As the current market context is the likely starting point for designation of roles and responsibilities, BGE's core concern stems from the fact that the current market operator (SEMO); the on-island TSOs (EirGrid and SONI) as well as one of the two interconnector TSOs (EWIC) are all part of the same company group (EirGrid Plc). BGE submits that if the chosen MO remains in the ownership of EirGrid Plc, suitably robust ring-fencing arrangements should be adopted and consulted upon with market participants.

In terms of conflicts in the RO auction, given EirGrid Plc's ownership of the interconnectors and the proposal that interconnector owners will participate in the RO auctions, if SEMO is the designated NEMO, then all parameters and results will have to be subject to significant oversight to ensure justifiable bids and competitive outcomes occur. Market participants must have sufficient confidence in pricing and market outcomes for investor certainty reasons.

The conflicts, as expanded on in our April response, are also likely to arise in procurement of DS3 services in which interconnectors will be direct competitors to other market participants. The RAs have correctly noted that to optimise synergies the entity that runs the DS3 auctions should be the same as the entity running the RO auctions. BGE agrees with this and ultimately believes that, rather than this role falling on the TSOs, an expanded role for a NEMO exists. Undoubtedly the TSO will have a role to play in determining parameters and issues such as the capacity requirement and DS3 product volumes to be procured. However, BGE strongly believes and urges the RAs to consider that the administration of the RO should be carried out by a suitably independent and objective body. While the TSO is often the entity that runs auctions overseas, those markets tend to have stringent rules around the independence of the different roles, e.g. BETTA. This BGE view does not preclude that certain non-commercial synergies (e.g. shared I.T. services subject to certain access restrictions) could not still be optimised to the benefit of the consumer.

BGE is in agreement with the stated minded to position that the MO responsible for imbalance settlement will also be responsible for RO mechanism settlement.

In this context, BGE provides its views on the questions raised below.

6.1 Institutional Framework Questions

6.1.1 Are the outlined governance arrangements suitable for implementation of the I-SEM RO?

BGE agrees that governance arrangements are necessary to ensure that changes to the CRM terms and conditions allow changes only where absolutely necessary (e.g. to comply with evolving binding EU rules). The potential for these changes should be balanced against minimisation of such changes to establish long-term investor confidence insofar as possible.

According to figure 6-3 in the Consultation Paper, the TSOs will set the 'amount to auction' or the 'capacity requirement'. The Consultation Paper does however also reference that the TSOs are proposed to fulfil the role of the capacity market delivery body. As discussed in the introduction to this section BGE believes that the TSOs do have a central role to play in setting certain parameters, the capacity requirement being one of them. It is BGE's view however that, for investor and consumer confidence, the administration of the auction should be carried out by a suitably objective body, independent/ ring-fenced from the TSO. This body would in BGE's view also have a role in verifying TSO analysis including, importantly de-rating standards including for interconnectors, pre-qualification requirements, auction parameters and outcomes. In effect there should be no discretion left to the TSO and though they could play a role in parameter setting this should be subject to the oversight of an independent body. A similar approach applies in the GB capacity auction context whereby parameters such as auction and pre-qualification are reviewed by a panel of technical experts.

The remaining suggestions in terms of capacity market rules to cover prequalification and auction rules; capacity agreements and settlement contracts to cover price, rights and obligations of capacity commitments; and a Trading and Settlement Code document to cover capacity payment and charges rules, seem appropriate.

6.1.2 Which options for contractual arrangements are the most appropriate as assessed against criteria?

BGE favours the capacity agreement/ rules based model akin to the current CRM and GB auction model. This is in BGE's view open to less unpredictable subjective unilateral changes per participant which is better for investor confidence. It is less likely to raise concerns around subjective favouritism or discretion as between the treatment of market participants. It is also likely to be simplest and more timely to develop/ alter/ adapt to changing legal necessary requirements than either of the other two complex alternatives.

6.1.3 Are implementation agreements required for new entrants participating in the capacity auctions?

BGE is strongly in favour of implementation agreements for new entrants. This is related to the answers under section 4.1.7 and 4.1.10 above whereby appropriately strict pre-qualification criteria should be required from participants part of which should be a signed implementation agreement verifying the details the new entrant is committing to being able to provide in the RO auction. As outlined in those answers, the situation that arose in GB whereby new plant that committed in the auction may not now be ready on time for delivery and without adequate financial cover to cover the capacity margin risk this has introduced, must be avoided. The prequalification criteria for new plant should include such implementation agreements with a level of penalty exposure to dissuade non readiness.

7. Miscellaneous considerations

There are a number of other issues that do not quite fall within the realms of the Consultation Paper which BGE wishes to comment on. These issues are:

- **Auction timing**: auctions will need to have a sufficient lag period to enable new plant to effectively bid into the auction with a view to being ready to deliver during the capacity obligation year in question. While BGE is sure that the RAs will take every care to ensure that the situation that arose in GB whereby committed new capacity may not in fact be built on time, will not occur, provisions must be made to cover contingencies in capacity gaps.
- **Closure conditions**: A potential gaming risk that could arise through the RO pre-qualification process is that plant that stays outside the RO auction on foot of submitting pre-qualification information stating that they will be closing before the commencement of the capacity obligation year, may not in fact close as stated. If that is the case, that plant should be prohibited from participating in subsequent RO auctions.
- **Secondary market trading**: while the RO is a useful exit signal mechanism, BGE cannot overemphasise the need for liquid secondary trading opportunities. For example, plants will need to carry out maintenance from time to time. For scheduled and forced outages it is critical that a deep, liquid secondary market exists to allow efficient plant trade out RO obligations where necessary.
  It is very possible that this market will be highly concentrated given that only large portfolio players with plant that may not be successful in the RO auction are likely to have the capacity to offer trades in the secondary market. BGE urges the RAs to consider stringent market power measures to control prices here. Furthermore, in times of low secondary market liquidity for example, the RAs might consider “pausing” RO obligations during periods of approved maintenance where both sides agreed to temporarily suspend RO obligations.

8. Summary and Conclusion

In conclusion, BGE believes that the new RO mechanism is an excellent opportunity to correct the failing of the current mechanism in not providing exit signals. The RO should not be designed at this early stage with the view that it will fail in its objectives and thus it is too early to consider additional performance incentives beyond those implicit in the RO, such as an administered price or explicit penalties particularly in light of the different market characteristics of I-SEM compared to US markets. An orderly exit of the correct plant is however required such that a plethora of exit signals do not ultimately result in efficient plant also exiting the market with a subsequent potential cost of new entry to the consumer. BGE believes that the delineation between adequacy and flexibility must continue to be respected and that the correct design of the RO mechanism can help ensure reliable plant while not undermining the incentives being dealt with under DS3 and to be provided through BM signals. In summary, BGE’s views on the key various issues raised in this consultation are:

1. Capacity requirement:

   a. The LoLE standard should be reduced from 8 hours to 3 hours. This: allows harmonisation with GB and France in line with EU requirements; better recognises the small island, low interconnected nature of I-SEM which with high renewables will be increasingly likely to be at risk of not meeting demand in peak periods; reflects analysis which shows that the benefits of the reduction greatly outweighs the potential costs of the added capacity requirement.

b. Capacity should be procured on an all-island basis as this: is in line with the expected energy market zone for the island and consistency in capacity and energy market zones is necessary if market distortions are to be avoided, and; best mitigates the potential exercise of market power;
c. Consultation on all aspects of the capacity requirement setting must occur including at least auction parameters, the demand curve and consideration of price floors at least on a transitionary basis.

2. Product design:

a. An indexed strike price, the reference unit for which should be a hypothetical BNE peaking/ marginal unit, should apply to annual contracts and long-term contracts alike. This: best mitigates peaker plant risk helping to ensure the capacity market contributes to achieving an appropriate balance of plant types enter through the capacity market; protects consumers provided sufficient liquidity exists in the forwards hedging market up to the strike price; is less unpredictable than basing the reference off the actual marginal unit which could change year on year. Regarding grandfathering of the reference unit, BGE has significant concerns around how long and short term contracts for capacity can be accounted for side by side. The treatment of grandfathering the unit for long and annual contracts: should ensure there is no discrepancy in the value/ benefit of the RO hedge for customers e.g. when different RO paybacks apply due to different simultaneous strike prices; should avoid administrative complexity in determining the RO paybacks to suppliers, and; should ensure inconsistent scarcity signals for different units of the same technology do not materialise. BETTA consideration of this issue may prove instructive for the RO design.
b. An administered scarcity price should not be adopted as this: pre-empts the failure of the RO, undermining the choice of this mechanism; adds additional complexity to capacity auction bids given the difficulty in forecasting administered scarcity periods and hence factoring in appropriate risk premiums with negative knock on effects on consumer pricing; risks the protection of the RO hedge for suppliers/ consumers; blurs the distinction between short term reserve shortage (the role of DS3 and the BM) and capacity shortages (the auspices of the RO); raises the potential for the exercise of market power given that the BM is a mandatory market which, if the scarcity price applies thereto, may incite market participants to inflate prices.
c. The market reference price for the RO should be the day ahead market. This: is conducive to DAM liquidity and cross border trading; best facilitates low complexity in hedging considering the DAM is the specified EU cross border transmission rights reference market and is the current market of choice for forwards SEM hedging; best ensures adequacy (a capacity mechanism objective) as opposed to flexibility (the role of DS3 and BM prices) ensuring those units contributing to adequacy at the DAM stage are eligible to participate and is more efficient as it mitigates their risk of needing to trade between the DAM and BM to manage price risk; does not dampen BM signals, which in tandem with DS3 revenues are key to attracting flexible capacity. It thus best enables the interaction of the energy, capacity and ancillary service workstreams such that an appropriate portfolio of adequacy and flexibility plant will exist. *From a supplier perspective however, this view is subject to appropriate market power and liquidity measures being adopted for the BM to ensure that BGE concerns around spikey BM prices driven by those in a position of market power, do not arise.*

3. Eligibility:

a. All market participants, regardless of whether they are in receipt of supports or not should be permitted to participate in the auction, subject to the same de-rating factors as others of their same technology and exposed to the implicit penalty exposure and obligations as all other participants ensuring a level playing field between all participants;
b. De-rating should apply on a technology by technology basis, based on historical data. Plant able and willing to self “up-rate” above the standard, should be permitted to do so. The de-rating standard should ensure continued investment by plant to at least maintain the standard which helps ensure maintenance of an efficient fleet or exit of inefficient plant in favour of entry of more efficient and economic plant in the medium-long term. The standard should be grandfathered for the duration of all contracts to ensure continued investment;

c. Participation should be mandatory for all existing plant which will reduce administration of setting the demand curve for the RO administrator as well as maximising liquidity and competition in the RO auction and help mitigate market power concerns;
d. It is critical that secondary trading arrangements are in place before the first RO capacity year commences to allow for e.g. for planned outages to be hedged. Market power in secondary trading is a serious concern for BGE given that the incumbent will likely be the sole or at least the main actor in this market and the RAs are urged to give considerable thought to mitigation of market price abuse in this respect.

4. Supplier arrangements: a flat €/MWh price, determined ex ante year ahead on foot of the RO auction clearing price should be deduced based on overall forecast annual demand and then paid for on a monthly basis by each supplier in accordance with their consumption in that month. Profiled payments should not be considered as these weigh heavily against residential heavy suppliers in favour of those with more balanced portfolios or with more SME, I&C customers. The costs thereof would ultimately fall on a smaller portion of the consumer market that do not have the ability to change their behaviour or react to price changes and drive up prices for those consumers contrary to consumer interests. Credit cover arrangements should apply to suppliers and capacity providers alike akin to the current process in SEM energy arrangements. FX risk should be mutualised.

5. Institutional arrangements: BGE has significant concerns around the impartiality of the TSO in the SEM/ I-SEM and believes that while the TSO has a role in parameter inputs, these should be subject to independent oversight. Furthermore, the administration of all markets need not be the responsibility of the TSO and an independent entity should carry out this role including administration and settlement of the RO mechanism. That is not to say that synergies cannot still be realised and BGE is in favour of shared services such as in the areas of I.T. subject to permissions, provided independence between market operator, TSO and interconnector operator/ owners is guaranteed.

I hope that you find the above suggestions and comments helpful and should you have any queries thereon please do not hesitate to contact me.

Yours sincerely,

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Julie-Anne Hannon
Regulatory Affairs – Commercial
Bord Gáis Energy

{By email}