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RE: I-SEM Capacity Remuneration Mechanism, Detailed Design, 2nd Consultation, SEM-15-014

Dear Natalie, Thomas,

1. Introduction and Summary

Bord Gáis Energy (“**BGE**”) welcomes this opportunity to respond to this second Consultation on the I-SEM Capacity Remuneration Mechanism (“**the Consultation**”).

In light of the current role of the capacity remuneration mechanism (“**CRM**”) in SEM as one of the three key revenue streams for market participants, BGE is keen to ensure that the design decisions made pursuant to this consultation do not undermine the general objective of CRMs in ensuring capacity adequacy for long term security of supply that balances maintaining efficient existing capacity with providing signals for entry of efficient new capacity. BGE is also cognisant of the need for decisions herein to meet the objective of the Reliability Option (“**RO**”) element and ensure that reliable (existing or new) capacity will be available particularly in times of scarcity. In this context, our high level views on each of the Consultation topics are as follows:

- i. BGE is in favour of a derivative of the Provider-Led approach to enabling cross border participation of capacity in the I-SEM RO mechanism. Compared to the Consultation approach, our preferred approach: better meets the EU vision of enduring participation of cross border capacity providers in EU wide CRMs, with providers directly taking on obligations and receiving payments on a level playing field with I-SEM capacity; is less complex and costly in its settlement; is less likely to interfere with FTR objectives and their value as hedging instruments. The preferred solution also better protects the consumer from hole in the hedge exposures likely to arise under IC-led approaches and offers efficient entry and exit signals for non I-SEM and I-SEM capacity providers alike;
- ii. The importance of a central secondary trading platform at I-SEM go live through which all physical secondary trades must occur cannot be underestimated. The platform should maximise liquidity, enabling direct and back to back trading in standard and custom products. Consideration of market power mitigation is necessary as discussed in section 3 below. If the platform is not ready at go live we urge the RAs to consider exemptions from difference payments until it is ready, otherwise consumers will over pay for capacity through higher auction fees. The platform is likely to become one of the most important sources of RO risk hedging mechanisms for I-SEM CRM participants. This will reduce the cost of the risk of RO exposures being incorporated into RO auction bids, and thus reduce the cost of capacity paid for by consumers. The availability of such a hedging mechanism will particularly help smaller non-portfolio players and assist in providing appropriate entry signals for reliable capacity;
- iii. In sections 4 and 5 we determine that it is premature to define a final methodology at this point for issues including in particular stop loss limits, performance bonds and enduring Full Administered Scarcity Price (“**ASP**”) levels. A holistic view of the potential application of stop loss limits (taking into account the capacity year, annual limits, monthly/ event limit interactions) is necessary in order to balance RO risks with the hole in the hedge, as a decision on one element cannot or should not be made in isolation from another. Absolute definitions of milestones must be ascertained before deciding on termination triggers and calculation of performance bonds will necessarily require quantitative insight of potential CRM auction outcomes. A stable Full ASP (“**FASP**”) for investment signals on a transition basis should apply with a decision on whether a higher enduring FASP should apply only being made based on quantitative assessment of the performance of the ASP

concept over the transition period. Decisions on the detailed design of the RO contract and the ASP must bear in mind the importance of providing a basis for predictable and stable investment signals. CRM investors exposed to volatility in the setting of parameters in the CRM be they stop loss limits, milestones, penalties/ bonds or varying ASPs will factor this risk into RO auction bids or could view such volatility as a barrier to entry, to the detriment of CRM and RO objectives and ultimately at cost to consumers. These decisions are equally important from “new”, “refurbished/ upgraded” and “existing” capacity perspectives;

- iv. Finally, in section 6 BGE advocates a block approach to auctioning for capacity in the transition period to avoid boom-bust investment cycles and enable stable pricing and long term consumer contracts. These transitional arrangements are important for existing and new capacity alike. The RAs in the I-SEM High Level Design decision committed to a CRM taking into account the missing money issue. BGE believes that a transition arrangement whereby predictable capacity payments are ascertainable for both existing and new capacity must be permitted. Otherwise drawbacks, (in light of for e.g. the “lumpy” nature of I-SEM’s generation), such as boom-bust investment will manifest to the detriment of the consumer.

2. Interconnector and Cross Border Capacity

BGE is in favour of permitting cross border capacity that is capable of contributing reliable physical capacity for the benefit of I-SEM consumers, to participate in the RO mechanism. There are a number of considerations to take into account in determining the appropriate approach to facilitating cross border participation including:

- EU considerations: the Consultation notes that pursuant to state aid considerations cross border participation should be permitted where “capacity can be physically provided to the Member State implementing the measure and the obligations set out in the measure can be enforced”. Another overarching principle of the EU internal market is that of non-discrimination between market participants across Europe such that competition is permitted on a level playing field. Thus overseas RO participants must be able to physically provide capacity into I-SEM and be subject to the RO difference payments and be treated on as equal a basis as I-SEM capacity as possible;
- The objective of a Capacity Remuneration Mechanism (“CRM”), to ensure long term security of supply;
- The time specific role of a Reliability Option (“RO”), to ensure delivery of physical capacity in capacity critical/ scarcity periods;
- The central role of Interconnectors (“ICs”) in facilitating and maximising availability on ICs for efficient cross-border flows and security of supply benefits;
- From a consumer perspective: the necessity of minimising the potential risk of a growing ‘hole in the hedge’ and mitigating this risk where it does arise; the need to respect the CRM high level decision that capacity providers will be physically backed; and, that I-SEM customers only pay for reliable capacity to I-SEM;
- Assurance of efficient exit of plant from I-SEM simultaneously with appropriate entry signals for more reliable plant.

In this context, BGE puts forward the below views in response to each Consultation question raised.

2.1 Interconnector and Cross Border Capacity Consultation Questions

A. Which of the approaches to the treatment of cross border capacity do you prefer and why? (For the Provider Led and Interconnector Led approach, please specify whether you prefer the “Performance based” or “Availability Based” variant).

BGE’s preferred approach to the treatment of cross border capacity is a derivative of the performance based “Provider Led” option. As noted in the introduction to this section, BGE is eager that consumers pay only for capacity that contributes reliable capacity. In this context and considering the need for cross border participants to be treated on a level playing field as I-SEM participants, BGE supports a ‘performance’ based as opposed to ‘availability’ based assessment of RO capacity adequacy.

The proposed operation of BGE's preferred approach and rationale therefor is outlined below:

- Cross-border participants enter the RO auction only if physically backed;
- Cross-border participants' capacity is de-rated by the same I-SEM technology based de-rating factors;
- The same strike price and same obligations to make difference payments when I-SEM spot price exceeds I-SEM RO strike price, would apply to non I-SEM capacity providers as I-SEM capacity providers;
- The non I-SEM capacity provider takes on the risk of any network or interconnector losses that may arise between the delivery of capacity from its unit, into the I-SEM market;
- If successful in the RO auction, the non I-SEM capacity provider receives the I-SEM clearing price for its capacity;
- In settlement, a performance based approach would apply. For reasons noted under answer D below BGE does not agree with measuring day-ahead capacity contributions based on FTR holdings however. Instead a settlement approach that allocates IC volumes to non-I-SEM capacity providers based on their proportionate pro-rata share of RO contract volumes on the IC is preferable. This settlement approach would apply regardless of the availability of the GB capacity provider or the IC itself. BGE however submits that given the exposure under a split market approach (for RO difference payments) and the potential difficulties in hedging same, further consideration to the risk of split exposure and its management should be given in the CRM rules development stage.

The benefits of BGE's favoured approach include for example:

- In line with internal energy market objectives, it allows competition in the I-SEM RO from non I-SEM capacity providers on as level a playing field as possible, with for e.g. equal application of physical backing requirements and technology rating factors. Moreover, placing the obligation to make difference payments as they arise and putting the task of factoring in transmission losses on non I-SEM capacity providers levels the playing field with I-SEM capacity providers who must themselves take account of outage planning and potential transmission failures on the island when assessing their potential contribution to RO obligations;
- As envisaged by EU state aid guidelines, this performance based derivative of the Provider approach, will ensure that only capacity physically able to contribute to I-SEM needs and in a way in which the obligations under the RO can be enforced, will participate in the RO to the benefit of I-SEM consumers in terms of security of supply at critical times;
- While ICs do not have a central role in BGE's preferred approach, their role in security of supply and maximising availability should be predominantly incentivised due to the obligation to pay FTR holders congestion revenues and indeed also by their ability to earn congestion revenues on non-FTR-allocated IC capacity. The approach also avoids placing risk on the IC owner of difference payments that it may not be able to hedge against, which risk would ultimately be borne by the consumer. The IC owner may also potentially earn additional FTR revenues if cross-border capacity participation seeks to hedge spot market risk through the use of FTRs, the right to which cross border capacity would pay a premium for;
- Requiring non I-SEM capacity providers to make difference payments when the I-SEM RO strike price exceeds the relevant market's spot price mitigates the hole in the hedge risk to consumers, thereby valuing this important consumer protection element of the RO mechanism;
- Efficient exit and entry signals: this approach should attract only the most reliable cross-border capacity in line with RO objectives which should avoid understating the capacity needed from on-island I-SEM parties reducing the risk of under procurement (and exposure to the hole in the hedge) to suppliers and consumers alike. The option also provides efficient entry and exit signals for capacity whether on island or cross border;
- In terms of simplicity, this approach avoids the complexity and cost of monitoring meters in other jurisdictions and may form part of an enduring EU CRM solution.

BGE believes that this derivative performance-based Provider-Led approach is on a whole more attractive than the option outlined in the consultation. It for example deals with certain of the Consultation outlined approach's drawbacks as explained further under answer E below. BGE does not support the "net off demand" approach particularly as it lacks an incentive for the IC to maintain

availability and support long term security of supply and raises questions around compliance with potential state aid obligations. The net off demand approach should therefore be discounted.

BGE views on the IC led, FTR led and Provider led approaches, none of which we support as drafted in the Consultation, are outlined in our answers below.

B. Should the de-rating of interconnectors be based on historic performance, or include forward modelling to project how its performance could change in the future?

The de-rating of the IC should be performance based rather than availability based and assessed based purely on forward modelling of future flows. Changes for example in carbon prices, capacity market outcomes and generation build out including increasing wind levels could affect flows significantly. These may lead to results very different from traditional IC flows based on historical inputs.

BGE supports the RAs leading this IC de rating issue and given the concerns around conflicts of interest in EirGrid Group, urges prudence and transparency in assessing the real potential contribution of the ICs to reliability at times of scarcity.

C. If there is a preference for the “Interconnector led performance based” approach there will be a need to allocate total interconnector flows between specific interconnectors. Which of the specific approaches set out in 2.4.6 do you prefer? These approaches were:

- **Balance interconnector utilisation;**
- **Pro-rata to interconnector metered flow; and**
- **Complex power flow modelling**

BGE is not in favour of either of the IC led approach – despite its current use in GB, it is not considered a long term or enduring solution to security of supply reliability for I-SEM and should be discounted.

The availability based IC approach discriminates in treatment between ICs and on-island capacity, does not contribute to long term security of supply needs particularly at times of scarcity, contributes to the exposure to the hole in the hedge for consumers and potentially puts the ICs in a better position to bid more competitively to other I-SEM RO capacity providers (given the lower risk they would face) which is discriminatory.

The approach in general does not support the EU’s agenda of providing entry/ exit signals for cross border capacity, merely providing only investment incentives for ICs. BGE’s proposed approach as outlined in answer A above better provides both entry and exit signals for non I-SEM capacity (e.g. the cost of cross border contributions to I-SEM margins will be decipherable from the I-SEM auction results). In doing so, our preferred approach as outlined in Answer A above better meets the objectives of security of supply and the EU’s vision on cross border participation in capacity mechanisms.

D. If there is a preference for the “FTR led” approach, which of the specific approaches set out in 2.4.15 (net or gross) do you prefer for the allocation of non-day-ahead flows?

BGE is not in favour of the FTR led approach and suggests that it be discounted at this point. We perceive difficulties in the effectiveness of its implementation given that RO auctions are due to be held T-4 yet the Joint Allocation Platform through which I-SEM FTRs are anticipated to be allocated, will only allocate FTRs for a maximum period of one year ahead. This would undermine capacity providers’ ability to mitigate RO risk and dis-incentivise their participation. It may also limit access for cross-border providers to RO auctions in T-1 which undermines the openness of the CRM to various technologies, and undermines long term security of supply – a central tenet of CRMs. Notwithstanding the role that FTRs will likely play in RO risk hedging regardless of the approach, explicitly tying participation in the RO to the holding of FTRs is not favourable or supported by BGE particularly in light of the two different roles of these mechanisms.

Critically, the FTR approach fails the need for RO participants to be able to react to scarcity signals. Scarcity is most likely to arise more often in the intraday and balancing markets, and this approach presumes that sufficient reliability indicators will occur at the DAM stage.

Ultimately, BGE does not believe that FTRs are an efficient avenue of allocation in whole or in part, for settlement purposes for any of the DA, IDM or BM windows. We urge the RAs to keep FTRs and RO contracts and processes separate to avoid undermining their respective roles. The FTR led option should be discounted.

E. If there is a preference for the “Performance based Provider Led” approach, which of the specific approaches set out in 2.4.25 do you prefer for the allocation of intra-day and balancing market trades?

- **As traded**
- **Pro rata to Reliability Option (in which case – do you prefer “gross” or “net”)**
- **Ignore – all in Balancing Market**

BGE’s preferred approach as outlined in Answer A of this section is a derivative of the Consultation’s Provider Led approach. The Provider Led approach outlined in the Consultation however has certain drawbacks, which BGE’s preferred approach deals with, including:

- the administrative complexity and cost (which will fall back on the consumer) of accessing and measuring metered flows in other jurisdictions which could actually result in the burden and costs of the approach outweighing its benefits as compared to other approaches, and in particular BGE’s preferred approach outlined in answer A above. BGE’s preferred approach does not require access to meters or costly IT systems for such as settlement is to be based on RO contract volumes held which information is in the hands of the IC owners from completion of the RO auction;
- allocation of DA flows based on FTR holdings – as discussed further in answer D above this is not favourable from a cross border hedging liquidity or cost perspective and dilutes the role of FTRs particularly when the on-island liquidity options, and their potential success, are unknown. While we recognise that FTRs will have a role to play in mitigating cross border parties’ RO risks in a spilt market, our preferred approach’s allocation based on RO volumes held as opposed to FTR volumes held avoids the risk of undermining the respective roles and value in risk-hedging, of the FTR and CRM mechanisms respectively;
- difficulties in allocating flows on an ID or BM basis and the additional complexity that may arise by using different allocation methods as compared to the DA. Due to the split market exposure and potential difficulties in hedging IDM, and BM exposure additional consideration in the rules phase is required to achieve a balanced settlement allocation approach across all timeframes.

These complexities undermine the state aid considerations of ensuring obligations under the CRM in question can be enforced, questioning the long term sustainability of the approach and as a long term investment signal for efficient exit and entry of reliable capacity.

F. If there is a preference for the “Hybrid” approach:

- **Should this be paired with the “Delivery Based” or “Availability Based” provider led approach?**
- **Should Interconnector participation be mandated or voluntary?**

BGE answers both of these questions together. BGE is not in favour of the Hybrid approach and suggests that it is discounted at this point.

BGE’s main concern with this approach is the potential unmitigated level of exposure to RO difference payments that may be paid for by the consumer.

The ICs’ role in security of supply and maximising availability should be predominantly incentivised due to the obligation to pay FTR holders congestion revenues and indeed also by their ability to earn congestion revenues on non-FTR-allocated IC capacity. The likely reliance for day-ahead price

mitigation on FTRs by cross border participants should also enhance the revenue stream from FTRs for ICs.

Finally, BGE notes that the IC led and hybrid approaches raise issues around conflicts of interest in EirGrid group between EWIC and the CRM operator. We request confirmation that these issues will be addressed to the satisfaction of industry and request clarity as to when we might expect consultation thereon?

3. Secondary Trading

BGE strongly supports a secondary trading market in I-SEM ROs. It will enable RO holders to trade out risks of exposures to difference payments particularly at times of outages. This avenue of risk management should result in less risk being bid into the RO auctions keeping costs of capacity down for consumers and reflecting the true costs of reliability in their market, contributing to the provision of efficient entry and exit signals. BGE submits however that the RAs take into account the following considerations when designing the secondary trading market:

- the overarching need for parties to be able to hedge CRM risk, otherwise consumers suffer through paying for higher RO auction prices that factor in high levels of risk;
- in line with the above, the need for this platform for risk mitigation to be available from I-SEM go-live – otherwise consideration may need to be given to exemptions from RO paybacks;
- the need for transparency in what entity is trading what RO obligations and at what times;
- the need to maximise liquidity;
- market power control/ mitigation measures on entities considered to be in a position of dominance in terms of secondary trading volumes and pricing control;
- Unit by unit trading.

In this context, BGE puts forward its views on each of the respective questions as outlined below.

3.1 Secondary Trading Consultation Questions

A. Do respondents agree that direct secondary trading of Reliability Options should be permitted?

BGE agrees that at a minimum direct secondary trading of ROs should be permitted. Direct secondary trading will be particularly helpful for managing RO exposure for plants with RO contracts facing long term or even planned short term outages. However, we believe that the “back to back” trading option, while riskier for the buyer given the reliance on the trading decisions of the original RO holder, should also remain an option (e.g. as an alternative ‘product’) on an RO secondary trading platform.

While the back to back model is riskier for both the original and transferee RO holder, this option would be particularly useful for short term unplanned outages/ trips.

Allowing both options maximises the liquidity of secondary trade opportunities, which in turn will reduce prices paid by consumers.

B. Should secondary trading of Reliability Options be via an organised secondary platform? If so, which one of the options is preferred?

It is a critical element of the secondary trading opportunity that all secondary trading of physical obligations occurs on an organised transparent central platform.

BGE urges the RAs to apply a similar philosophy to the design of the secondary trading market, as has been applied to the design of the key physical trading markets of I-SEM. This implies that exclusive central trading of physical capacity with no right for bilateral trades, should apply. We believe that similar concerns of potential abuse of market power arise in the secondary trading market as could do in any of the energy trading markets. On this basis we submit that a centralised market for secondary trading through which all physical secondary trading exclusively occurs, is adopted in I-SEM. This will

maximise the liquidity of this important hedging mechanism, maintain transparency in a dynamic market and should go some way towards mitigating the exercise of market power. The mandatory element should provide useful benchmarks for monitoring market power.

The platform should be available to enable the trade out of risk shortly after completion of the first RO auction. While timelines are tight, BGE believes that a simple platform, at least initially, could be used (e.g. a trading screen but capable of being regulated and catering for collateral needs and extremely transparent). Synergies with other platform types required for I-SEM operation could provide an avenue for compliance. The lack of availability of a platform at this early stage could result in increased risk premiums feeding into RO auction bids ultimately to the consumer detriment. If it is not available for I-SEM go live BGE urges the RAs to consider applying exemptions from RO difference payments until it is live, particularly from a consumer protection perspective.

An organised secondary trading platform, through which all physical trading is mandated should also greatly assist new entry of non-portfolio players to the market.

Finally, consideration should also be given to the increasingly administrative reporting obligations such as under REMIT and EMIR legislation and the role the platform can play in reducing this burden by providing options for direct reporting of platform trades on behalf of market participants.

C. Do respondents believe that “back-to-back” trading to lay-off exposure to difference payments should be permitted?

Yes, secondary trading options should allow for both direct and back to back trading opportunities. As outlined in answer A of this section above, BGE sees no reason why both should not be offered on the platform.

D. With respect to the creation of a centralised Reliability Option secondary market platform:

I. Is there likely to be sufficient demand for secondary trading to justify the cost of the development of a centrally organised platform;

Yes. BGE believes that aside from financial hedging of exposure to difference payments under the RO (for which liquidity is anticipated to be minimal), market participants will have a significant desire for access to a secondary trading platform. This avenue of hedging the risk of ROs is likely to be the main one and should be facilitated by the RAs insofar as possible given the benefits to smaller non-portfolio players that should be better able to support business cases. Benefits for the consumer should also manifest through for example a reduced RO clearing price compared to the price that might appear were no organised, regulated liquidity secondary trading market to manage risk available.

II. Do respondents think that capacity providers should be allowed to acquire Reliability Option volume in excess of their de-rated capacity (plus the tolerance margin), and if yes, how the limit on Reliability Option volume for the net primary and secondary volume should be structured?

Yes. BGE believes that all capacity providers should be allowed to acquire RO volumes in excess of their derated capacity plus a tolerance margin as it will have a key role to play in maximising liquidity on the secondary trading platform. Given the size of the I-SEM and the anticipated limited interaction of financial players in the secondary traded market for ROs, the liquidity of this market will be heavily dependent on capacity providers that did not obtain an RO contract in either of the T-4 or T-1 auctions, as well as on capacity providers that are confident in their ability to deliver on RO obligations above their de-rated capacity value.

Secondary trading participants should be permitted to trade up to their nameplate capacity in most cases. While de-rating of capacity is critical in the primary RO auctions given its key role in providing an exit signal for capacity that is not sufficiently efficient or reliable, we do not believe that strict de-rating need necessarily apply in the secondary market. Adopting this approach for the secondary market enables capacity providers to capitalise on efficiency. Protection against providers overstating reliability should exist by virtue of the RO payback exposure which should instil prudence in secondary market

traders, and by virtue of collateral requirements in the secondary market. From a market power perspective, consideration may need to be given, for providers in a position of market power, to relaxing de-rated factors on a gradual basis as one gets closer to real time delivery.

Finally, it is a precursor to RO secondary trading that any participant must necessarily have entered and been successful in the pre-qualification process in T-1 and/ or T-4 capacity auction preceding the date of secondary trade.

III. What limits should be placed on secondary trading timeframes, including: the timing of secondary trade execution - how soon after the auction should they be allowed, and how late in relation to real time delivery should they be allowed; and the length of the Reliability Option contract which can be traded?

Timelines

BGE believes that the ability to secondary trade RO contract risks should be available from as close to the outcome of the first T-4 auction as possible. While it might appear contradictory to apply de-rating factors in the main RO auctions with a relaxation of factors in secondary trading, the reasons for both are different as outlined in answer II immediately above. In primary auctions, de-rating factors play a key role in providing exit signals. In secondary trading, participants should be permitted to capitalise on their efficiency and reliability insofar as they can prudently manage that.

In practice, capacity providers e.g. generators, are made aware of planned outage schedules agreed with the TSOs several months in advance. It is a benefit to both generators and consumers to allow trading as early as possible post auction so that the costs of risks can be mitigated as early as possible. Similarly there are benefits from an unplanned outage/ trip perspective to allowing secondary trades to occur as close to real day delivery as administratively possible. 5 weeks as an RO secondary trade length as suggested in GB is the least that should be permitted as for example it is questionable as to whether this is a sufficient length of time for units that are transferring obligations pre-commissioning? Should a longer RO contract period be permitted for these units, they should be permitted for all units as in our view this would best enable a level a playing field of competition as possible to develop. The simpler the centralised platform, the more achievable these timelines are.

Products

In terms of the use of standard and custom products on the platform, BGE supports the availability of both types of products. Provided the platform is transparent and RA monitored, the ability of market power abuse to occur should be limited. Notwithstanding the evident benefit of liquidity and competition of standard products, given their narrow remit (e.g. may not always match desire outage lengths), allowing only for standard products could in fact result in a more costly solution for generators seeking to cover outages which in turn will feed into the RO auction price paid ultimately by consumers. The concerns that custom products could impact liquidity and competition and benefit large portfolio players could be mitigated by appropriate market power arrangements including for e.g. 1) regulators have access to who is trading on it and offering what products to whom and at what price; 2) some limitations could perhaps be placed on the volumes a participant with market power can trade within its portfolio or a requirement to offer it for a certain length of time on the public screens, to protect smaller suppliers.

BGE is in favour of allowing plants that are not yet commissioned, to trade their RO contracts as it may reduce the sharpness of T-1 auction prices in favour of consumers. We however seek confirmation that such plants will not be exonerated from any milestone penalties that may arise? Otherwise the incentive to deliver and contribute to security of supply will be severely undermined as will exit and entry signals for efficient reliable capacity.

We are also in favour of permitting secondary trading after the physical delivery of electricity, through the central platform.

IV. Should the Capacity Market Delivery Body maintain the processes and capability to undertake pre-qualification throughout the year, and what service standards are required for processing new applications?

Pre-qualification standards for T-4, T-1 and secondary trades should be on a par. BGE is however open to a more regular pre-qualification process outside T-4, T-1 auctions provided the standards to be passed are not relaxed as compared to the process original RO holders went through, otherwise consumers may not receive the true value of the product for which they originally paid.

V. Should a secondary acquirer of a Reliability Option start from a zero position against each “stop-loss” limit, or should the loss transfer?

BGE supports the application of stop-loss limits for both original and transferee RO holders. There should be no overlap in the volume of the stop loss limit as between the original RO holder and the transferee to ensure double application of limits is avoided.

BGE believes that it is premature to decide on the value of the stop loss limit that transfers to secondary RO holders, without first understanding the actual RO year that will apply, the breadth of stop loss limits beyond annual that will be permitted and their potential impacts.

BGE discusses the stop loss issues in section 4 below, under answers D-G. We submit that once the issues noted therein have been dealt with, a decision on whether or not the loss will transfer should be based on the need to maximise liquidity in the secondary market, ensure transparency and administrative simplicity as far as possible. The solution must also not frustrate the hedge protection for consumers.

4. Detailed Reliability Option Design

4.1 Detailed Reliability Option Design Consultation Questions

❖ Reliability option contract length questions

A. Principle of Longer Term Reliability Options:

I. Do respondents agree that plant requiring significant investment should be able to avail of longer term Reliability Options?

BGE agrees that plant undertaking significant investment should be permitted to elect for longer term ROs. Given the portfolio of generation on the Irish system, there is a need for exit signals but also appropriate entry signals (that fit with the objective of the RO element of the CRM) for both new and upgraded plant. Access for new/ upgraded plant to contracts longer than one year to support business cases and facilitate financing will have a key role to play in supporting entry signals. This view is however subject to the level of investment undertaken by refurbished/ upgraded plants as discussed further under answer B below.

II. Do respondents agree that existing plant should be restricted to reliability options with a term of 1 year?

BGE believes that the length of contracts granted to existing plants should be in line with DS3 contract lengths. Alignment will assist business cases for investment. A shorter contract length for existing plant than for new or refurbished plant supports efficient exit signals for older inefficient plant.

III. Do respondents believe that longer term Reliability Options should only be available to new-build plant, or should also be available to existing plant where significant investment is being made to enhance or maintain its capability to provide capacity?

New build plant should be permitted to elect for a longer term RO contract. Existing plant undertaking significant investment and that qualifies under the category of refurbished/ upgraded plant through the

process discussed in answer B below should also be permitted to support their financial arrangements with longer term contracts.

B. Classification of plant as new, upgrade or existing

I. Do respondents have a view on which approach should be used to classify capacity providers as “new”, “upgrade” or “existing”?

II. Do respondents prefer the approach of classifying providers as “new”, “upgrade” or “existing”, please indicate your view of the criteria, evidence and thresholds that should be used to inform this classification.

BGE answers both of the above questions together.

BGE believes that it is appropriate to distinguish between “new” “upgraded/ refurbished” and “existing” plant. A balance must however be achieved between incentivising new entry, minimising technology lock-in and minimising the costs of obtaining the correct balance of capacity on the Irish system to ensure that future efficient investments are made. The delineation between each category in terms of definition and capital investment thresholds must be clear, transparent and predictable such that stable investment signals are provided through the CRM/ RO mechanism.

BGE believes that a plant bidding to contribute new MWs of capacity to reliability margins should be considered “new”, provided it is not physically operating at the time of the auction in question.

To define a plant as “upgraded” or “refurbished”, a plant should be in a position to demonstrate the MW additional contribution to reliability margins and financial commitments made, relative to a business-as-usual counterfactual. This process must necessarily be open, transparent and carried out on a case-by-case basis.

Plants that are physically operating at the time of the auction in question should be categorised as “existing”.

BGE’s views on the information to use in such classification outlined in the Consultation are:

- “cost threshold”: informing a decision on the status of a plant based on the spend per MW above a pre-defined threshold appears reasonable, simple and transparent. It is not however sufficient to classify on this basis alone and further information to confirm status is necessary;
- “tangible facts”: there is merit in using tangible facts in determining classification to demonstrate for example tangible reliability improvements beyond basic standards and beyond what was already being provided by a plant in question;
- “expert judgement”: given the subjective nature of this criterion BGE sees a limited role for this in deciding on the category of a plant.

The process used to classify between these three categories should be objective, transparent and predictable such that potential subjectivity is avoided.

C. Maximum available Reliability Option lengths

I. Do respondents have a view on the appropriate maximum Reliability Option lengths that should be available to new-build and upgraded plant?

In the interests of achieving the objectives of both security of supply (CRM) and reliability of supply during scarcity (RO element) plus the need to achieve EU 2020 renewables targets (DS3), BGE believes that alignment of RO lengths with those for DS3 would be the optimum approach to contract length setting. New and retrofit build business cases would be bolstered by the ability to optimise (without double counting) revenues from two different revenue streams over similar time periods. The approach should also result in the optimum level of capacity and reserve being simultaneously procured (through separate processes) resulting in efficient outcomes from a supplier and consumer tariff perspective at least at I-SEM go-live.

To align with DS3, new capacity should have the option to elect for contracts with durations of up to 15 years. For refurbished plant, to also align with DS3, such plant should be permitted to elect for contracts of up to 15 years also. As discussed under answer B. I,II above such plant must prove their refurbished/ upgraded status.

II. How do respondents view the Reliability Option lengths in relation to the five generic frameworks set out in this section?

BGE agrees with the SEM Committee's view on the technology specific life/ technology specific balanced options in that they would inevitably lead to more administration for the RO operator and involve an element of subjectivity (particularly in the "balanced" option). These approaches also raise the risk of targeting particular technologies contrary to EU non-discrimination rules.

An economic life of 5 or 10 years is however unrealistic and falls significantly short of the true "generic economic life" of CCGTs for e.g. BGE believes that 15 years is the minimum length that a long term contract should be permitted for.

❖ Option Fee Indexation

BGE agrees with the need to index Option Fees to account for the value change between the times the RO auction clearing price was delivered until the delivery year when option fees commence being paid.

❖ Stop-loss limits questions

BGE emphasises the need to balance the risks and costs of the RO with the need to mitigate the manifestation of a hole in the hedge for suppliers. Stop loss limits have the capability of reducing perceived RO risks but by corollary could negatively impact consumers through hole in the hedge exposure. A careful balance therefore of the types and levels of stop loss limits to apply in I-SEM is needed.

Further, access to a secondary trading platform will play a critical role in reducing perceived RO risks, and in reducing RO auction option fees. As discussed in section 3.1 answer B above, if secondary trading is not available at I-SEM go live, consumers will face increased costs of capacity. The RAs are urged to consider this impact and consider that exemptions from making difference payment paybacks beyond stop loss limits may be necessary if the balance between capacity provider risk and increased CRM costs as well as hole in the hedge risk, is to be achieved.

In general however, BGE is amenable to annual stop loss limits and provided the secondary trading platform is ready at I-SEM go-live we believe exemptions beyond stop-limits should not be permitted, for e.g. for bespoke scenarios as they would further increase the suppliers' hole in the hedge.

D. Do respondents favour the I-SEM Capacity Year running from October to September, with annual stop loss limits applying over that I-SEM Capacity Year?

BGE does not believe that an informed decision on the three key elements that we see to be at the core of the issue of stop-loss limits can be made without further information and assessment from the RAs.

For example, the decision on what capacity year (Jan – Dec vs. Oct. – Sep.) will apply in the I-SEM CRM, will have a significant bearing on whether annual, monthly and/ or event limits are appropriate and how they should be defined. The solution needs to be based on a holistic view of all three elements (the calendar year, annual limits, event or month limits) to ensure a balanced outcome. The decision in BGE's view needs to strike the correct balance between mitigating the risk exposure and incidental costs of the RO as against the need to prevent a potentially unpredictable hole in the hedge exposure for suppliers and consumers alike. BGE urges the RAs to consider the need for more information and assessment before debating this issue further, taking a holistic view of the interactions between calendar year, annual limits, event or month limits and the different outcomes that might result depending on what decision is made under each of the three elements.

E. Do respondents believe that “per event/day” and “per month” limits are required in addition to the annual stop loss limit?

As discussed in answer D immediately above, BGE urges the RAs to further assess a holistic view of the interactions between calendar year, annual limits, event or month limits and the different outcomes that might result depending on what decision is made under each of the three elements. Further debate with industry based on such analysis is then requested with a view to achieving a balance between mitigating the risk exposure and incidental costs of the RO as against the need to prevent a potentially unpredictable hole in the hedge exposure for suppliers and consumers alike.

F. Which approach do respondents favour for the definition of the Per Day/event limit?

As discussed in answer D above, BGE urges the RAs to further assess a holistic view of the interactions between calendar year, annual limits, event or month limits and the different outcomes that might result depending on what decision is made under each of the three elements. Further debate with industry based on such analysis is then requested with a view to achieving a balance between mitigating the risk exposure and incidental costs of the RO as against the need to prevent a potentially unpredictable hole in the hedge exposure for suppliers and consumers alike.

G. Please provide views on the appropriate levels for the each of the proposed stop loss limits.

BGE urges the RAs to further assess a holistic view of the interactions between calendar year, annual limits, event or month limits and the different outcomes that might result depending on what decision is made under each of the three elements. Further debate with industry based on such analysis is then requested with a view to achieving a balance between mitigating the risk exposure and incidental costs of the RO as against the need to prevent a potentially unpredictable hole in the hedge exposure for suppliers and consumers alike. With regard to the levels in particular, the levels should achieve this balance and ultimately incentivise efficient running and reliability in line with the RO objectives.

❖ **Commissioning Window and Implementation Agreements questions**

H. Is a period of four years from the Auction Date to the start of the first Delivery Year appropriate?

BGE believes that a lag period of 4 years is reasonable particularly if stringent pre-qualification criteria that discourage speculative RO bidding applies and is enforced. A strict pre-qualification process and the lag period should encourage efficient entry signals and result in the correct capacity necessary for the RO mechanism. Alignment with DS3 should apply.

I. Does setting the Long Stop Date at 18 months after the start of the first Delivery Year strike the correct balance between the costs incurred by the market and the ability for delayed or longer-running capacity projects to be completed?

Provided stringent pre-qualification criteria applies and is enforced to discourage speculative RO bidders, the number of plants resorting to use of a Long Stop Date should be minimal. On this basis, 18 months is considered reasonable and should allow for the entry of appropriate plant that fit with the I-SEM's CRM objectives.

J. Are the proposed milestones reasonable?

BGE re-iterates the importance of the pre-qualification process to avoid speculative bidding by RO auction participants and ultimately avoid expensive replacement of capacity for which consumers would pay. Certain “milestones” should form part of the pre-qualification “criteria”. On grant of an RO contract to a party, the contract framework should clearly set out appropriate milestone-based penalty mechanisms that would ensure that only those participants with genuine business plans that can contribute to real reliability when required are awarded and deliver on their RO contracts.

These milestones should be set from the beginning of the lag period in question and not concentrated into a short period such as 18-24 months before delivery. The earlier knowledge of the inability of a project to deliver is obtained, the earlier replacement capacity can be obtained at least cost to the consumer. The milestones proposed in the Consultation appear reasonable. However, GB is a good example of where insufficient milestones at inappropriate times led to the risk of under delivery of capacity procured in the long term (T-4) auction, which can place potentially high costs on consumers in replacing such within tighter time periods than T-4. BGE therefore urges the RAs to liaise further with industry (perhaps best facilitated through the I-SEM Rules Working Groups process) in order to specify exactly the definition of each milestone and critically the timing of which each milestone will apply whether as a criterion or a milestone, depending on the categorisation of the plant in question (new, refurbished, existing).

K. Are there any other milestones, especially prior to Substantial Financial Commitment, which could be used to add security to the delivery of new capacity?

The pre-qualification process, clear definition of criteria/ milestones, timeliness of when the criteria and milestones apply as between the pre-qualification and lag period apply will help ensure security of delivery of new capacity as outlined in answer J above.

L. What proportion of the contracted capacity is appropriate to use to identify Substantial Completion?

The appropriate timing of this milestone is central to its role in limiting speculative bidding, not acting as a prohibitive barrier to entry and ensuring consumers do not over-pay for reliability as discussed in answer J above. A figure akin to the 90% adopted in GB seems reasonable.

M. Is six-monthly reporting appropriate?

Reporting should be done on at least a six monthly basis.

N. Do any (or all) of the reports need to be independently verified?

Provided the timing of, and level of related penalties to, milestones are appropriately set the need for independent reports should diminish. Some milestones are more indicative than others in terms of the progress of a project against its project schedule for example which may suggest a better case for independent verification (depending for e.g. on how far one is deviating from the schedule). As suggested in Answer J however, these issues should be dealt with simultaneously with determining clear definitions of milestones and of the timing of milestones through the auspices of the I-SEM Rules WG. A balance must be struck between the real risk and cost of missing a milestone to failing to deliver under an RO contract as against creating costly barriers to entry by introducing independent verifications.

O. Does 18 months provide sufficient time after the Auction Date to achieve Substantial Financial Commitment?

There are a number of ways of defining Substantial Financial Commitment in terms of financial close. Further clarification of this definition through I-SEM Rules working groups is necessary as discussed in Answer J above. The definition, the criteria for pre-qualification and its strict enforcement will dictate the suitability of this 18 month timeline.

P. Is it appropriate to terminate a Reliability Option for failure to achieve Substantial Financial Commitment?

BGE believes that there should be termination of ROs for failure to achieve certain milestones. However given the far-reaching consequences of such a termination, explicit understanding of the definition of any milestone that justifies termination is necessary and should be further considered as discussed in answer J and O above. In determining these milestones that will have such consequences, a balance must be struck between incentivising efficient new entry and mitigating barriers to entry all at least cost to the consumer.

Q. Should failure to achieve any other milestones (within a suitable window) trigger termination of the Reliability Option?

As aforementioned, BGE believes it is appropriate to trigger RO contract termination in certain circumstances. However, as discussed in answers J, O and P above, the application of milestones whether as “criteria” in the pre-qualification phase or as “milestones” in the lag period/ post RO contract award phase, needs further discussion considering the need for alignment also with DS3. There are a number of ways of defining many of the milestones outlined in the Consultation but importantly the timing of their application will have a large bearing on the risks new entrants’ factor into the RO and the costs that consumers may pay for procurement of capacity. BGE urges the RAs to finalise these critical issues which will be central to balancing incentives for new entry as against barriers to entry and costs on consumers, through for example the auspices of the I-SEM Rules working group.

R. Is it appropriate to partially terminate a Reliability Option if it can achieve ‘Minimum Completion? What level should be set for Minimum Completion?

Correct application of the pre-qualification process and milestones should dissuade unacceptable delays in project delivery and limit the potential for this scenario to arise. Should it arise however, providers should be permitted to operate for the part of its RO contract that is considered Completed (as defined through further discussion) subject to penalties being paid for the remainder of the RO contract volume that is not delivered. Allowing for this potentially reduces the cost of replacing the full volume of the RO contract through a shorter term auction.

S. If a Reliability Option is terminated under the terms of the Implementation Agreement, should this project be ‘sterilised’ for a period of time following the termination and be unable to participate in capacity auctions?

BGE agrees with enabling such capacity to participate in future auctions but believes that the “sterilisation” period must achieve a balance between ensuring security of supply objectives are protected as against avoiding the length of the period acting as a barrier to entry for projects that suffer genuine delays as against protecting the consumer from overpaying for capacity in subsequent auctions in which “sterilised” capacity volumes participate. Sterilisation will have a key role to play in dissuading speculative bidding and intentional withholding of committed capacity and a sterilisation period of at least 2 years should be considered in order to achieve this balance.

T. Should the I-SEM consider terminating Reliability Options if the information submitted as part of the qualification process is discovered to be false or mis-leading?

BGE urges the RAs to ensure the pre-qualification criteria are suitably evidenced to avoid the risk of serious misinformation leading to under delivery of contracted volumes. Given the far-reaching consequences of termination the information leading to such must not be of a trivial nature. The information that results in termination should for example materially affect the deliverability and reliability of the MWs, and source of MWs, of capacity committed under the RO contract. A final decision on this, as discussed under answer J above where we suggest that pre-qualification criteria, milestones and termination conditions all be clearly defined and applied on a suitable timed based bearing in mind needs to align with DS3 contracts, is best dealt with for e.g. through the auspices of the I-SEM Rules working groups.

U. Do respondents agree that the level of the performance bond should be based on a pre-estimate of the cost to the market of non-delivery of contracted capacity?

Again, BGE emphasises the importance of the pre-qualification process milestones and enforcement in mitigating speculative bidding. Appropriate pre-qualification will reduce the reliance on the milestones and related penalties in the lag period. The performance bond must balance the need for avoiding speculative trading as against the need to incentivise appropriate new entry/not create a barrier to entry or increase consumer costs. (Through the RO auction clearing price). This implies the need for it to be set in a manner that is predictable, stable and non-volatile. The methodology for the bond needs to be set at the time participants are bidding into the auction to facilitate appropriate bidding and

quantification of the risk. For stable investment signals that achieve the balance noted above, the bond setting process must be objective, transparent and most important of all not variable.

Without however a holistic understanding of the full auction rules (which may allow some indication of possible price outcomes) it is premature to set the calculation method at this point. We suggest the issue is best dealt with in the CRM rules stage when informed positions can be made based on quantitative analysis.

V. Do respondents agree with the principle that the level of performance bond should rise over time, reflecting increased costs to the market? If not, what alternative principle should be used and why?

The closer one gets to the delivery time of contracted capacity, the more expensive it will be to replace capacity that does not deliver under the RO contract. It is the case therefore that performance bond levels are more critical to protecting the consumer the closer to delivery time it is.

The earlier the capacity provider notifies of its inability to deliver by the completion date, the lower the termination fee/ level of performance bond that should be called upon which incentivises truthful reporting and early admission of project problems. An increase in the bond during the lag period is thus supported. However as discussed in answer U, the setting of the bond levels and timelines at which they apply must be explicit, objective, and transparent and set well in advance such that they provide stable investment signals that support business cases and support accurate cost of risk reflective bids in RO auctions for consumer benefits.

W. At what level in €/MW does the performance bond create a serious barrier to entry? Does this differ for small vs. large plant or for different technologies?

BGE believes that a balance between dissuading speculative bidding, minimising costs to consumers and creating the appropriate incentives for the optimal procurement of efficient capacity is necessary. Achieving this will be best enabled through the pre-qualification process. The level of the performance bond as noted in answer U above needs to be transparent and non-volatile. We believe that there is a difference between the cost of replacing capacity depending on the volume of capacity to be replaced, particularly at short notice and are in favour of bond levels that are realistic and do not result in inordinate risks being price into RO auctions for which the consumer will pay. Without a holistic understanding of the full auction rules (which may allow some indication of possible price outcomes) it is premature to set the calculation method at this point. We suggest the issue is best dealt with in the CRM rules stage when informed positions can be made based on quantitative analysis.

X. Do respondents agree with the principle that use of a fixed €/MW level for all participants, regardless of size, to set the size of the performance bond does not fully capture the costs and risks to the I-SEM and that a more complex approach is needed? Do participants have an alternative preferred method for handling the greater risks to the I-SEM created by larger new capacity projects?

BGE is conscious that DS3 will also apply bonds and that alignment/ consideration of the interaction between DS3 and capacity bond levels is necessary. We urge the RAs to consider this interaction further and on the basis of more information/ detail on what the potential costs of participating in each auction will be. The outcome should ensure that the bond levels are set such that barriers to entry are avoided but that consumer costs are minimised to the extent possible. Stable investment signals as between the two revenues streams will provide the foundation for the business cases of much of the plant required to achieve the objectives of the RO and/ or DS3. We understand it may be more costly to replace larger capacity but without a holistic understanding of the full auction rules (which may allow some indication of possible price outcomes) it is premature to set the calculation method at this point. We suggest the issue is best dealt with in the CRM rules stage.

Y. How should the level of the performance bond change over time? Should this have any link to the milestones?

BGE agrees that the performance bond levels should increase over time in line with how close to delivery an RO contract is getting. However, recognition of better adherence to project plans and milestones by some parties than others may be facilitated by levying heavier increases on those that actually miss milestones than those meeting them. As discussed above, the RAs and industry should work further together, bearing in mind DS3 requirements also, in order to appropriately set the pre-qualification criteria and lag period milestones that should apply in both mechanisms. The clear agreed definition of each milestone and appropriate timing of when each applies will better inform the appropriate stages at which performance bonds should increase. The bond level should meet the principles of being predictable, stable and set sufficiently in advance that risks can be accurately quantified to support entry signals and business cases while ensuring achievement of security of supply objectives and minimising the costs consumers pay through auction clearing prices.

We support phasing in the level of Performance Bond in the first years of the CRM once clearly agreed definitions of milestones and their timelines as well as bond levels based on informed analysis are set. This issue should be dealt with in the CRM rules development phase.

Z. Do you consider that the Time To First Delivery (/Time to LSD) proposed here for the CRM should also apply equally to the delivery of System Services under the DS3 arrangements? If you consider that the time (s) should be different, on what basis / what rationale should they differ?

Alignment of the lag period and milestones that apply as between capacity and DS3 is supported. BGE once again urges that the process of aligning pre-qualification criteria, contract milestones and termination conditions etc. be further considered through the I-SEM Rules WG considering the far-reaching consequences of these dual mechanisms on entry signals, business cases, achieving security of supply, reliability and flexibility objectives all while minimising the costs for consumers.

Miscellaneous

The DS3 and Capacity pre-qualification and procurement processes should be carried out separately and independently until such a stage that experience in, and the interactions between, DS3, the energy market and CRMs is understood.

5. Level of Administered Scarcity Price (ASP)

BGE understands the role of the ASP in the BM in providing a strong incentive to generate or reduce load at times of scarcity. We consider however that before any ASP price applies in the market, it should be set at a level above which the natural commercial operation of the BM would set a price and should apply only in times of “true” scarcity.¹ The max or full ASP (“**FASP**”) should only apply in the market when full depletion of available reserve levels (aside from short term reserve erosion for which sufficient capacity margin exists) together with an involuntary loss of load, both exist. BGE submits that ASPs should be introduced over the transitional period to 2021 and that experience of market outcomes are necessary to enable the RAs to make informed quantitative assessments of the appropriate levels of the enduring FASP after the transition period.

¹ Implying the need to ensure that, insofar as possible, the BM is permitted to set the price at all times including in scarcity periods in that all capacity including OCGTs and DSUs for e.g. are factored into BM pricing before an ASP price applies

5.1 Level of ASP Consultation Questions

- A. Which of the options do respondents prefer (and why) for the enduring level of the Full Administered Scarcity Price (FASP)?**
- I. VoLL;**
 - II. EU Consistent (e.g. with GB);**
 - III. Euphemia Cap; or**
 - IV. Existing SEM PCAP**

BGE believes the FASP needs to be set at a level that incentivises availability in times of true scarcity while balancing the need to ensure efficient, predictable entry/ exit signals persist while ensuring the consumer does not overpay for capacity.²

The RAs should ensure that the choosing of FASP achieves the above noted balance. In particular, a regularly changing unpredictable ASP level which is not known in advance of auction bidding severely risks the customer paying higher capacity prices on foot of RO auction bids that factor in volatile ASP price risks. A volatile FASP also undermines the investment incentive and risks increasing the supplier hole in the hedge particularly if capacity providers do not succeed in the RO auction and are thus not subject to different payment pay-outs.

The first FASP must apply for the duration of the transition period and should be an “introductory” FASP well below SEM or GB VoLL or FASP levels. The enduring level of the FASP should only be determined at the end of the transition period, based on a quantitative assessment of how BM prices outturned as well as the success of the transitional FASP level in achieving the objectives of capacity signals, reliability signals and consumer cost protection. The transition BM and FASP performance information will enable the RAs to make informed quantitative assessments as to whether the FASP needs to change. The enduring FASP must be predictable and provide stable investment signals. The initial FASP level that might be used in the transition period is discussed further in answer G below.

- B. Do respondents agree with the definition of full load shedding (when Full ASP applies) as set out. If not please explain why, and your proposed alternative definition.**

BGE does not agree with the definition of full load shedding being aligned with the EirGrid red alert scenarios to act as triggers for application of the FASP. FASP should only apply in cases of involuntary load shedding occurring in tandem with certain frequency deviations; FASP triggering due to voltage reasons should be discounted. Before the FASP applies, we submit that at a minimum:

- Load must have involuntarily been shed on foot of system frequency deviations that cause automatic disconnections of customers or due to system demand not being met due to demand being shed to maintain normal frequency levels.

The real measure of actual scarcity is in our view measurable only through actual involuntary loss of load related to frequency events that are capable of having market wide supply and demand impacts.

As aforementioned, BGE does not agree with voltage deviations triggering an FASP event. Voltage deviations below normal levels are often not correlated to actual scarcity of generation on the system. System voltage deviations below ‘normal’ levels can occur due to for e.g. a transmission network issue, and the voltage deviations often lead to localised as opposed to market wide issues. For e.g., if annual maintenance of transmission circuits coincided with adverse weather, this could cause further forced regional outages for which local involuntary custom demand shedding may be the only mechanism available to the TSO to prevent a local network blackout. It is the case however that with such local voltage driven load shedding issues that market wide generation margins may be at a healthy level. As the I-SEM CRM is an unconstrained market wide mechanism, we do not believe that it should be diluted by applying the FASP (or indeed any ASP level) for issues caused by just one area of the network. FASP triggers should apply only when both full depletion of market wide levels of reserve as well as insufficient capacity margin from which additional reserves can be drawn, exist. The underlying

² Due to for e.g. the costs of a volatile unpredictable ASP being factored into RO auction bids by participants or due to an increase in the hole in the hedge

cause of FASP triggers should be capable of causing market wide involuntary loss of load. Using voltage deviations as a trigger for FASP should therefore be discounted.

Similarly, in terms of involuntary loss of consumer load triggering an FASP (in tandem with a frequency event), the trigger for FASP in this situation also must only apply when there is a genuine lack of capacity to meet demand which occurs only when both an insufficient capacity margin from which additional reserves can be drawn, as well as full depletion of reserves exist. Capacity providers and consumers alike cannot be punished (through application of an ASP) due to for example the TSOs carrying insufficient reserve on the system when options to maintain reserve are still available.

- C. Do respondents agree that virtual bidding removes any incentives on capacity providers to withhold power from the DAM or the IDM to sell in the BM? Do you agree that this applies regardless of what market power controls are placed on DAM, IDM and BM bids? Do you agree that this applies regardless of the level of the Full ASP? If you do not agree, please explain why.**

While virtual bidding may be an avenue of redress available to capacity providers in terms of mitigating ASP exposure, it is not a straightforward solution. Capacity providers must necessarily be in a position to forecast ASP or spike events accurately to enable the hedge to work effectively.

- D. If stakeholders consider that it is appropriate to set the Full ASP at a lower level for an introductory period they should also set out, how long that introductory period should be and why, or alternatively the principles that the SEM Committee should employ in deciding when to move from the introductory full ASP to the higher rate full ASP.**

BGE is in favour of the FASP being set at a lower level for an introductory period until experience with the likelihood of FASP situations arising, how capacity providers can hedge this risk and how well the balance between incentivising reliability capacity, ensuring efficient, predictable entry/ exit signals and ensuring the consumer does not overpay for capacity, can be ascertained and assessed. A period in line with the I-SEM transition period should provide the RAs with information to enable quantitative assessments to determine an appropriate enduring FASP.

In essence in the transition period, the starting price for the linear curve ("B") as discussed under answer G below should form the basis for the first of the ASP prices and an exponential curve hugging the X and Y axes should persist, leading to the FASP ("A") price of the curve being close to the Euphemia price cap. This should not be reviewed for the transition period up to 2021 for stability of investment incentives. On review FASP should only be increased if quantitative assessments show that the transitional FASP is not achieving the right balance of incentivising reliability capacity, ensuring efficient, predictable entry/ exit signals, preventing involuntary loss of load and ensuring the consumer does not overpay for capacity.

- E. If you favour a different level of Full ASP, either for an introductory period, or after any introductory period, please indicate the level and justify your response.**

BGE favours a smooth transition to the RO and anything that contributes to such is to be supported. An incremental move towards full ASP over time will avoid exposing capacity providers to 'cliff edge' exposures and will smooth the transition to the new dynamic market. Volatility in all elements of the RO design should be avoided particularly during the transition period to 2021. Given the breadth of risk across all the I-SEM markets, a balanced approach to adopting an ASP and FASP should be taken such that it is not so penal as to undermine the balance of avoiding volatile risk exposure levels being factored into auction bids; avoid the risk of creating barriers to entry or dis-incentivising availability for which the consumer will ultimately pay. A transition FASP should be significantly less than VoLL levels and closer to Euphemia cap, and after the introductory period should be based on quantification assessments as discussed in answer D above.

F. Do respondents agree with the proposed approach of using a static approach to setting the piece-wise linear ASP function at the inception of the I-SEM, and if not why not? If yes, do you agree with the proposed approach of setting the piece wise linear equation as a function of the remaining MW of available operating reserve?

Subject to the views expressed in answers above in this section (particularly the need to set FASP to on a transitional basis, with market experience being assessed after a time to determine the need for a different enduring FASP), BGE believes that a predictable, static approach to the ASP function will help mitigate the volatility that we are keen to avoid at least for the transition period. Please however see further our answers D and E above on setting the ASP and the transition to a full ASP as well as answer G below.

G. What should the value of X in Figure 12 be?

BGE has assessed the potential value of the starting point (“B”) which in turn will inform what the “X” on the piece wise curve is. On the basis that the Consultation notes that short term drops in reserve will not trigger the ASP if sufficient generation margin exists, BGE has assumed that at point B:

- all available thermal generators have been committed to maintain reserve (peakers etc)
- all demand side units have been committed
- All possible trading actions on the ICs have been exhausted,

this is in line with BGE’s desire that the BM should in the first instance be permitted to find a price in times of scarcity.

On this basis, BGE submits that the point ‘B’ price could be set at the likely most expensive BM inc or based on a track of day ahead oil prices X a 25% low efficiency unit conversion factor.

An exponential curve approximately hugging the X and Y axes for the majority of the curve to Point ‘A’, could subsequently apply. X will therefore equal the % that the “B” value forms of the final decided FASP price but as outlined above it is critical that experience at least across the transitional period is obtained of how well the BM price does in achieving the balance of incentivising reliable availability while ensuring the consumer is not over-paying through high priced auction fees that factor in volatile ASPs, before deciding on an enduring FASP.

H. How far in advance of the start of the Capacity Delivery Year should the piece-wise linear function be set. Does this need to be before the T-1 auctions?

BGE believes that this function needs to be set as far in advance as possible in order to reflect the cost of such in bids and ensure that consumers only pay for the true value of capacity and scarcity. Ideally before market participants bid into any of the RO auctions, they will need to know and understand their full potential risk exposure, otherwise the risks of changing ASPs and the basis for such is unknown which uncertainty will be factored into RO auction prices and paid for by consumers.

Given the need to minimise volatility to achieve stable investment signals and ensure consumers are not suddenly exposed to high RO auction fees, we submit this detail is known as close to T-4 as possible. For certainty and predictability reasons, BGE does not believe that the function needs to be regularly altered and suggests that consideration be given to keeping this function in situ for a set period of time. Upon review and determination of whether the objectives of the RO and ASP are being met, the ASP linear function could be open to change subject to market wide consultation.

I. Do respondents think that any changes need to be made to the governance of the target operating reserve policy? If yes, what are these changes?

BGE does not believe that the current target operating reserve policy should be adjusted. The use of the largest infeed as a basis of calculating reserve is well proven and has resulted in very low levels of customer disconnection. Furthermore, provision has been made for certain DS3 products to be introduced that are capable of allowing for generation margin volatility. As discussed under answer A of this section, FASP should only apply when insufficient capacity margin in tandem with depleted reserve levels occurs such that involuntary loss of load happens. In terms of governance of the TSO, to mitigate

the risk of a full ASP event, the TSOs should be monitored to ensure that are always carrying sufficient reserve levels as per security of supply guidelines. Daily reports of expected reserve levels and the risk of an ASP or FASP event arising should capture this. Notice of such risks should be published <4 hours in advance.

6. Transitional Issues

6.1 Transitional Issues Consultation Questions

BGE supports the need for a transitional CRM to apply in I-SEM. We counter the suggestion in the Dundalk workshop held on 20th January last that “transitional” arises from the need to allow time for new-entrants to build”. Transitional arrangements are needed for new and existing capacity alike and the CRM is about maintaining efficient capacity while providing efficient entry signals for new investment. We believe that, as recognised in the I-SEM High Level Design Decision (SEM-14-085), energy-only markets risk “missing money” issues arising in the generation adequacy sphere. Notwithstanding the healthy capacity margin existing in the SEM, the RAs have also previously recognised the lumpy nature of our system’s capacity whereby early exit of one or more plant can have a large negative impact on margins. Certain factors must be taken into account when considering the transitional issues for the CRM:

- From a consumer perspective, boom-bust cycles of capacity must be mitigated insofar as possible otherwise sharp increases in the demand for capacity generation (with related sharp prices) will occur intermittently and unpredictably to the consumer detriment;
- A smooth transition to the RO with efficient exit and and entry signals for capacity is necessary. Stability and predictability in the mechanism will assist capacity providers’ investment cases and avoid the risk of sudden exit;
- The need for increasing grid stability and operational knowledge for the TSO as well as stable revenues for investors in capacity.

It is on this basis that BGE responds to the below questions on this chapter.

A. Which of the suggested options (annual auction, block auction, do nothing) do you prefer?

BGE is not in favour of the “do nothing” option believing that it goes against the HLD decision to adopt a CRM for I-SEM in the first instance and that it risks the boom-bust cycle of generation and consequent drawbacks for suppliers and consumers as outlined in the introduction to this section of the response.

BGE’s preference is for a “block auction” over an “annual auction”. The key drivers for our preference are that:

- the threat of sudden unexpected exit of (efficient) capacity from the I-SEM in the intermediary years 2017-2021 is reduced, which in turn mitigates the risk of boom-bust cycles of generation, avoiding the potential costly replacement of capacity suddenly dropping out of the market;
- the approach will also facilitate the offering of consumer contracts beyond one year;
- the ‘block’ auction offers better predictability and certainty of price from a capacity provider’s perspective which will enable them to plan longer term investments as well as enable new plants’ business cases;
- the TSO will have a heightened forward looking understanding of the system’s needs over the short term which should in turn reduce the anticipated costs of catering for reserves when more certainty on what is at the TSO’s disposal, exists;
- the perceived risk of market power exercise such that RO competition is affected can be mitigated by applying certain bidding parameters. It is preferred subject to suitable market power mitigation principles applying to prevent portfolio players arbitraging in such a way that results in inefficient plant remaining on the system to the detriment of more competitive efficient plant.

BGE requests further engagement on the principles behind the determination of the price in the combinatorial auction, through the CRM rules development stage, to ensure transparency and consistency in the final methodology.

B. If you prefer the do-nothing auction, do you believe this should be accompanied by relatively low levels of Administered Scarcity Price?

BGE for reasons outlined in the introduction to this section and to answer A above, is not in favour of the “do-nothing” auction particularly as it appears contrary to the I-SEM HLD on the RO. Should this option be progressed, the ASP would open up suppliers to potentially unpredictable and unmanageable levels of risk and the ASP consideration to its non-application for a time. The option should be discounted at this point.

C. Are there any other transitional issues respondents feel that we should take account of when implementing the CRM?

BGE requests clarity on the timing of the RO auction with a delivery year of 2021 and that of the transitional auction in terms of whether they will be held simultaneously or consecutively.

We do not support the “glide path” option put forward at the workshop in September 2015 on the CRM as it is considered too prescriptive and non-competitive and raises state aid compliance considerations.

We also suggest that consideration is given to DS3 objectives and operation of the balancing market and balancing the right market signals with procurement of the right type of new entry needed in I-SEM.