

**Power NI Energy Limited  
Power Procurement Business (PPB)**

**I-SEM Detailed Design**

**Capacity Remuneration Mechanism**

**Third Consultation Paper**

**Response by Power NI Energy  
(PPB)**

27 April 2016.



## **Introduction**

PPB welcomes the opportunity to respond to the RAs third consultation on the detailed design of the Capacity Remuneration Mechanism.

## **General Comments**

The CRM is a critical element of the I-SEM that is essential to ensuring the long term stability and security of supply in a small island market. Reliability Options (ROs) are relatively complex instruments that incorporate both a hedge against high spot market prices and scope to recover money that is missing more generally from the energy market. Their operation is further complicated in the context of a small system that is targeting high levels of intermittent generation.

The following sections highlight critical issues that remain to be discussed but which are vital to the understanding, sustainability and integrity of the CRM. It also summarises PPB's views on the specific issues raised in the third CRM detailed design consultation.

### ***Key elements of the design remain to be discussed***

There are a number of critical elements of the CRM design that remain to be considered but which must be addressed before any overall assessment of the suitability and sustainability of the CRM proposals can be assessed.

Key components include the process for determining the capacity requirement and the rules regarding any adjustment thereto to reflect non-participating capacity. The capacity requirement is particularly critical given the outcome that emerged in the most recent determination for the SEM that derived a capacity requirement with a very low margin over peak demand which contradicts the analysis in the generation adequacy statement and is in conflict with the actual margins required even for Northern Ireland in isolation.

It is also proposed that this requirement could be adjusted to reflect the opting out of certain capacity. However there has been no discussion on the rules or objectivity of such procedures and therefore the scope for manipulation and the associated risks for participants is unclear. Such adjustment also affects the extent of the "hole in the hedge" which has knock-on effects for Supplier charges, etc.

It is vital that a full description of the arrangements and the governance around them is set out to enable full consideration of the composite

arrangements, the risks that different market participants are exposed to, and the overall “fit for purpose” of the final CRM design.

### ***Auction Frequency and Volumes***

The auction process is not standalone and must be timed to interact with other market arrangements, a primary example being the DS3 arrangements that will influence bidding in the RO auctions. The merits of auction timing flexibility, or options to utilise such flexibility, are not clear for the I-SEM.

### ***Market Power***

It is evident from all the analysis presented by the RAs across a number of workstreams that the I-SEM will have a dominant generator and a dominant retailer. Measures will need to be developed to ensure such market power does not negatively influence the outcomes for customers and other competitor participants in the markets.

A key concern with the analysis in this consultation paper is that while it clearly identifies that market power will exist primarily with ESB, it then seeks to apply mitigation measures globally rather than focusing the measures on dominant or pivotal participants. Such an approach may result in less competitive outcomes in the market and create additional barriers to entry that will inevitably be more costly for customers in the long run. It is therefore essential that such measures are proportionate and targeted at the underlying causes of market power.

We also highlight that the focus of the measures is on capping prices to protect customers whereas, while predation is referenced many times in the consultation paper, no measures are proposed to ensure dominant players do not bid below cost to the detriment of its smaller competitors in the CRM.

The proposals in relation to auction price caps and bid limits need to be carefully considered to ensure they do not become a barrier to entry. For example setting the Auction price cap at the value of “Net CONE” will not encourage new entry since a new entrant will inevitably experience prices in some years that are below new entry prices which need to be offset by prices in excess of the Net CONE in other years. The international experience, where auction price caps apply, sets the cap at a multiple of the Net CONE price to overcome such issues. A margin is also necessary because of forecasting errors and also to reflect the additional risk from the one-way CfD element of the RO proposed for the I-SEM.

### ***Auction Design***

Given the market power issues in the I-SEM, we consider that simple auction formats and bid structures are the most appropriate to best counter the market power issues.

We do not agree with the proposals to set clearing prices based on a unit that is not actually the marginal unit, with pay as bid arrangements for any residual out-of-merit capacity that is required to reach the capacity requirement. This is discriminatory and has the potential to place more power in the hands of the TSOs should any discretion be allowed which immediately raises conflict of interest concerns. It also increases the spectre of regulatory risk and the proposed “consumer welfare” consideration is likely to deliver a short-term outcome that is not in the long terms interests of customers.

Sloped demand curves may be helpful in the T-4 auctions by enabling the capacity to be flexed. However, unless the required Security Standard, confirmed as 8 hours LOLE in the first CRM decision paper is relaxed to adopt a flexible standard, then it would seem that the T-1 auctions will have a firm quantity requirement that is a vertical demand curve.

The relative size of generating units relative to peak customer peak is always going to be a problem in a small market like the I-SEM. Hence lumpiness will always be a more pronounced issue. However we do not believe that the answer can be provided by sloping demand curves and/or paying some units (likely smaller ones) a different “out-of-merit” CRM price. This latter proposition would likely increase the market power of ESB who own a large number of the smaller and less efficient generating units that are likely to be around the margin.

### ***Auction Parameters***

A key requirement is that the process for the derivation of any parameters must be transparent and be consistent and objective such that participants or potential investors can forecast the evolution of the parameters with a reasonable degree of certainty, since otherwise it will merely generate superfluous and unnecessary risk that will be reflected in higher costs for customers.

If a sloping demand curve is to be used, its derivation must be tied to objective and publically available inputs and with the curve determined in a formulaic manner.

As noted earlier, any price cap must be based on a multiple of the Net CONE price and, given the higher risks in a small market, the multiple should be higher than has been employed to date in much larger markets.

Again as noted earlier, any bid limits should be targeted towards dominant/pivotal participants. We also dispute that bid limits should be different for new entrants than would be imposed on existing participants. Not only is this discriminatory but it also ignores that today's new entrant is tomorrow's existing plant and any differential treatment will be recognised by potential new entrants and the risks will be built into their bids. We believe the consequential effect can only be that either investment is deterred and/or the cost is increased, both of which are not in the long term interests of customers.

### ***Auction Governance, Roles and Responsibilities***

The role of the TSOs requires careful consideration given concerns around conflict of interest and the scope for institutional bias. The consultation paper proposes that the TSOs will administer the auction process but does not set out the full range of the TSOs' responsibilities and activities. For example, no reference is made to the development of the Capacity Market Code (CMC) yet the February Information note indicated the TSOs are to be responsible for drafting the CMC.

We are also disappointed at the proposals to new develop the CMC as a standalone code with a separate framework agreement and requiring separate accession to the TSC. We consider the CMC should be a section within the overall I-SEM TSC.

### ***Other Residual Issues***

We do not agree with the proposals relating to the strike price. The price should remain based on the daily index to avoid creating spurious risk for capacity providers and we consider the appropriateness of the 15% Reference Efficiency requires revisiting.

## **Responses to the Specific Questions**

### ***Chapter 3. Auction Frequency and Volume questions***

#### ***Q3.1: Do respondents agree with the proposed approach for transitional auctions, T-4 auctions and T-1 auctions? If not, please explain.***

The approach for the enduring T-4 and T-1 auctions generally seems fine although more detail is required on wider aspects of the CRM design to enable a full understanding of what is intended. For example, the process for consulting on and determining the overall capacity requirement and subsequent rules to reduce the requirement to reflect non-participating capacity needs to be specified such that participants are able to predict and understand the process and timings to enable their effective participation in the process.

It isn't clear if the transition year auctions are to be held annually each year in June or whether they are all to be held during 2017 with the first one for 2017/18 held in June 2017. Given that it is proposed to commence the capacity year on 1 October each year, holding the auctions just 3 months prior to the commencement of the delivery period is not practicable given that generators who are unsuccessful may want to cease operations, which may not be possible with a maximum of 3 months notice.

#### ***Q3.2: What is respondents view in relation to the flexibility around the timing of the T-1 and T-4 auctions?***

It is not clear why any flexibility is required around the timing of auctions. It seem more logical to have a firm date that all parties plan and work to rather than having uncertainty over the date. Under the proposals, there could be two T-4 auctions on the same date for two different delivery years (i.e. one three and a half years ahead and the other four and a half years ahead).

Similarly for T-1 auctions, we believe it would be more practicable, for all parties, to hold such auctions a year ahead of the commencement of the delivery year such that parties who are unsuccessful have sufficient time to manage an orderly exit, if that is their decision having failed to secure a contract.

The other timing issue that needs to be considered is the relationship with other market processes such as DS3. As we have noted in our response to the DS3 consultations, participants will want to reflect the outcome of the DS3

process which will impact on the missing money calculation which in turn will affect their formulation of bids into the CRM auctions.

**Chapter 4. Market Power questions**

**Q4.1: Do respondents agree that market power is a material concern in the I-SEM CRM? If no, why not? Should the SEM committee be concerned with unilateral market power, the potential for collusion or both?**

We agree that market power is a significant concern in the I-SEM CRM. We note however that the Market Power control framework (as illustrated in Figure 7 on page 24 of the consultation paper) doesn't reflect the exercising of market power through predatory pricing, notwithstanding predatory pricing is referenced elsewhere in the consultation paper, for example, in paragraphs 4.1.9, 4.3.4 and 4.3.9. We do not agree that such predatory action is any more likely in auctions with shorter lead times than in any other auction. The example provided in footnote 18 on page 29 is also not relevant to the I-SEM given the central procurement and the fact all Suppliers will pay the same price.

We have previously highlighted our concern that predation is perhaps a more likely abuse of market power in the I-SEM given the primary incentives on semi-state participants may not be profit maximisation. It is therefore concerning that there is no discussion of possible mitigation measures for such a manifestation of market power.

There is no evidence presented of any explicit or tacit co-ordination in the market and hence we do believe there is a need to be concerned about the potential for collusion. Rather, we consider the primary concern should be unilateral market power given the dominant market share of ESB, and as noted above, in particular to ensure measures are adopted to mitigate against predation.



***Q4.2: Do respondents think that the overall market power control framework and package of mitigation measures set out in this section is comprehensive and proportionate? Are there any additional market power concerns that the SEM Committee should be focussing on? Should the SEM Committee bar any existing firm transmission access intermittent generator which has opted out of an auction (on grounds of retiral) from bidding in subsequent auctions, if it subsequently does not retire and/or apply other sanctions?***

As highlighted in our response to the previous question, the framework ignores predation, notwithstanding that it is a significant potential risk in the I-SEM CRM. Mitigation measures such as minimum price offer rules, that have been employed in the US to address such issues, should be developed.

We are also concerned at the proposals to prevent capacity that opts out of T-4 auctions from participating in T-1 auctions, and to apply enforcement action on dispatchable plant that opted out because of retirement plans but which remain operational. The Irish market is small and flexibility is required as decisions on profitability driven by changes in prices, outages on other generators, etc. may create a requirement and an opportunity that should not be foreclosed. Hence we do not believe such measures are proportionate.

We do not understand paragraph 4.7.14 which implies that plant that had opted out because of plans to retire could nevertheless have also resulted in a reduction to the capacity requirement. This raises many concerns over the veracity of the process for reducing the capacity requirement and adds further weight to the need for the rules that will be applied to adjust the capacity requirement.

We also have major concerns with the proposals relating to the price control of bids. It is unclear why such limits should be imposed on all participants rather than being targeted at those with market power. All encompassing restrictions will not provide a market outcome and will effectively result in what is effectively a regulated CRM with high risks that investment will be disincentivised as a consequence of ongoing regulatory risk.

The use of a sloping demand curve to mitigate against physical and/or economic withholding might be an option for the T-4 auctions. However, it is not clear that such an approach could be used in the T-1 auctions since to contract for less than the capacity requirement must inherently mean that there will be insufficient capacity to provide security of supply to the level of

the required security standard. There has been no discussion on changing the security standard to being variable, and hence the sloping demand curve may not offer any tangible benefit for the T-1 auctions and given there is less threat of new entry competing in the T-1 auctions, utilising the mechanism to contract for less capacity in the T-4 auctions, that has to be made up in potentially less competitive T-1 auctions could have a unintended outcomes.

***Q4.3: Do you think that firm transmission access plant which has bid at a certain point within the tolerance band in the T-4 auction (below the maximum) should be allowed to bid more capacity (up to the top of the tolerance band) in the T-1 auction?***

There is no reason to restrict such a strategy as the generator will have a firmer view on its availability closer to the delivery period and may adopt a prudent strategy in the T-4 auctions that it can refine in the T-1 auction.

Equally important is a viable secondary market that would allow the generator to trade and refine its capability in either direction and would therefore enable further competitive strategic options to be employed by participants.

***Q4.4: What metrics should be used to assess whether a capacity provider is dominant, for the purpose of either applying other Bid Limits and/or controls on aggregation (the approach to setting the level of bid controls is discussed in section 6)?***

A range of metrics is appropriate and clearly market share is a primary consideration and we agree that ESB is dominant on the basis of this simple metric. Given this dominance, and the fact ESB is pivotal, it means that the two or three pivotal tests will always be met and hence these add little value unless the ESB portfolio were to be structurally disaggregated at some point in the future. It is also not helpful to seek to utilise these metrics and yet to then apply global mitigation measures when such measures would be more appropriately targeted at those participants who are dominant and have market power.

***Q4.5: Do you agree that dominant /pivotal generators should be prohibited from acting as Capacity Aggregators? Should associated businesses of dominant / pivotal generators (e.g. their Supply arms) also be prohibited from acting as Capacity Aggregators too?***

It would seem reasonable to prevent dominant / pivotal generators from further increasing their position by acting as a capacity aggregator. Similarly there is no compelling reason to permit associated businesses to carry out such an activity since that is likely to have the same effect.

***Q4.6: Should there be a prohibition on ESB and other dominant generators providing aggregation services?***

In line with our response to the previous question, we consider it would be reasonable to prohibit ESB (and other dominant generators) from providing aggregation services as it would otherwise merely increase their dominance.

**Chapter 5. Auction Design questions**

**Q5.1: Which auction format (simple sealed bid, multiple round descending clock, combinatorial format, i.e. Option 1 to 3 in Section 5.2) do you think is most appropriate for the transitional auctions, T-4 and T-1 auctions, and why?**

The consultation paper makes various comments on the different auction formats and their potential impact on pricing without providing detailed justification and as a result it is difficult to provide informed comment on such assertions. In theory each of the approaches should end up with the same outcome but this may not be the case in the I-SEM given its unique features and the dominance in the market. However it is difficult to predict what the outcomes would be without conducting extensive analysis that has not yet been completed.

Our enduring preference would be for a descending clock approach that provides for greater information and price discovery. Our primary concern with this approach in the current market relates to the scope for market power to influence the outcome. On balance we therefore consider that a simple sealed bid format would be the most suitable although we consider that market power mitigation measures, particularly with regard to ensuring there is no scope for predation, remain essential to ensure a sustainable outcome is achieved.

**Q5.2: Do you have any preference for the structure of bids for the auctions? Explain your rationale.**

Our preference would be for a simple PQ pair approach. The additional value of allowing a supply curve is not obvious and could provide further scope for dominant participants to exploit market power. Further, it isn't clear that the monotonically increasing function of "P" represents the normal cost curve for capacity.

**Q5.3: Do stakeholders agree with the proposed approach of adopting Option 3b to deal with the lumpiness/discrete bid problem? If not, please explain why not, and your preferred alternative approach.**

We do not agree with the adoption of Option 3b. Such an approach would result in in-merit capacity providers being excluded from the market and we have concerns that such an approach could also create distortionary incentives for units that are smaller in size and that are likely to be required to

solve the lumpiness problem under the proposed approach, and further, it would likely confer additional market power to ESB who is the only participant who has a number of small sized units in its portfolio.

Option 3b adopts a “consumer welfare” rather than a “social welfare” (option 3c) standard which distorts the efficiency of the process and could create inefficient outcomes that may appear beneficial for consumers in the short term but which deter investment and result in higher consumer costs over the longer term.

For T-4 auctions, where the quantity being procured is less than the full capacity requirement, we consider that the best approach would be to simply accept prices in merit order and to flex the requirement to ensure “all or nothing” acceptance is achieved with no “out of merit” acceptances. For T-1 auctions, the residual capacity requirement must be secured in full to ensure the security standard is delivered for customers. In these auctions we consider that the same merit order principle should be retained and that the capacity secured should be the full capacity of the last in-merit generator. This may result in a slightly higher security standard than is the target but would maintain the integrity of pricing and recognises that while lumpiness is a feature in electricity systems, customers benefit from a higher standard of security of supply in any such years.

***Q5.4: Do stakeholders agree with the approach of setting the clearing price based on the highest accepted in-merit winner, and paying any out-of-merit winners based on a pay-as-bid basis? If not, please explain why not, and your preferred alternative approach.***

We do not agree with this approach which artificially depresses the clearing for the CRM and which could for example result in c400MW of capacity being successful in the CRM while being out of merit. As outlined above, we consider there should be a single clearing price with no distortion of the pricing that would arise from paying a different price to out of merit capacity.

**Q5.5: Should the SEM Committee introduce a sloped demand curve, either as a market power control, or for other reasons?**

We consider that the SEMC should introduce a sloped demand curve for the T-4 auctions which would also enable flexibility to fill or reject all or nothing bids at the margin. However, we do not believe it is possible to adopt a sloping demand curve in the T-1 auctions since to do so could result in less capacity being secured than is required to ensure security of supply for customers is not less than the required standard<sup>1</sup>.

Where a demand curve is to be employed, a critical issue is that the process for determining the curve must be defined in a robust, consistent and objective manner to minimise the risk or perception of regulatory risk that would have a detrimental impact on the long term stability of the CRM and investment incentives.

**Q5.6: Winner determination. Do you agree with winners being determined purely on price offered for each Capacity Delivery Year?**

We agree that there should be a single clearing price in the CRM auction. However, it is less clear that the contract length should be ignored as part of the process since to do so may result in a less efficient overall outcome (as is recognised in paragraph 5.4.9 of the consultation paper).

The adoption of option 1 will result in an inefficient outcome and therefore the other options, that do seek to account for the overall value, should be further investigated to seek to identify an assessment process that delivers a more efficient overall outcome.

**Q5.7: Winner determination. Do you agree that the auctioneer should be able to accept “out-of-merit” bids to manage the lumpiness problem or should only in-merit bid be accepted? What rules should be used to determine whether the marginal bidder is accepted (if only in-merit bids can be accepted) or to determine which out-of-merit bid should be accepted?**

As set out above in our response to Q5.4, we do not believe it is appropriate that out-of-merit bids could be accepted to manage the lumpiness issue.

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<sup>1</sup> Unless the Security Standard was changed to be variable but paragraph 2.2.16 of the first CRM decision paper (SEM-15-103) clearly states the decision to retain a fixed 8 hour LOLE standard

**Q5.8: Price determination. Do you agree that it appropriate to pay auction winners on a “pay-as-clear” basis, with this uniform clearing price being based on the highest accepted in-merit bid price? Should any out-of-merit winners be paid a different price to in-merit winners?**

As highlighted in response to previous questions, we agree that there should be a single clearing price that is based on the highest in-merit bid and that there should be no out-of-merit winners.

**Q5.9: How do you think the lumpiness / discrete bid issue should be dealt with?**

See our response to Q5.3 above.

**Q5.10: Do you have any comments on the treatment of tied bids?**

Developing a more sophisticated assessment of contract with different duration would help address assessment where the contract duration is different. Unit size could be used as a criterion as smaller units are generally more beneficial in a small system. A net welfare function is likely to provide a more efficient outcome and therefore should be investigated.

**Q5.11: What is the appropriate level of information to be provided: before qualification; between qualification and the auction start; between rounds in the case of a multiple round auction; and after the end of auction?**

We consider that as much information as is available should be provided prior to the auction and at the end of the auction. The main area that requires careful consideration relates to between rounds should multiple round auctions be adopted. This consideration depends heavily on what market power measures are imposed and whether the release of more or less information between rounds would further increase or mitigate market power. Hence further consideration will be required once the market power proposals are more developed.

**Q5.12: Are any additional restrictions on bidder communications (over and above existing competition law) required?**

It is not clear why any further restrictions are necessary.

**Chapter 6. Auction Parameter questions**

***Q6.1: Do you have any comments on the overall scope / process of auction parameter setting outlined above?***

The process for the determination of various parameters must be robust and transparent and must ensure consistency and objectivity at all times in order to minimise regulatory risk and create certainty for participants and potential new entrants.

***Q6.2: If a sloped demand curve is introduced, what principles should be used to determine the slope of the demand curve, and the range within which the demand curve is sloped?***

As has been noted in response to earlier questions, we can see there may be benefits from adopting a sloping demand curve for the T-4 auctions where some capacity is already being held back for the T-1 auction and flexing around this quantity, depending on price, can be accommodated in the T-1 auction (assuming the delta is relatively small). However, it is not clear that a sloping demand curve can be employed in the T-1 auctions where to do so would result in the provision of a different security of supply for customers, over-riding the standard that has been pre-defined. In all consultations to date, the security standard is a static requirement and hence at the T-1 stage this implies a fixed requirement.

If a sloping demand curve is introduced, the derivation of the slope would need to be based on consistent methodology using for example costs derived from the BNE/CONE. The range would also need to be relatively small and we note that pro-rating the GB arrangement would result in  $\pm 150\text{MW}$ . However the range in a smaller market such as the I-SEM would need to be tighter than in GB and hence it may be more appropriate to reduce the range to  $\pm 100\text{MW}$ . All of this discussion on range is also dependent on a robust determination of the capacity requirement which must be more credible than the capacity requirement determined for the SEM that for 2016 represented only a very small margin over peak demand and that is inconsistent with the requirement evident from the figures in the Generation Adequacy Statement.



***Q6.3: If introduced, should the sloped demand curve be different for the transitional period?***

If introduced, the curve should be adopted in an enduring form to ensure participants can gain experience of the application of a consistent methodology that is not exposed to continual change and regulatory risk.

***Q6.4: What impact do you think the sloped demand curve will have on competition?***

The impact of a demand curve on competition is difficult to estimate in the absence of detailed scenario and sensitivity analysis.

***Q6.5: Do you agree with the requirement for an Auction Price Cap? What principles should be used to determine the level for the Auction Price Cap/what level should it be set at?***

We can understand the thinking around an Auction Price Cap but simply setting a cap equal to a desktop derived Net CONE price will not deliver new investment. In the derivation of the BNE price in the SEM, there have been various assumptions used by the RAs that do not reflect reality and hence result in an artificially low price, e.g. in relation to WACC, plant lifetime, IMR, etc.

Any derivation of a Net CONE for the I-SEM would need to reflect I-SEM specifics, including that the maximum contract term is 10 years, IMR will be limited by the RO strike price, and the risk of net costs (limited by the stoploss) should the capacity be unavailable when prices spike above the RO strike price. All these parameters would need to be objectively set such that regulatory risk is minimised to provide a stable mechanism that investors can assess with confidence. It would also need to reflect the CONE in year T rather than in year T-4.

Any price cap would need to be a multiple of the Net CONE since there will be forecast errors (e.g. DS3 payment rates and revenues in year T may not be known at the time of the auction for year T in year T-4). Further, if the CRM price is likely to fall below the Net CONE level in any year, the price would need to be higher in years of scarcity to compensate such that over the lifetime of a unit it can recover its costs and make a reasonable return. We note the international experience where auction price caps have been applied is for the multiple to be 1.5 to 2 times Net CONE and there is no reason to consider that the I-SEM should not adopt a higher multiple given the greater

risks in a smaller market where lumpiness of unit sizes relative to demand, high levels of intermittent generation, etc. magnify the risks to investment.

**Q6.6: Do you agree with the requirement for other Bid Limits?**

There may be a requirement for bid limits as part of a range of measures to mitigate against market power but we consider that any such limits should be targeted such that they only apply to those participants deemed to be dominant. As noted in our responses to the market power questions set out in Chapter 4, we are concerned that there are no proposals to counter the risk of predation and consider that bid price floors will be required to mitigate this risk.

**Q6.7: Should the other Bid Limits be applied at the same level to all existing non-intermittent firm transmission access generators, or should the limits be technology specific?**

Firstly, as covered in our response to the previous question, Bid limits (both maximum and minimum) should be targeted at dominant participants.

We do not consider there is any benefit in expending additional effort to determine technology specific limits but should instead adopt a generic approach.

We agree with the statement in paragraph 6.4.4 that a new investors need to have an expectation that it can cover its Net CONE from the CRM payments, However, we strongly disagree with the assertion in the second half of the paragraph that existing owners have sunk costs and hence once committed do not necessarily need to receive Net CONE and as a consequence espousing that a lower bid cap could be imposed on existing generators without jeopardising security of supply.

This fails to recognise that today's new investors will become an existing plant owner after a few years and hence as part of their market due diligence they will take account of penalties imposed on "existing" plants as they contemplate their potential investment and any such penal impositions will be reflected in a potential new investor's decision process, contaminating it and increasing the cost of new investment. This risk is clearly evident from Footnote 59 on page 74 of the consultation paper which contemplates equity investors losing their equity and this is not something that will go unnoticed by potential investors. Such a penal imposition on existing plants will deter and/or

increase the cost of new investment and is therefore unlikely to be in the long term interests of customers.

***Q6.8: Should the other Bid Limits be applicable to all bidders, or just dominant/ pivotal generators?***

As noted in response to the previous questions, we consider that it would not be proportionate to apply limits to generators who are not dominant or pivotal and hence bid limits must be restricted to dominant/pivotal generators.

***Q6.9: What principles should be used to determine the level for the other Bid Limits/what level should they be set at?***

Given that the limits are required as part of market power mitigation measures, the principle should be that bids are reflective of the missing money (after reflecting the effect of the RO CfD payments that limits IMR) which would be expected in a truly competitive market. Any imposition beyond this would represent regulatory manipulation that would impinge on the long term sustainability of the market and security of supply for customers. The bid limits should set a narrow spread that allows for forecasting error and within which dominant/pivotal generators must bid thereby ensuring that prices for customers are not inflated or predatory pricing cannot be exercised, both of which, were they to occur, would be a cost for customers.

**Chapter 7. Auction Governance, Roles and responsibilities questions**

***Q7.1: Do you agree on the proposed role of the TSOs with respect to the auctions?***

The role set out is for the TSOs to administer the auction process and clearly there is a requirement for this to be undertaken. However it would have been helpful for the full range of the TSOs' involvement in the various aspects of the CRM to be clearly set out such that a full consideration could be given. For example, the emerging thinking following the CRM2 consultation is that the TSOs will determine Generator de-rating but not Interconnector de-rating. The TSOs also seem likely to have significant influence over the secondary RO market, while the extent of their involvement in determining the Capacity Requirement and in any subsequent adjustment to the requirement (due to opt-outs, etc) is as yet unclear.

There are also issues raised in Chapter 3 regarding flexibility in relation to the timings of auctions and it unclear what input the TSOs will have in relation to the selection of the auction dates should flexibility be allowed.

In the absence of full clarity on the complete range of issues, it is difficult to comment on whether there could be any conflict of interest or other concerns that require to be addressed.

***Q7.2: Do you agree on the requirement for an Independent Auction Monitor and its proposed roles and responsibilities? If not, please specify what changes you would make? Should this role be combined with the role of SEM/I-SEM Market Auditor?***

We welcome the proposal to have an independent auction monitor and while the roles and responsibilities seem broadly appropriate, the scope of the activities may require further refinement once the detail of the CRM is determined.

It is not obvious that the same skills are required to undertake the CRM Auction monitoring role as are required for the SEM Market Auditing role and hence there is no obvious synergy in either scope of work, skills and experience required or timing. It would therefore be better to tender for the services separately.

***Q7.3: Do you agree with the SEM Committee's proposed approach to managing conflicts of interests in the Capacity Market Code? Are any other steps appropriate to ensure that any actual or perceived conflicts of interest are managed?***

Where a clear and unambiguous process can be identified and audited then it may be possible for conflicts to be managed. However there are many areas beyond Eirgrid's ownership of the EWIC where the TSOs have strong influence on the design and operation of the market that can be tilted in their favour through how the TSOs present information to the RAs and the wider industry and this more subtle form of bias is not easy to address. For example the proposition is that generator de-rating will be carried out by the TSOs in accordance with the derating methodology set out in the CMC. However it is likely that the TSOs will have a high level of influence in the design of the methodology and any analysis that is used to support the design and hence that could clearly be a conflict that influences the ongoing efficiency and outcomes of the auctions. Similarly the CMC is to be developed by the TSOs and again as we have seen in the drafting of the TSC, there is likely to be a bias (conscious or unconscious) towards the TSOs position.

***Q7.4: Do you have any comments on the proposed auction governance arrangements?***

We are concerned at the proposals to have a separate standalone set of rules for the Capacity Market that also require separate accession. As noted in CRN Decision paper 1 (SEM-15-103), a number of respondents stated the CRM rules should, where possible all be encompassed within the revised TSC and the decision at that time indicated that all the settlement elements would be in the TSC but was silent on the remaining CRM rules. The Information note (SEM-16-007) was the first occasion where the proposition of a separate CRC Code was clearly identified. We do not see the necessity for a separate Framework Agreement and Code and believe that it would be better to have a single I-SEM framework agreement and code.

It is also unclear whether the latest proposal is for the CMC to be developed by the TSOs. The consultation paper indicates that the CMC will impose obligations on the CRM Delivery Body to develop auction rules but is silent on the actual CMC rules development. This is confirmed in Figure 14 but which is silent on who is developing the CMC. However the February information Note clearly states in the first paragraph of section 2.6 (page 9) that the legal

drafting will be undertaken by the TSOs. It would be useful to understand what the latest proposals are for the development of the CMC rules and how conflicts will be managed in this process.

***Q7.5: Do you have any views on the model and process for making modifications to the Capacity Market Code?***

The main concern is that the process needs to be transparent and robust such that there is a high degree of stability to engender investor confidence. It is not readily apparent why a different change process is required and our preference would be to stick with a tried and tested modifications process.

***Q7.6: Do you think that disputes in respect of the Capacity Market Code should be resolved by a similar process to TSC disputes? Should there be a separate panel for Capacity Market Code dispute resolution?***

The disputes process should seek to be as similar to the existing disputes process as is possible. However, the nature of disputes in the CRM are potentially more material, for example relating to a participant being excluded from an auction and not securing an RO contract that could force closure of the unit, or not enable an investment to proceed. Hence the value underpinning a dispute is likely to be much greater than is typical in the SEM (e.g. over data used in settlement, etc.) and hence could potentially be more litigious. This may therefore mean differences are necessitated by the nature of the disputes that might arise under the proposed CRM and the liability issues will require much greater debate during the development of the rules and contractual framework.

**Chapter 8. Questions on other Residual Issues**

**Strike Price Questions**

***Q8.1: Do you agree with the proposed approach to incorporating the carbon price into the Strike Price formula?***

We agree that the cost of carbon should be included in the strike price formula although the changes to the formula that are proposed do not deliver the desired outcome because the new CIG and CIO terms are defined in terms of electrical output which is then further adjusted by the reference thermal efficiency.

It is also unclear whether the formula fully reflects other cost items that should be included. For example the definition of GRP makes reference to a transport adder which is to be considered in the upcoming CRM parameter consultation. However it isn't clear if it is anticipated that this will include the cost of daily gas capacity as well as the gas transportation commodity charge, which is the correct approach. Similarly there is no reference in the formula to variable O&M costs that are currently included in SRMC bids in the SEM.

***Q8.2: Do you agree with the approach of moving to a month-ahead index?***

We do not agree with the proposal to move to a month-ahead index. Referencing to a monthly index will result in a less volatile strike price but that could well be lower than the actual SRMC of a peaking unit on any individual day within the month. This creates a scheduling risk for the generator as there could be occasions where it isn't scheduled and therefore not earning market revenues yet would be forced to make RO payments driven by the variance between month ahead and spot gas prices. This creates an artificial risk for the RO holder which they will need to reflect in their bid in the CRM auction, either increasing prices for customers or else pricing the provider out of the market as a consequence of the risks arising from the pricing mismatch.

***Q8.3: Do you agree that a reference thermal efficiency of around 15% is appropriate? If not, why not?***

The reference thermal efficiency must be selected to ensure that the strike price is higher than the SRMC costs of all units in the market, and not just for the majority of the time. We would also highlight that in Northern Ireland, generating units were historically required to have a minimum on-time of

minutes rather than hours and hence plants could be scheduled for less than an hour and also, usually only at part load since they will be required to carry spinning reserve. It is not clear why it is stated that the shortest period that scarcity can occur is one hour since our understanding is that scarcity pricing could apply in any balancing period which is currently 30 minutes. Hence the reference efficiency must be set at a level that ensures such unit's SRMC costs are less than the derived strike price. The analysis indicates that calculated efficiency ratios are around 15% and hence the proposal. However given the analysis is derived from operation at full load for one hour, this represents the top end of an appropriate efficiency ratio and hence a reference efficiency of 15% is the maximum and further analysis to consider the lower bound of efficiency ratios for part load operation for the duration of a single BM period should be undertaken.

***Q8.4: Do you agree that the appropriate oil price is the Heavy Fuel Oil price?***

There are very few generating units left in the market that are HFO fired (only Tarbet) and those units are scheduled to close in 2022 even before any consideration of the possible impact from I-SEM CRM exit signals. A better approach may be to add HFO into the formula in addition to Gasoil rather than as a substitute for it, at least while HFO fired units remain active in the market.

***Q8.5: Do you agree with the principles / criteria set out in Section 8.2.28, that the SEM Committee proposes to use to choose between data sources for fuel and carbon prices, exchange rates?***

We generally agree with the principles and would highlight that the key criteria is that the generator should be able to access the prices contained in any index when it trades in the physical markets. There are additional costs incurred in fuel procurement (e.g. collateral) which need to be recoverable by generators in the market, e.g. as part of VOM costs.

***Q8.6: Do you agree with the proposed governance / process for changes to fuel and carbon prices, exchange rates and transport adders used in the calculation of the Strike Price?***

It is not clear how the TSOs will have access to accurate transport adders for Gasoil or HFO.



It is also important that changes are kept to a minimum and where there is a proposal to change, that such a proposal is consulted upon with sufficient notice to ensure that the impact on other arrangements such as forward contracts, that will likely intersect with the CRM ROs, can be taken into account and any associated modifications can be concluded.

### **Socialisation Arrangements Questions**

***Q8.7: Do you agree with the proposed approach for setting the Supplier's contribution rate? If not, please explain.***

It is difficult to comment on the approach as there is insufficient information on the proposals. The critical calculation relates to the determination of the value of the potential hole in the hedge and there is no discussion on the drivers of the gap or the methodology by which the value could be determined but it is merely left to SEMO to make a proposal to the RAs. There are other critical considerations such as whether a per MWh charge is the most appropriate charging method or whether an alternative approach such as demand during scarcity events would be more appropriate. The materiality of this discussion will depend on the value of the shortfall and whether that would influence customer behaviour depending on the charging methodology.

The shortfall is also influenced by many of the other decisions yet to be made, including, for example, if interconnectors received the same capacity payment, that covers both missing money and the forecast value of the RO CfD payment element, yet do not pay back to customers under the RO when prices exceed the RO strike price unless there is a physical interconnector outage. This means customers are paying a premium as part of the CRM option fee for the CfD cover yet are not actually receiving full protection in the case of interconnectors and are being asked to contribute a second time for the same cover as part of the socialisation arrangement. Similarly, the arrangements for adjusting the capacity requirement for non-participation will also affect the RO cover secured and hence the level of the hole in the hedge. Until these issues are finalised it is difficult to provide definitive comment on the most appropriate arrangement for plugging the hole in the hedge.

**Q8.8: Do you have a preference as to which option (Suspend and Accrue or Immediate Additional Charge) should be applied to socialisation of any shortfall in Reliability Option difference payments? If not, please explain.**

We are not suppliers and hence have no preference. However we would note the comment in 8.3.10 that “any shortfall can be covered through borrowing”. The proposals thereafter on whether to Suspend or to require an immediate charge are really therefore about determining “who” borrows. However there is no discussion on who has the lowest cost of borrowing, for example, would the TSOs with guaranteed recovery through a “K” factor mechanism have lower borrowing costs than Suppliers who may have difficulty recovering the cost from their customers?

The other area not mentioned, yet evident from Table 8, is the influence the different options create on the obligation or incentive to be balance responsible. We would have expected some consideration of the impact of the different options on the efficient functioning of the market.