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27<sup>th</sup> April 2016

**RE: Response to Capacity Remuneration Mechanism Detailed Design  
Third Consultation**

Dear Karen, Thomas,

Tynagh Energy Limited (TEL) welcomes the opportunity to respond to this Capacity Remuneration Mechanism Detailed Design Third Consultation (SEM-16-010).

The response has been separated into two sections: Section A describes TEL's views on the CRM 3 Consultation Paper and Section B answers the questions raised in the Consultation.

**Section A**

**1. Market Power**

TEL agrees with the market power concerns highlighted in the consultation and some of the proposed mitigation measures. The introduction of restrictions on bidder communication should remove the market power concerns of Tacit Co-ordination from market participants who do not have market power. Therefore, the proposal to apply bid limits to all participants is excessive. TEL believes that bid limits should only be applied to market participants who fail a dominance test.

Considering the minded to position of the RAs for the CRM is an interconnector led approach, as an owner of an interconnector and potential CRM participant, there is now a conflict of interest for EirGrid in the qualifications and operation of the CRM auctions. Even though the RAs will determine the de-rating for the interconnectors, the TSO will still be heavily involved in the de-rating methodology. The minded to position for the interconnector led approach has resulted in a market power issue for EirGrid. In order to remove any doubt around conflicts of interest for Eirgrid the parameter modelling for the CRM must be a transparent process.

**2. Auction Design**

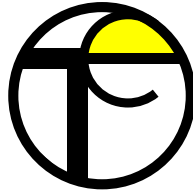
TEL agrees with the minded to position from CRM 2 for separate T-1 auctions for the transitional year auctions. However, TEL believes the four separate T-1 transitional year auctions should be held within a short period of time to provide clarity to the market participants.

TEL disagrees with the proposal that allows an auctioneer to accept out-of-merit bids based on an optimisation as all auction winners should receive the same price. The ability to accept of out-of-merit bidders could incentivise the auctioneer to pay higher for one out-of-

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merit bidder and reduce the clearing bid for the majority of in-merit bids. TEL believes the combination of a supply curve bid structure for the tolerance band and a sloped demand curve (with a minimum of 8 hours LOLE) should mitigate the issues around “lumpiness and discrete bids”.

### 3. Strike Price

TEL agree with the approach of moving to a month-ahead value for NBP gas as the basis for setting the component of the Strike Price associated with gas fired generation. However, considering these plants may be purchasing daily gas capacity there should be a daily gas capacity adder to the month-ahead index in order to replicate the actual SRMC.

Since the reference thermal efficiencies and prices for gasoil and heavy fuel oil plant are different, TEL believes the strike price formula should incorporate both of these plants. TEL would like clarification on what the ORP is likely to be. On page 89 the ORP is stated to be gas oil but on page 94 the ORP is stated to be heavy fuel oil.

### 4. Auction Price Cap / Bid Limits

The likelihood is that the current proposed design coupled with the other changes in the market will see a number of plants exiting the system, this may see under capacity in the medium term. A price cap equal to the Cost of New Entry will not be sufficient to entice new entry.

Considering the GB and US PJM have set the Auction Price Cap at 1.5 times estimated Net CONE and ISO New England have a multiple of 2, the proposal for the CRM auction cap to be 1 x Net CONE will stunt the entry of new investment required to maintain the security standard. If market power is controlled, then the risk of driving up the auction price is mitigated and the need to set the Auction Price Cap at such a low value is removed. TEL believe that an auction price cap should apply once bid limits are applied to those mandated bidders who fail a dominance test.

### 5. Price Floor

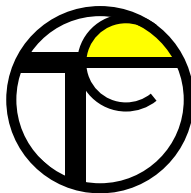
Previous experience of an RO auction in New England (detailed in our previous responses) showed that the price of the RO fell to a Price Floor where there was excess supply or alternatively the price reached the Price Cap when there was a shortage. This was due to the binary nature of product – you either were successful and received revenue with a requirement to be available at times of system stress, or were not. Where there is insufficient capacity there is a reluctance to enter the market as the price will fall as soon as there is sufficient capacity. In the CRM, in the absence of a price floor, the price is likely to tend to 0. An inefficient generator is better getting some capacity revenue than none at all. This will lead to considerable stress and possibly exit of newer and more efficient plant. A price floor set at a figure close to 50% of the existing capacity pot would provide for a more orderly exit of generation.

## **Section B**

### **Auction Frequency and Volumes**

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

TEL agree with the proposed approach for the transitional, T-4 and T-1 auctions.



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

TEL suggest a reduced timing around the T-4 and T-1 auctions. Considering the significant increase in I-SEM markets that participants will have to operate in, it would help market participants to structure their resources effectively if the auctions were held at the same time/month each year.

### **Market Power**

1. *Do respondents agree that market power is a material concern in the I-SEM CRM?*

Yes.

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?*

TEL agree with the RA's opinion that "while a market participant may or may not exercise market power, the key issue is that it has the capability to do so". Therefore, TEL believe that market power mitigation measures should only apply to those which are deemed to be dominant and possess market power. Option B (only on those mandated bidders who fail some dominance test) for the bid limits is such an approach.

The conflict of interest for EirGrid as TSO and interconnector owner could potential provide EirGrid with market power in the CRM auction.

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?*

Yes.

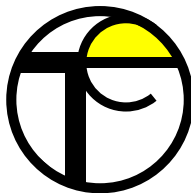
4. *What metrics should be used to assess whether a capacity provider is dominant, for the purpose of either applying other Bid Limits and/or controls on aggregation (the approach to setting the level of bid controls is discussed in section 6)?*

Considering the HHI metric is currently being used for controlling SEM market power and there has been no reported market power abuse to date, it would make sense to continue using the proven HHI metric.

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?*

TEL believe that dominant/pivotal generators shouldn't be able to act as capacity aggregators due to the additional auction complexity as well as market power issues.

Associated businesses of dominant / pivotal generators (e.g. their supply arms) should be prevented from acting as capacity aggregators.



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

Yes.

### **Auction Design**

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?*

TEL does not have a strong opinion on this but has a minded to preference for the simple sealed bid format as the most appropriate for the transitional, T-4 and T-1 auctions. The lower potential for market abuse, simplistic approach for bidders to participate and relatively low cost makes the sealed bid approach a more viable option than the multiple round descending clock format. However, TEL believe that participants must be able to submit supply curves in the simple sealed bid format in order to provide the require bidding flexibility to participants without the need to develop the combinatorial format.

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

TEL prefer Option 2 (supply curve) as it provides greater bidding flexibility to the capacity provider. This must be subject to capacity provider being able to submit bids with a supply curve close to their available capacity i.e. the supply curve can have two values such as 399 MW and 400MW. The increased flexibility could provide the auctioneer the ability to mitigate the “lumpiness / discrete bids” issues.

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.*

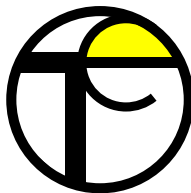
TEL strongly disagree with the proposed option 3b of selecting out-of-merit bids. This discussion is all based on one of the key complexities highlighted in point 5.4.2 which is the rules require the auctioneer to accept all or nothing of the marginal bid. If the supply curve (option 2) for the structure of bids was available this could mitigate some of the issues with lumpiness/discrete bids. However, the ability to submit small supply curves (e.g. 399 MW to 400 MW) could still lead to this problem. TEL believe Option 2a (a net welfare function calculation) similar to GB should be applied once the LOLE of 8 hours is maintained. If not option 1 is the only suitable proposal.

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.*

TEL strongly disagree with this approach as it provides incentives to the auctioneer to select out-of-merit units and pay a lower price to the in-merit units. All auction winners should be paid the same price.

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

TEL believe a sloped demand curve should be introduced once the approach of settling the clearing price based on the highest accepted in-merit winner. The sloped demand curve and supply curve bid structure should mitigate the need for selecting out-of-merit units. If



the security standard is to remain at 8 hours, this must be the minimum retained in the auction. If excess capacity is purchased it will result in the system operating closer to a more realistic LOLE.

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

Yes.

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?*

See question 3 above.

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?*

Yes. All winners of the auction should be paid the same price.

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

The sloped demand curve and supply curve bid structure should mitigate the issues with lumpiness / discrete bid issues. If excess capacity is purchased it will result in the system operating closer to a more realistic LOLE.

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

The ranking rules for GB, as highlighted in the consultation, appear to be a reasonable treatment of tied bids.

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?*

TEL agree with the list of information as highlighted in the consultation. In terms of the information between qualification and start of the auction, TEL agree that publishing the volumes opted out of the auction would assist in incentivising cost reflective bidding. TEL think the publication of volumes won on each capacity market unit at the end of the auction would assist in the transparency of the auction and aid the secondary market trading.

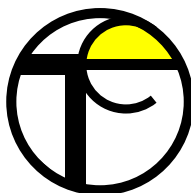
12. *Are any additional restrictions on bidder communications (over and above existing competition law) required?*

The restrictions on bidder communication proposed should ensure the integrity of the auction.

### **Auction Parameters**

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

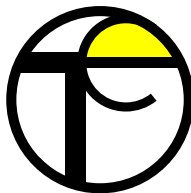
The capacity tolerance bands must be provided with the de-rating factors for each dispatchable generator.



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?*  
The sloped demand curve should move from shallow to steep and always maintain at least the security standard of 8 hours.
3. *If introduced, should the sloped demand curve be different for the transitional period?*  
The approach that is to be applied in the transitional period should be the same as that applied in the enduring arrangements. This will provide a trial run for determining the full impact of the sloped demand curve before implementing on long term contracts in the T-4 auction. After the transitional period, if necessary, the sloped demand curve can be adjusted.
4. *What impact do you think the sloped demand curve will have on competition?*  
It will reduce price.
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?*  
Considering the GB and US PJM have set the Auction Price Cap at 1.5 times estimated Net CONE and ISO New England have a multiple of 2, the proposal for the CRM auction cap to be 1 x Net CONE will stunt the entry of new investment required to maintain the security standard. If market power is controlled, then the risk of driving up the auction price is mitigated and the need to set the Auction Price Cap at such a low value is removed. As mentioned in the market power section, TEL believe that an auction price cap should apply once bids limits are applied to those mandated bidders who fail some dominance test.
6. *Do you agree with the requirement for other Bid Limits?*  
Yes, once they apply to bidders who fail some dominance test.
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?*  
The bid limits should only apply to bidders who fail some dominance test.
8. *Should the other Bid Limits be applicable to all bidders, or just dominant/ pivotal generators?*  
The bid limits should only be applicable to dominant/pivotal generators.
9. *What principles should be used to determine the level for the other Bid Limits/what level should they be set at?*  
TEL think that long run costs must be part of the principles used to determine the level for the bid limits.

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

1. *Do you agree on the proposed role of the TSOs with respect to the auctions?*  
Considering EirGrid has a conflict of interest as interconnector owner and TSO, transparency of the qualification process, calculation and publishing of results is critical to removing any doubt of abuse of position by EirGrid. The development of the auction guidelines must incorporate all market participants to ensure there is equitable treatment



for participants. TEL agree with the proposed role of the TSOs with respect to the auctions once the overall CRM auction is carried out in a transparent process.

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?*

TEL believe an Independent Auction Monitor is required considering the significant sums of money and potential conflict of interest for EirGrid.

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?*

TEL agree that control/responsibility and transparency mitigation measures proposed could reduce the conflict of interest.

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

The development of the auction guidelines must incorporate all market participants to ensure there is equitable treatment for participants.

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

No opinion.

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?*

No opinion.

#### **Other Residual Issues**

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

Yes.

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

TEL agree with the approach of moving to a month-ahead index. However, considering these plants will be purchasing daily gas capacity there should be a daily gas capacity adder to the month-ahead index to replicate the actual SRMC.

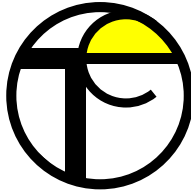
3. *Do you agree that a reference thermal efficiency of around 15% is appropriate? If not, why not?*

Since the reference thermal efficiencies and prices for gasoil and heavy fuel oil plant are different, TEL think the strike price formula should incorporate both of these plants. The methodology to arrive at the thermal efficiency of approximately 15% is reasonable.

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

The formula on page 89 states the oil price is gas oil spot reference price. This needs to be clarified.





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?*  
Yes.
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?*  
No opinion.
7. *Do you agree with the proposed approach for setting the Supplier's contribution rate? If not, please explain.*  
No opinion.
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.*  
No opinion.

Should you have any queries, please do not hesitate to contact me.

Yours sincerely,

**Cormac Daly**  
**Risk and Regulatory Manager**