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# SEM Committee

## Integrated Single Electricity Market (I-SEM) Capacity Remuneration Mechanism Locational Issues

Consultation Paper SEM-16-052

Consultation Response from



September 2016

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## Introduction

BnM welcomes the opportunity to respond to this ‘Supplemental’ consultation given our concerns regarding the potential impact it could have on the design and implementation of the I-SEM’s Capacity Remuneration Mechanism.

Bord na Móna recognises the difficult task facing the RAs and SEM Committee and acknowledges the work done in preparing the options outlined in the Consultation. However, Bord na Móna is suggesting a design which retains the fundamental integrity of the Capacity Auction while ensuring that the TSOs have sufficient resources to maintain a safe, secure and reliable network.

A proposal for a modified hybrid of Option B and E is described herein.

## Context

Bord na Móna, together with the majority of the other Market Participants, has grave reservations and concerns around the possible outcomes to the CRM-RO auction being contemplated by the SEM Committee in this ‘Supplemental’ Consultation. At the outset, it is important to point out that Bord na Móna, notwithstanding the fact that it is one of the smaller players in the Market, has proactively engaged with the RAs and other stakeholders in the design and implementation of the I-SEM to date. However, in numerous responses to various consultations, we have expressed a degree of apprehension around the constrained timelines (and commensurate pressure on quality assurance) for Project delivery. Unfortunately, the very existence of this particular ‘Supplemental’ consultation is a direct consequence of the Project Plan (including the unrealistic timelines) being overly ambitious.

The aftermath of attempting to shoe-horn a ‘Supplemental’ Consultation into the existing Project Plant configuration has limited this consultation to just 4 weeks<sup>1</sup>. This abbreviated consultation period cannot be considered ‘best’ or even ‘good’ practice. In addition, formal industry requests for an extension were met with the response that an extension was not merited as the SEM Committee purposely “*prepared a focused and much shorter supplemental consultation paper*”.

Such a reply begs the obvious question as to whether there is additional information, analysis, impact assessments, and modelling in the possession of the RAs that were not shared with potential Capacity Providers which could be of assistance to them in developing their thinking on this ‘Supplemental’ issue?

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<sup>1</sup> This is a complex Consultation – examining the various combination of options outlined by the SEM Committee for determining auction winners, clearing price determination, definition of local constraints, treatment of local constraints in T-4 auction, and Market Power mitigation (existing and new units) results in over 500 possible permutations.

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## Background

Bord na Móna, in common with the SEM Committee is working on an assumption, an eminently reasonable assumption, that given the small size of the all-island market, the energy market will be a single bidding zone. Logic, precedence and experience from other markets require harmonised bidding zones in energy and capacity markets. Bord na Móna can see no objective rationale for splitting the energy market into a plurality of bidding zones and hence there is no rationale for contemplating bidding zones or proxies zones for the capacity market.

Bord na Móna has consistently posited that Capacity and Flexibility are two separate products which should be procured and remunerated separately. Section 2.4.1 of the ‘Supplemental’ consultation would suggest that the SEM Committee is also minded to view Capacity and Flexibility (Ancillary Services) as separate and distinct ‘products’. It is also agreed that Capacity Mechanisms are designed and implemented to deliver Generation Adequacy in a particular market/bidding zone, and accepting that the HLD stipulates a single bidding zone for the island of Ireland, the logical and inescapable conclusion is that the capacity procured from the Capacity Auction must be for the bidding zone as a whole, and importantly must be procured from providers who can do so most efficiently. The ‘Supplemental’ consultation notes that while some locational constraints may be transitional, the root cause of locational issues cannot, in general, be simply attributed to either transmission or ancillary service related constraints. Bord na Móna is acutely aware of the need for the I-SEM CRM to comply with the Commission’s guidelines around State-Aid and noting that the root cause of the locational issues is not related to overall generation adequacy and the efficient procurement of capacity, it makes eminent sense to solve the locational issues through AS arrangements.

## Preferred Auction Framework Design

In response to the underlying issues detailed in the ‘Supplemental’ Consultation, Bord na Móna has a relatively straight forward proposition – RO contracts should be awarded to **all** Capacity Providers who clear in the unconstrained Auction. Ex post the Auction, the TSOs with RA oversight then assess the Auction outturn against the requirements to maintain a safe, secure and reliable network. Where verified service deficiencies are identified, these services are then procured (one year contracts) by the TSO from providers at a price no greater<sup>2</sup> than their bid price<sup>3</sup>. In essence, this is a modified hybrid of Option B & E where the additional services are procured via AS arrangements.

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<sup>2</sup> Service providers deemed necessary by the TSO, but who didn’t clear in the auction, would be required to ‘open their books’ and justify their bid price- if deemed to be greater than their specific *net going forward cost* the RAs would regulate downwards the contract price to this value for that service provider.

<sup>3</sup> This could be a bid price greater than the clearing price, the Uniform Price Take Offer Cap or an administered price derived from the units net going forward cost.

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Such an approach is equitable, transparent, simple to implement, promotes competition, reduces the potential for gaming and by drawing a distinction between Capacity and Ancillary Services, minimises the downside risks around State-Aid compliance. In addition, such an approach dramatically reduces the complexity of representing constraints, simplifies the transition between T-1 and T-4 auctions and lessens the impact of market power.

For the avoidance of doubt, Bord na Móna does not support any Option whose outcome could deliver unhappy winners following an unconstrained auction (or what would have been the merit order in an unconstrained auction).

On a without prejudice basis, if there were to be displaced winners, Bord na Móna, in the interest of both equity and the long term investment signals, would require that such displaced winners be awarded the clearing price. The absence of compensation for sunk investments which clear the auction but are displaced because of locational constraints, where locational signals already exist, would overnight turn the SEM/I-SEM from a competitive market-place into a mere **post code lottery**.

The underlying principle should be that the plant which wins an RO contract in an unconstrained auction should be awarded a contract at the Auction clearing price. For the purposes of this submission, Bord na Móna is not addressing the lumpiness/inflexibility question, having already made our position clear in response to SEM-16-10.

The rationale supporting the above proposal includes:

- a) it is not the fault of the competitive capacity provider that it might happen to be in an area with sufficient transmission infrastructure and adequate provision of ancillary services and consequently it should, at the very least, receive the outcomes described above.
- b) to 'constrain off' units without reward would conflict with some of the assessment criteria for managing locational CRM issues set out in the consultation paper, most notably relating to equity, competition and discrimination. Such an action would not be aligned with the views expressed in CRM3 Decision Paper that:  
*'The winner determination process will require and ensure that all lower-priced segments of a bid from a CMU must be accepted in whole before any higher-priced segment from that CMU is accepted in whole or in part<sup>4</sup>'*
- c) the implementation of the changes need to be introduced in such a way as to give appropriate signals to investors who may be fearful of further regulatory interventions being introduced mid-business cycle for other future projects.

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<sup>4</sup> CRM qualifies this with: 'The higher-priced segment might be accepted in part if it is flagged as a flexible bid segment'

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## 2.6 SUMMARY OF QUESTIONS

### 2.6.1 Do you agree with the assessment of the potential for exit and lack of new entry during the transition period set out in this section, and do you think that the potential for exit creates a security of supply issue given locational constraints?

Yes, the potential for exit exists and the likelihood for new entry during the transition period is limited. However, the *raison d'être* of a capacity mechanism is to ensure generation adequacy for the market as a whole.

The changing generation mix (policy driven), the tardiness in delivering identified and necessary transmission infrastructure, uneven spatial development across the jurisdictions and the small, isolated island nature of the market are physical challenges that are not solved by Capacity alone (either MW or Units) but instead require a combination of system services to maintain the 8 hour security standard. As stated above, the locational constraints (which by definition are in flux) can be best solved by specific ancillary services contracts isolated from and separate to the CRM.

### 2.6.2 Do you agree that locational constraints should be incorporated in the CRM? Please elaborate your rationale in your response.

No. The reasoning articulated in the 'Background' Section above is, for the sake of completeness, reproduced below in response to this specific question.

Bord na Móna has consistently posited that Capacity and Flexibility are two separate products which should be procured and remunerated separately. Section 2.4.1 of the 'Supplemental' consultation would suggest that the SEM Committee is also minded to view Capacity and Flexibility (Ancillary Services) as separate and distinct 'products'. It is also agreed that Capacity Mechanisms are designed and implemented to deliver Generation Adequacy in a particular market/bidding zone, and accepting that the HLD stipulates a single bidding zone for the island of Ireland, the logical and inescapable conclusion is that the capacity procured from the Capacity Auction must be for the bidding zone as a whole, and importantly must be procured from providers who can do so most efficiently. The 'Supplemental' consultation notes that while some locational constraints may be transitional, the root cause of locational issues cannot, in general, be simply attributed to either transmission or ancillary service related constraints. Bord na Móna is acutely aware of the need for the I-SEM CRM to comply with the Commission's guidelines around State-Aid and noting that the root cause of the locational issues is not related to overall generation adequacy and the efficient procurement of capacity, it makes eminent sense to solve the locational issues through AS arrangements.

In response to the underlying issues detailed in the 'Supplemental' Consultation, Bord na Móna has a relatively straight forward proposition – RO contracts should be awarded to **all** Capacity Providers who clear in the unconstrained Auction. Ex post the Auction, the TSOs with RA oversight then assess the Auction outturn against the requirements to maintain a safe, secure and reliable network. Where verified service deficiencies are identified, these services are then procured (one year contracts) by the TSO from

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providers at a price no greater<sup>5</sup> than their bid price<sup>6</sup>. In essence, this is a modified hybrid of Option B & E where the additional services are procured via AS arrangements.

Such an approach is equitable, transparent, simple to implement, promotes competition, reduces the potential for gaming and by drawing a distinction between Capacity and Ancillary Services, minimises the downside risks around State-Aid compliance. In addition, such an approach dramatically reduces the complexity of representing constraints, simplifies the transition between T-1 and T-4 auctions and lessens the impact of market power..

### 2.6.3 Feedback in relation to the specific Grid Code requirements are sought in respect of the following:

- The extent to which the Grid Code requirements can be relied upon to manage exit of plant which does not obtain a Reliability Option;

Grid code requirements should not be relied upon to manage exit of plant which does not obtain a Reliability Option as effectively such plants would not be recovering their long run costs, and expecting such plants to run at a loss cannot not be an economically rational outcome.

- Whether it is appropriate to provide assurances that generators which do not obtain a Reliability Option in the transitional auctions (which happen on a T-1 basis) be released from their obligations to give 3 years notice in accordance with the Grid Code; and

Equity would suggest that such assurances should be provided.

- Whether the Grid Code requirement should be extended from 3 years notice, to say 3 years 6 months to align with T-4 auction timings.

BnM supports this proposal.

### 2.6.4 Do you agree with the key principles proposed for any locational capacity framework within the CRM?

Bord na Móna refers again to our response to Q.2.6.2 above, where the local system constraints are best remedied post the clearing of the unconstrained CRM auction *via* the ancillary services market.

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<sup>5</sup> Service providers deemed necessary by the TSO, but who didn't clear in the auction, would be required to 'open their books' and justify their bid price- if deemed to be greater than their specific *net going forward cost* the RAS would regulate downwards the contract price to this value for that service provider.

<sup>6</sup> This could be a bid price greater than the clearing price, the Uniform Price Take Offer Cap or an administered price derived from the units net going forward cost.

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2.6.5 Do stakeholders agree that clear and large existing capacity delivery constraints should be reflected within the CRM auction, for example limiting this to the North-South constraint and the Dublin area constraint?

No – CRMs are designed to deliver the notional security standard for the market – locational issues and constraints are best remedied post the clearing of the unconstrained CRM auction *via* the ancillary services market.

2.6.6 Do stakeholders agree with the high level proposed solution for dealing with locational capacity issues?

Bord na Móna refers again to our response to Q.2.6.2 above, where the local system constraints are best remedied post the clearing of the unconstrained CRM auction *via* the ancillary services market.

2.6.7 If you do not agree with or have further view any of the proposals or assessment set out in this section, please outline why and where relevant suggest alternatives.

As already referenced, we propose within our response a transparent, flexible and economically efficient solution, which is simple to introduce, and which, above all, introduces an element of fairness and non-discrimination to existing plant which may, through no fault of its own, be located in an area with sufficient transmission infrastructure and adequate provision of ancillary services.

## 3.6 SUMMARY OF QUESTIONS

3.6.1 Which option do you prefer for the Auction Design Framework and why?

Bord na Móna refers again to our response to Q.2.6.2 above, which describes an Auction Design Framework which is a modified hybrid of Option B and E.

3.6.2 Should the capacity price be set equal to: a) the highest-priced bid accepted in the unconstrained merit order; or b) the highest-priced bid which is both: accepted in the unconstrained merit order; and selected as a winning bid after lumpiness and locational considerations have been resolved?

The capacity price should be set equal to a) the highest-priced bid accepted in the unconstrained merit order. This is a simple approach which reflects fair and competitive free market based principles which could not be construed as being discriminatory and which will underpin long-term energy sector investor confidence.

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3.6.3 Should a bidder that would have been accepted in an unconstrained auction but which is not awarded an RO receive a “constrained-off” payment in the CRM? If yes, how should the “constrained-off” payment be determined, and why?

On a principled basis, we do not believe that such a bidder should be ‘constrained off’ in the first instance.

However, and on a without prejudice basis to our preferred solution, if the CRM were to be designed in a manner where unconstrained auction winners were to be ‘constrained off’, equity and the integrity of the SEM/I-SEM as a market rather than a post-code lottery would require such unhappy winners to receive compensation equivalent to the auction clearing price.

3.6.4 How should local capacity deliverability constraints be defined?

Adapting an Auction Design Framework which is a modified hybrid of Option B and E, as described in response to Q2.6.2 above, effectively negates the need to define local capacity deliverability constraints.

## 4.4 SUMMARY OF QUESTIONS

4.4.1 Should the inclusion of locational capacity delivery constraints in the CRM occur in T-1 auctions, T-4 auctions, or both?

Adapting an Auction Design Framework which is a modified hybrid of Option B and E, as described in response to Q2.6.2 above, transfers localised system services deficits out of the CRM framework and into the AS procurement process.

4.4.2 What circumstances or criteria should be considered in relation to the T-4 auctions being conducted without explicit consideration of locational capacity delivery constraints?

Adapting an Auction Design Framework which is a modified hybrid of Option B and E, as described in response to Q2.6.2 above significantly reduces the complexity of locational issues in T-4 auctions..

4.4.3 Are there any further considerations that should be taken account of regarding the longer term management of locational capacity delivery constraints? If so please detail your rationale for these.

We advocate an approach which will automatically and fairly adjust to take account of medium to longer term investments delivered by transmission upgrades, new entrants, DSUs and technological advancements – delivering social benefit, competition, fairness, flexibility and, significantly, investor confidence. We believe that our proposals provide the basis for a balanced solution in this regard.



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## 5.1 SUMMARY OF QUESTIONS

5.1.1 Do you believe that the suite of market power controls set out in CRM Decision 3 are sufficient to address any additional market power issues raised by local security of supply considerations? If not, what additional measure would you propose, and why?

The paper clearly sets out in Sections 5.2 and 5.3 that the suite of market power controls are not sufficient to address market power considerations raised by local security of supply considerations. However adapting an Auction Design Framework which is a modified hybrid of Option B and E, as described in response to Q2.6.2, effectively removes locational consideration and the associated potential for market power abuse from the CRM Auction.

Finally, we are available (and would welcome the opportunity) to discuss the contents of this submission with the RAs if deemed necessary.



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