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Ref: TEL/CJD/18/109

26th June 2018

RE: Response to SEM-18-028

Dear Karen, Thomas,

Tynagh Energy Limited (TEL) welcomes the opportunity to reply to this Capacity Remuneration Mechanism Consultation (SEM-18-028). We have split our response into two sections, Section A includes comments on the consultation as a whole, while Section B answers the specific questions in the consultation.

Section A

This is a crucial consultation for the enduring market, who will participate in it, how much it will cost the Irish tax payer and most importantly how reliable the Irish system will be. The two fundamental questions from this consultation are:

- 1) Should constraints be in the T-4 Auction?
- 2) What should the Capacity Requirement be calculated from?

TEL see that the assessment criteria for the Detailed Design is still a pertinent reference and these should be reviewed when considering these questions; the enduring design has to be competitive, equitable, stable, efficient, practical, guarantee security of supply and comply with European Directives and Decisions.

European Directives / Decisions:

The EU State aid Decision is used as the basis for the move from Auction Format B. This is correct. But the Decision also stated that '*The commission underlines the importance of implementing market reforms, in particular in the ancillary services market that reward the locational value of plants, as a condition to move away from the separate procurement of locationally important plant*'¹. The consultation appears to largely disregard this aspect of the Decision. Instead stating that a review will take place in parallel. Once the SEMC accept the merit of the EC Decision, then it is just a matter of assessing and implementing the changes. These changes could take the form of DS3 Locational scalars, Strategic Reserve Contracts or even changes to TLAfs, but none of these will take four years to assess and implement. Constraints should not be in the T-4 Auction.

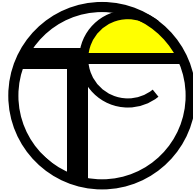
Efficient and Practical:

At a high level, if the SEMC decide to always put existing constraints into the T-4 auction even when these are expected to be resolved by the capacity year, then there will always be a four

¹ European Commission; State aid no. SA.44464 (para 158)

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year lag. This will see plants behind these constraints being paid additional costs. This year the constraints element of the T-1 auction cost the customer nearly €30,000,000. Over a four year period (even allowing for the removal of over procurement), this could amount to more than €100,000,000 additional cost to the tax payer. A simpler way, and what was the original plan for the T-4 auction, was that constraints would not be included in the auction, but would be resolved in the T-1 auction when there is greater clarity of the constraint requirements. To ensure that there is no over procurement for this period it would be necessary to hold back a larger amount, possibly as much as 7.5% for the T-1 auction.

Competition and Equity:

The proposed auction design will result in unsuccessful in-merit bidders, those unconstrained plant not being awarded contracts at the market price, while some units behind constraints with market power would be able to bid as they see fit. The impact of this will see more efficient plant not behind a constraint exit the market. There will be two reasons for this; firstly, the unsuccessful in-merit bidders will be given an exit signal, secondly, even the successful in-merit bidders (those who bid low enough to stay on in the market) will lose market share as the successful out of merit units will have received a greater contribution towards their fixed costs and will be able to cross subsidize their energy bids. This Auction format will not produce a competitive environment throughout the market but will reward market power. Furthermore, these constrained plant will benefit from the constraint premium in the CRM and will also benefit from whatever additional locational signals can be introduced. It is more equitable to outline the changes under consideration prior to the March Auction and ensure that these are introduced as soon as is practicable. These locational signals are likely to be introduced fully within two to three years.

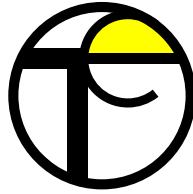
Stability:

This criterion is described as 'The trading arrangements should be stable and predictable throughout the lifetime of the market...' . However, the consultation indicates that in parallel with this consultation the TSO will carry out a T-4 Locational Capacity Constraint analysis, as a result of which there may or may not be constraints in the Auction. But, also in parallel, a full and comprehensive review of locational signals. Both the review and the analysis add doubt to the short and long term stability of the enduring design. If the enduring mechanism is likely to be unconstrained, once these ancillary changes are implemented, then it will be more stable to have the auction unconstrained now, and in parallel introduce these locational signals.

Security of Supply:

The Capacity Requirement is a key part of the market going forward. If we assume that anyone who is unsuccessful in the T-4 auction is given an Exit signal, then the auction needs to ensure that there is sufficient capacity to meet Ireland's genuine Loss of Load standard. The SEM has not had a Loss of Load event since 2007. This does not correlate with Ireland's LOLE of 8 hours per year. If the SEMC continue with the existing LOLE, along with the non-inclusion of reserves; and only that level of capacity stays on the system, then there is likely to be significant loss of load. As Eirgrid will have significantly under procured. This will have untold damage to the Irish and Northern Irish economies. The SEMC need to ensure that this doesn't happen. We urge the SEMC to make sure that there are sufficient winners to meet a realistic LOLE and provide reserves. There are fears that necessary constrained plant will exit if there are no constraints in the T-4 Auction. TEL do not believe that existing plants will exit if they are still under contract either through a T-1 auction RO or through a Strategic Reserve Contract (this appears to have been described in the State aid Decision paragraph 164.

TEL believe that an unconstrained T-4 Auction with a realistic LOLE standard of 0 hours (or at most 3 hours) combined with the inclusion of reserves will meet the design criteria. This design can then be supported both by T-1 auctions containing constraints and Strategic Reserve Contracts.



Section B

Chapter 2:

1. *Do you agree with the SEM Committee's proposal to reflect transmission constraints in the T-4 auction? Please explain your rationale.*

No.

The recommendation appears to be driven by an inability to have a 'full suite of reforms to locational signals' in place by March 2019. This seems short sighted. The Locational Decision was published in December 2016. Nearly 30 months prior to the first T-4 auction and these reforms have not been carried out, or even properly assessed.

The TSO appears to have kicked to touch in their recommendation regarding the inclusion of constraints in the T-4 Auction. They have asked that they be allow to complete their analysis in parallel, and if there is a need in March to include constraints, they will.

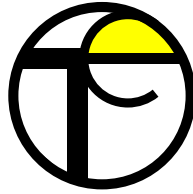
One of the CRM Detailed Design Criteria is that the system will be Stable. This is the first T-4 Auction. We are nine months from the auction, after a five year design process and we are not confident of the Auction Design (it is implied that constraints may not be included after the full suite of reforms for locational signals). We need to get this right first time, if the SEMC can see that the T-4 auction for 2024/2025 should not have constraints in the auction, then they should not be present in the 2022/23 (two years earlier) auction either. If this means that the T-4 auction is delayed, this would be a better outcome than having an intermediary form of T-4 Auction Design to go alongside the T-1 Transitional Auctions.

If this recommendation is implemented (combined with the State aid Decision), then unconstrained generators are at a huge disadvantage. These constraints are expected to be temporary in nature. It is expected that the North-South Interconnector should mostly resolve the Northern Ireland constraint, while upgrades in the transmission system in Dublin should relax the Dublin constraints. If the constraints are due to be largely resolved, then it is unacceptable to include them in the T-4 auction.

It would also appear that putting constraints into the T-4 Auction runs counter to the recommendations of the State aid Decision (paragraph 158) which stated that the constraints should be resolved through ancillary services: *'...underlines the importance of implementing market reforms in particular in the ancillary services market, that reward the locational value of plants, as a condition to move away from the separate procurement of locationally important plant'*.

There are many reasons why constraints should not be included in the T-4 auction, but the strongest arguments to include them appear to be expedience and convenience. This is not appropriate for what should be an enduring design solution. It may be worth considering delaying the T-4 Auction by a year until the full review of locational signals has been completed.

- 2) *Do you have any comment on the possible inclusion of multi-year pay-as-bid Reliability Options to meet the minimum Locational Capacity Constraint requirement?*



We do not support this as stated. New participants should be allowed bid in for multi year pay as bid Reliability Options, but not confined to a constrained area. Constraints have previously been described in RA consultations as temporary. If a plant was to be successful in the T-4 auction for development in Northern Ireland, and the North South Interconnector is subsequently built and there is no requirement now for the plant, the System operator will be paying out of market payments for 5-10 years. This is not efficient or competitive.

3) *Do you have a preference between the options set out above in relation to pay-as-bid offers? Please explain your rationale.*

Option 3, but only if no locational constraints. If locational constraints are included then Option 1.

Chapter 3:

1) *Do you have any comments on the SEM Committee's proposal to move to an auction format based on Auction Format C for the CY2022/23 T-4 auction, following the State aid decision?*

Fundamentally the EC Decision means that Auction Format B is no longer available. However the Decision states *'...underlines the importance of implementing market reforms in particular in the ancillary services market, that reward the locational value of plants, as a condition to move away from the separate procurement of locationally important plant'*. This expresses a preference that constraints should be resolved through System Services, not through a Capacity Mechanism. We support this. The Auction should be unconstrained, with any constraints being applied in the T-1 Auction. Failing that, the TSO's should have the ability to offer necessary plant a Strategic Reserve Contract. These plant would then be excluded from the market but could be dispatched by the TSO when required.

2) *Do you have any comments on the TSOs proposed AASM for implementing the new auction format, as set out in Appendix A, or the RAs' proposed change to the N parameter?*

We would disagree with the proposed AASM. This mechanism to support constraints is flawed, it is simpler to design the T-4 Auction correctly so that it is an enduring solution and facilitate a T-1 auction that can also resolve constraints if required.

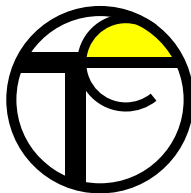
3) *Do you have any comment on the proposed change to the format to accommodate multi-year pay-as-bid Reliability Options?*

We do not believe that it is correct to change the format if locational constraints are included. Multi year bids should be included in the unconstrained auction. If the price rises above the ECPC and they clear they will then have a multi year RO, but it will not be dependent on a temporary constraint. This will reduce the potential of some participants exploiting a temporary constraint to maximise capacity payments.

Chapter 4:

1) *What are your views on the potential changes proposed to the CR methodology i.e: Incorporate some measure of operating reserves in the CR? What MW value?*

Yes, operating reserves should be included. If Eirgrid only contract those plant that are required to provide demand, then we will not have the reserves which we require. An argument against including reserves was that there would be over purchasing due to Option format B, this has been removed. Reserves have to be included. If only those plant that are successful in the Capacity Auction remain in the Market, and the TSO does not contract plant to provide reserves then the system will be short capacity whenever it reaches peak demand minus operating reserve requirement. It follows that the maximum level of operating reserve requirement needs to be included in the capacity requirement. This equals 75% of the largest in feed on the system or 375MW.



2) *Whether the 8-hours LOLE standard should be tightened (reducing the LOLE target). What level do you consider to be appropriate and why?*

It should be tightened, Ireland should move towards EU harmonisation. It is bizarre using the figure of 8 hours loss of load to calculate a reduced capacity requirement and not reflecting reality. Ireland operates to a level of 0 hours loss of load, and has for more than 10 years. If we do not procure the capacity to reflect this then we will lose load. That is not acceptable for Irish industry. Ireland did not over procure in 2018/19, if anything Ireland under procured. Ireland did not take into account reserves and based its requirement off an unrealistic LOLE. If the SEMC does not want to move to a realistic standard of 0 hours, then the level of 3 hours would be consistent with many of our neighbours.

Chapter 5

The SEM Committee welcomes views on the following consultation questions:

1) *Which of the options for the value of Full ASP do you consider most appropriate for the first T-4 capacity auction, and why?*

Before addressing the issue of full ASP there needs to be a review of the risk associated with each generator. The risks are not equal amongst all generation as those plants behind a constraint will be dispatched by the TSO, however those plants who are not behind a constraint are exposed to potential errors on the part of the TSO. Until this risk rebalancing occurs TEL cannot support a move from the existing ASP. However, if it was within a generator's control, i.e. if the TSO were to flag a potential event through a Loss of Load Probability Report and a generator subsequently failed to bid at a or below cost, and they failed to be dispatched then they would be liable to difference payments, then it would be fairer to use a full VoLL.

2) *Should we move to setting VoLL on an October to September year, rather than the current Calendar Year basis, so that a single value of VoLL pertains within a Capacity Year?*

Yes.

Chapter 6

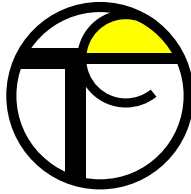
1) *Should the proportion of the CR the SEM Committee hold back from the T-4 CY2022/23 auction for the T-1 CY2022/23 be increased from 5% to 7.5%, and why?*

No, it should not be increased unless constraints are not in T-4, in which case it would be appropriate to hold back the additional 2.5% for the T-1 auction. While there is an argument that DSU participation will increase by 22/23, there is nothing to prevent DSU's from participating in the T-4 auction as in GB.

2) *Should the minimum MW in each constrained area be adjusted for volumes withheld from the T-4 auction to the T-1 auction for CY2022/23? Which of Options 1, 2 and 3 do you prefer, and why?*

No. It is inappropriate to include constraints in the T-4 Auction, it is also contrary to paragraph 158 of the EC State aid Decision.

3) *Which of the demand curve options, Options A or B, in your view is the most appropriate for the first T-4 capacity auction, and why?*



Option A. The diagram presented is misleading and suggests that Option B will cut the x axis at 120%, there is nothing in the accompanying text to support this. Effectively then option B is just a lower demand requirement than Option A.

Chapter 7

1) Do you agree with the proposal to keep the Auction Price Cap (APC) at 1.5 x Net CONE for the T-4 auctions? If not, please explain. Is your response in any way contingent upon the final value of BNE Net CONE for CY2022/23?

No, this should be set at 3 times. There has already been announcements of closure for more than 1000MW after the first auction, it is reasonable to assume that new investment will be required by T-4.

2) Do you agree with the proposal to keep ECPC at 0.5 x Net CONE for the T-4 auctions? If not, please explain. Is your response in any way contingent upon the final value of BNE Net CONE for CY2022/23?

No, the value to the system of generation is CONE, this will become more apparent in 2022/23, when the need to ensure that plants are recovering all costs will be far more apparent.

3) USPC setting: Do you agree with the proposed approach for UFI submissions?

No

4) USPC setting: Do you agree with the proposal to apply 2% p.a. inflation projection for estimating costs for CY 2022/23?

This seems very low with the advent of Brexit and the implications for Irish inflation indices

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

Yours sincerely,

Cormac Daly
Regulation and Business Development Manager