



**Energia response to SEM Committee  
Consultation Paper SEM-19-010**

***Capacity Remuneration Mechanism 2020/21 T-1  
Capacity Auction and 2021/22 T-2 Capacity Auction  
Parameters***

**2 April 2019**

## **1. Introduction**

Energia welcomes the opportunity to respond to the SEM Committee Consultation Paper SEM-19-010 titled “Capacity Remuneration Mechanism 2020/21 T-1 Capacity Auction and 2021/22 T-2 Capacity Auction Parameters” (the “Consultation Paper”). Before commenting on its substance, we would like to note that the 4-week consultation period (with extension request refused) was inadequate. A minimum consultation period of 6 weeks should be observed for all consultations to enable interested parties to meaningfully comment. Through necessity therefore we have focused in this response on CRM parameters the RAs are proposing to change, notwithstanding our wider concerns with other parameters non-exhaustively summarised in Table 1.

The Consultation Paper states that for the majority of parameters, the RAs do not intend to deviate from the existing values. The Existing Capacity Price Cap (“ECPC”) is the notable exception where feedback is sought on the potential for reducing it from the current multiple of 0.5 times Net CONE. This is an unwelcome proposition that Energia and the industry as a whole, represented by the Electricity Association of Ireland (EAI), does not support. Reducing ECPC is unnecessary, unjustified, potentially puts security of supply at risk and is not in consumers’ interests. Rather than decrease ECPC, there is a strong, logical and justifiable case for the ECPC to be adjusted upwards for all future auctions. The remainder of this response elaborates.

## **2. Comments on proposed parameters for CY2020/21 and CY2021/22 Capacity Auctions**

Energia fully endorses the EAI response to the Consultation Paper and its firm position against any reduction to the ECPC for the 2020/21 T-1 and 2021/22 T-2 capacity auctions, or indeed any future auctions. We strongly urge the RAs to consider the detailed reasoning put forward by EAI as follows:

- “The ECPC has already been set as a multiple of 0.5 x Net CONE for the first two T-1 transitional auctions for CY2018/19 and CY2019/20 respectively, and also for the T-4 auction for CY2022/23. The RAs suggest that they are considering the feasibility of reducing ECPC for CY2020/21 and CY2021/22, based on the fact that they have now had some experience with the process and the administration of other aligned processes, i.e. USPC. Such a rationale views the administrative burden and associated cost exclusively from the viewpoint of the RAs and ignores the costs incurred by a participant who finds that their expected going forward costs exceeds a reduced ECPC and is now faced with the costs, time and tying up of resources to prepare, validate and submit a USPC application and engage in that process. The RAs have not provided sufficient justification for reducing the ECPC. Rather, a reduction of the ECPC would significantly heighten the perception of regulatory risk in this market (raising the cost of capital), would needlessly interfere with proper market functioning (as explained further below) and would potentially put security of supply at risk, to the detriment of both investors and consumers alike.

- The rationale for the ECPC is to limit the market power of existing generators. This must be balanced with the need for generators to be given an opportunity to recover their total costs if there is demand for their product, consistent with a competitive market process, noting that a competitive market is at the core of the extant State Aid approvals (SA44464 & SA44465). The USPC process is not a valid substitute for getting this balance wrong – i.e. setting the ECPC too low<sup>1</sup>. Apart from its other flaws, this is because the USPC process expressly rules out recovery of so-called sunk costs that would neither be denied from or discounted by rational actors in a competitive market. Thus, it is not simply a matter of balancing the administrative burden of going through the USPC process and mitigating market power, as suggested by the RAs. Consistent with regulatory duties, an appropriate balance must also be struck between mitigating market power and allowing the proper functioning of markets, and by providing a substitute for markets (through regulatory intervention, where justified) that is proportionate, consistent and provides for recovery of costs that a competitive market would allow.
- EAI believes it is important to point out that direct comparison with other markets can be misleading as a justification, for example, for altering bid caps. For example, in the Great Britain (GB) capacity mechanism, existing plant are not prevented under the scheme from earning a rate of return deemed necessary, since this may be included in their submitted justification for needing a higher level of payment. In contrast to the GB scheme, the inflexible bid cap (or any USPC approved based on the inflexible definition of NGFC) under the new SEM CRM does in fact prevent the recovery of total costs and earning any rate of return for many generators. In Great Britain, therefore, there is no presumption that price caps must be imposed on certain generators, unlike under the rules of the new SEM CRM.
- It should also be noted that the determination of ECPC as a multiple of 0.5 x Net CONE was based on an estimate by the RAs considered sufficient to cover the Net Going Forward Costs (NGFC) for the majority of capacity required to meet the capacity requirement. However, this estimate was based on analysis of Non-Fuel Operating Costs (NFOC) from historical generator financial reporting which did not include capital costs associated with ongoing operations. Thus, according to this methodology, ECPC set as a multiple of 0.5 x Net CONE would have underestimated these costs.
- Market participants are exposed to the risk of significant difference payments which have been magnified during the bedding in phase of the new SEM. Tangible examples of this ‘uncertainty’ were the January 24<sup>th</sup> (and Oct ‘18) Difference Payment ‘events’ which cost RO holders (through no fault of their own) €6.8 million over a couple of trading periods. The risks/costs associated with ROs, including in the recent events where plants were not scheduled or dispatched during RO events, were not properly reflected in the ECPC / USPC, neither were these risks factored into the comparisons with the “International

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<sup>1</sup> In response to SEM-16-073, the EAI made the point to the SEM Committee that the ECPC was not sufficiently high to allow the recovery of fixed and sunk cost – this assessment is arguably validated by the increased number of USPC applications that, from the Regulatory Authorities’ (RAs’) admission, appear to have been received over the course of the capacity auctions held to date for the new SEM.

benchmark” and hence, in reality there is a strong, logical and justifiable case for the ECPC to be adjusted upwards rather than the suggested RA reduction.”

It is worth adding to the above that the capacity auction rules typically prevent the clearing price in the auction rising above the ECPC unless new capacity enters and sets the clearing price<sup>2</sup>. However, in conditions of shortage the competitive market price of an auction would rise above ECPC in order to encourage new entry. In such conditions the ECPC level is therefore holding auction clearing prices below the efficient and competitive level. This therefore means the ECPC should only be applicable in conditions of excess supply and should only apply to market segments facing these conditions, and where these conditions do not exist the ECPC is undesirable and has a price depressing impact.

Energia has consistently held the view, as reflected in responses to SEM-16-073 and SEM-18-028, that the ECPC multiplier is set too low. Energia is strongly opposed to any reduction from this already low level. To do so would further hinder cost recovery (thereby putting security of supply at risk and increasing the cost of capital) and would increase regulatory intervention in the market where it is neither justified nor proportionate in circumstances where the RAs have a statutory duty to ensure that their actions are proportionate and that decisions taken shall be fully reasoned and justified in the interests of consumers having regard to the promotion of competition, the need for license holders to finance their activities and the need to ensure security of supply.

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<sup>2</sup> The clearing price may also rise above ECPC where a plant with a USPC sets the clearing price.

**Table 1: Summary of Energia comments on proposed parameters for 2020/21 and 2021/22 capacity auctions**

<b>Parameter</b>	<b>Proposed Value for 2020/21 T-1 and 2021/22 T-2 capacity auctions</b>	<b>Energia Comments</b>
De-Rating Curves, defining De-Rating Factors by unit Initial Capacity and by Technology Class (including Interconnectors)	To be calculated by the System Operators and submitted to the Regulatory Authorities for determination.	<p>Energia reiterates its previous comments in response to SEM-18-009 whereby a more conservative de-rating of interconnectors is required as they are less predictable with uncertain direction of flows.</p> <p>Energia also maintains (for reasons outlined in response to SEM-17-027) that meaningful tolerance bands for de-rating factors should be re-instated as provided for in Decision Paper SEM-15-103. In the confidential annex of our response to SEM-17-027, we provided supporting evidence that there is “legitimate technical variation” to justify a meaningful (positive) tolerance band for Gas Turbines in particular. In the light of this evidence we have previously called for greater transparency around the process to understand the basis for a zero tolerance band. Without this necessary transparency the purported rationale for a zero tolerance band for Gas Turbines is not justified.</p>
Capacity Requirement	To be calculated by the System Operators and submitted to the Regulatory Authorities for determination.	Energia reiterates its previous comments in response to SEM-18-009 whereby a tightening of the LOLE standard from 8 hours to 3 hours is more appropriate to harmonise standards with neighbouring markets in Europe.
Indicative Demand Curve	<p>The Demand Curve will be based on the following principles:</p> <ul style="list-style-type: none"> <li>- The curve will be horizontal at the Auction Price Cap (1.5 x Net CONE) between OMW and 100% of the Capacity Requirement;</li> <li>- The demand curve will be vertical at 100% of the Capacity Requirement between a price of 1.5 x Net CONE and 1 x Net CONE;</li> <li>- The demand curve will be a straight line slope with a zero-crossing point at 115% of the Capacity Requirement.</li> </ul>	<p>We note that the Demand Curve to be used in the T-1 and T-2 auctions is to revert to that used in the initial transitional auctions (and different from that used in the T-4 auction). Energia agree this is an appropriate Demand Curve shape to use for these auctions and would support the comment in the Consultation Paper that a subsequent T-1 auction for CY 2021/22 is not required.</p> <p>Energia calls for transparency in the determination of the final Demand curve.</p>
Auction Price Cap	1.5 times Net CONE	Energia reiterates its comments in response to SEM-16-073 that the APC multiplier of 1.5 times Net CONE is at the lower end of international norms and there is justification for increasing

Parameter	Proposed Value for 2020/21 T-1 and 2021/22 T-2 capacity auctions	Energia Comments
		this to 2 times Net CONE to account for increasing investment costs (due to regulatory risk and structural market power) and a stable regulatory framework.
Existing Capacity Price Cap	The SEM Committee welcomes respondents' views on the appropriate ECPC.	Energia does not support any reduction in the ECPC. In fact there is strong and justifiable cause for the multiplier to be adjusted upwards for future auctions. Reasons for this position have been explained elsewhere in this response.
New Capacity Investment Rate Threshold (NCIRT)	€300,000 per de-rated MW	<p>We note that the NCIRT is to remain in line with the values used in the previous auctions to date. Energia would like to repeat their comments from previous responses to SEM Committee consultations on auction parameters (SEM-18-009 and SEM-18-028) that the auction rules will discourage investment in refurbishment and plant upgrade unless they are allowed to benefit from a long-term contract. Accordingly, Energia would seek the introduction of the following:</p> <ul style="list-style-type: none"> <li>- an additional threshold for plant refurbishment at rate of €50/kW of de-rated capacity;</li> <li>- once this threshold is met bid limits should be determined by APC (in line with British rules for plant refurbishment).</li> </ul>
Annual Stop Loss Limit Factor	1.5	Whilst the proposed Annual Stop Loss Limit Factor of 1.5 is the same as that used in previous auctions, Energia remain of the view communicated in response to SEM-15-014 that this factor is too high. The annual limits should be set such that the potential losses cannot be more than the revenue received i.e. the multiple should be set at a maximum of 1.
Billing Period Stop Loss Factor	0.5	Similar to the Annual Stop Loss Limit Factor, whilst the proposed Billing Period Stop Loss Factor of 0.5 (i.e. 0.75 times the Annual Option fee) has not changed, Energia rare again of the view that this factor is too high. It exposes generators to excessive risk of potentially losing more than their entire capacity market revenue over

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Parameter	Proposed Value for 2020/21 T-1 and 2021/22 T-2 capacity auctions	Energia Comments									
		<p>a couple of RO events.</p> <p>As per comments in response to SEM-16-073, Energia recommends implementing a lower Billing Period Stop Loss Factor of 0.125. Energia considers this to be a more reasonable limit in respect of cash reserves generators are required to hold to cover potential RO difference charges. It would also help ensure that persistent unreliable generators are impacted through losses of capacity revenue rather than a typically reliant generator who may have an unfortunately timed outage that coincides with a RO event which results in an excessive and disproportionate financial penalty.</p>									
Indicative Annual Capacity Exchange Rate	The Exchange Rate will be proposed by the System Operators and included in the Initial Auction Information Pack.	We note that the Indicative Annual Capacity Exchange Rate will be included in the Initial Auction Information Pack as per the process for previous capacity auctions. Energia has no further comment in respect of this.									
Increase Tolerance and Decrease Tolerance by Technology Class	<table border="1"> <thead> <tr> <th data-bbox="488 1155 635 1240">Technology Class</th> <th data-bbox="635 1155 778 1240">Increase Tolerance (%)</th> <th data-bbox="778 1155 916 1240">Decrease Tolerance (%)</th> </tr> </thead> <tbody> <tr> <td data-bbox="488 1240 635 1294">All except DSUs</td> <td data-bbox="635 1240 778 1294">0</td> <td data-bbox="778 1240 916 1294">0</td> </tr> <tr> <td data-bbox="488 1294 635 1330">DSUs</td> <td data-bbox="635 1294 778 1330">0</td> <td data-bbox="778 1294 916 1330">100</td> </tr> </tbody> </table>	Technology Class	Increase Tolerance (%)	Decrease Tolerance (%)	All except DSUs	0	0	DSUs	0	100	We note that the Increase and Decrease Tolerance by Technology Class is to remain the same as that used in the T-4 CY2022/23 capacity auction. Energia has significant concerns in relation to the absence of transparency around the application of this parameter following on from SEM Committee decision SEM-18-030 and will be writing separately to the RAs in respect of this.
Technology Class	Increase Tolerance (%)	Decrease Tolerance (%)									
All except DSUs	0	0									
DSUs	0	100									
Performance Securities	<table border="1"> <thead> <tr> <th data-bbox="488 1518 699 1603">Date / Event</th> <th data-bbox="699 1518 916 1603">Termination Charge Rate (€/MW)</th> </tr> </thead> <tbody> <tr> <td data-bbox="488 1603 699 1715">More than 13 months prior to beginning of Capacity Year</td> <td data-bbox="699 1603 916 1715">10,000</td> </tr> <tr> <td data-bbox="488 1715 699 1800">From 13 months to beginning of Capacity Year</td> <td data-bbox="699 1715 916 1800">30,000</td> </tr> <tr> <td data-bbox="488 1800 699 1863">From beginning of Capacity Year</td> <td data-bbox="699 1800 916 1863">40,000</td> </tr> </tbody> </table>	Date / Event	Termination Charge Rate (€/MW)	More than 13 months prior to beginning of Capacity Year	10,000	From 13 months to beginning of Capacity Year	30,000	From beginning of Capacity Year	40,000	Energia notes that the Performance Securities timelines and amounts are to remain the same as that used in the T-4 CY2022/23 capacity auction and have no further comment at this time.	
Date / Event	Termination Charge Rate (€/MW)										
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Termination Charges	<table border="1"> <thead> <tr> <th data-bbox="488 1939 699 1975">Date / Event</th> <th data-bbox="699 1939 916 2024">Termination Charge Rate (€/MW)</th> </tr> </thead> <tbody> <tr> <td data-bbox="488 1975 699 2024"></td> <td data-bbox="699 1975 916 2024"></td> </tr> </tbody> </table>	Date / Event	Termination Charge Rate (€/MW)			Energia note that the Termination Charges timelines and amounts are to remain the same as that used in the T-4 CY2022/23 capacity auction and					
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Full Administered Scarcity Price and Reserve Scarcity Price	<table border="1"> <tr> <td data-bbox="491 577 699 667">Short Term Reserve (MW)</td> <td data-bbox="699 577 914 667">Administered Scarcity Price (€/MWh)</td> </tr> <tr> <td data-bbox="491 667 699 696">Demand Control</td> <td data-bbox="699 667 914 696">25% of VoLL</td> </tr> <tr> <td data-bbox="491 696 699 725">0</td> <td data-bbox="699 696 914 725">25% of VoLL</td> </tr> <tr> <td data-bbox="491 725 699 754">500</td> <td data-bbox="699 725 914 754">500</td> </tr> </table>		Short Term Reserve (MW)	Administered Scarcity Price (€/MWh)	Demand Control	25% of VoLL	0	25% of VoLL	500	500	Energia is supportive of keeping the Full Administered Scarcity Price at 25% of VoLL. This is the value that has been used in each of the capacity auctions to date and there is currently no justifiable evidence to amend it from this level.
Short Term Reserve (MW)	Administered Scarcity Price (€/MWh)										
Demand Control	25% of VoLL										
0	25% of VoLL										
500	500										
Values for determining strike price in accordance with the Trading and Settlement Code	The SEM Committee proposes to retain the existing values for the 2020/21 T-1 and 2021/22 T-2 capacity auctions.		The Strike Price formula should be amended as per previous Energia submissions to ensure that commodity prices are up to date. It remains incorrect to reference monthly price indices.								