



ELECTRICITY
ASSOCIATION
OF IRELAND

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Date: 4/11/2022

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RE: SEM-22-054A Performance of SEM CRM

Introduction

EAI welcomes the opportunity to respond to the EY review of the Performance of the SEM CRM. Clearly, the CRM has not delivered required capacity, and has instead required several measures to avoid the risk of inefficient and disorderly exit¹. It is critically important to understand the underlying reasons for this through direct engagement with investors and plant operators in the SEM. EY have not done this, and this is a fundamental shortcoming of the report².

It is regrettable that the review did not engage directly with investors and was timed to coincide with ongoing T-3 and T-4 auctions. We signalled clearly at the time when trade associations were approached for input, that engagement with investors and plant operators was critical to be able to develop a better picture of the mechanism of the CRM, the shortcomings and benefits and potential improvements. Attached to this response you will find a detailed non-paper on State-aid (SA)compliant CRM improvements which would increase both the value of capacity and the volume of capacity that will be procured in the remaining auctions before the lapse of the existing SA approval in 2027.

However, our members can be supportive in principle with the following:

1. **The proposal for an energy-only stack.** Though it is unclear if this is achievable in the current market systems. It could be seen to positive address external RO risks outlined later in this response, i.e., an energy-only stack could be used to identify those generators not instructed not to run for system reasons in order to protect them from RO risk. It could also be a mechanism to be able to better monitor interconnection

¹ [CR18228-Information-Note-on-DMILC-process.docx \(live.com\)](#)

² Note in accepting an RA invitation for a bilateral meeting with EY the EAI also stressed the need for EY to engage directly with participants and this belatedly happened following publication of the final report

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actions as differentiated non-energy, and in a separate stack. However, there is limited detail in how the proposal would work or could be implemented and there is merit in discussing this proposal further as part of a wider industry discussion. We would suggest it should be considered as part of the wider Scheduling and Dispatch project which should also be reviewing the incorporation of contracted and uncontracted storage onto the system.

2. **Proposal for greater focus on infrastructure investment to positively impact on the CRM procurement.** Investment infrastructure has been a long awaited and urgently needed action to be able to address the effects of constraints, improve the optimisation of existing generation, improve wind penetration and provide certainty for future generation investment.
3. **Process reforms that lead to more time for delivery.** We support additional time being made available for delivery via more timely auctions and reforming pre-qualification to ensure that the proposed plant have the best chance for delivery. Currently, the T-4 technically allows for 3.5 years for delivery when accounting for when the auction runs and the time until the end of the Capacity Year. EAI members would also be in favour of the delivery process acknowledging the risks outside the control of developers to mitigate, such as was being signalled by the recently rejected CMC_10_22.

The remainder of this response outlines various concerns we have with the approach taken in this report.

Scope of the EY Report

The lack of clear objectives set out by the RA or the issues the report is seeking to address, calls into question the completeness and efficacy of the report recommendations. Whilst EAI would support some of the EY recommendations, other aspects of the EY report seem to misunderstand and/or fail to recognise the underlying problems³. EAI would argue that appropriate remuneration, procurement and delivery should be the main focus of any review of performance and relevant reforms.

³ including recognising the risk of new capacity not delivering; the need for co-ordinated action on the part of state bodies; and longer lead times for delivery of new capacity

Gaps in the EY Report

The objective of this section of the EAI response is to highlight any gaps in the EY recommendations. It is important to note that many of these gaps in understanding, assumptions or conclusions in the EY report would have been mitigated by early engagement with investors into the CRM. We would also refer to the EAI non-paper for a consistent overview of the key areas of concern.

- **Price caps not considered in the covering SEMC consultation:** We remain firmly of the view that the price cap for existing plant is set too low particularly considering the declining DS3 tariffs and expected energy revenues reduction thermal units can expect as more renewables come on the system. Units will become increasingly reliant on ECPC being set at sufficient levels to ensure efficient units can remain online. The USPC methodology is also failing to capture the value that existing plant contribute to the system, since they higher the value of existing generation by allowing the price caps to remain low. The overuse and reliance of the USPC, which should be an exception mechanism, in fact hides what the true clearing prices should be at auction and undermines the vision of price caps. However, as price caps remain low, this makes investments riskier and, either investments fail to arrive, or increased USPC will be needed to support any investment in the CRM. This should be seen as a signal that price caps are set too low and need revision.
- **Incomplete view of exit landscape:** The EY would appear to support the view that that zero exits of existing units due to ECPC is indicative of well-functioning price caps. As more renewables come on the system the risk of inefficient exists escalates and therefore the need to address the price cap issue has become more urgent. In addition, the need for LRSA contracts to retain existing units also points to a dysfunction in price caps for existing units. Therefore, we would be unsupportive of this view in the report.
- **Lack of consideration of other key parameters (BNE, VOLL and Capacity Requirement):** We acknowledge that the SEMC is in the process of reviewing the methodology that is used to calculate VOLL and BNE as required by the new EU Electricity Regulation and look forward to engaging with the SEMC on this important

issue in the near future⁴. VOLL should include a review of capacity adequacy including LOLE to align the SEM to other EU member states. EAI plans to respond to the consultation issued on the Capacity Requirement methodology and Best New Entrant proposed reference plant, please see those responses for further insights. The locational nature of the auctions has undermined the predictability of capacity requirements, which does not bode well for informing prospective investment decisions. In our view there is a lack of a clear and transparent link between capacity needs set out in the GCS and the capacity requirement for auctions is required. This is clear in the report. Any intervention by the RAs must follow a transparent predictable methodology that relies on the same documents that investors have access to. Otherwise, the investment signals for existing and new investors will remain low, underestimated or unverifiable by those that the signals are seeking to attract.

- **Perceived benefit of increased scarcity events:** The EY report reaches strong conclusions on increased scarcity events, without evidence of why this is necessary and what the outcome is expected to be. We have been clear as a membership that scarcity events are difficult to achieve in a market that has a lower threshold at the level of the Reliability Option Strike Price and no incentive to scarcity price given the material penalties of Difference Charges. We have also been clear that lowering the related ASP to levels around the Strike Price would be devastating for capacity and would send the wrong signal potentially throwing the market into higher priced stress events and encouraging disorderly exits. Administered Scarcity Price is a significant incentive that should be calibrated correctly to reflect the degree of extreme scarcity that it is designed to mitigate through capacity response. Any attempt to increase scarcity events artificially will not appropriately solve the capacity dilemma. Reform of the ASP should also not be considered further without considerably more transparent analysis on BM pricing during tight margin events to fully understand why is it that BM prices aren't spiking intuitively. The separate outcomes of RO Strike Price and ASP reflect the respective aims of both concepts, and their respective aims should not be diluted without fully understanding the underlying problem. It would be helpful if the RAs could share additional evidence where possible to be able to better understand how the RAs are confident with the rationale for increased scarcity events being beneficial in their own right. Any recalibration of the ASP or 'sharpening' (see QPAR

⁴ including recognising the risk of new capacity not delivering; the need for co-ordinated action on the part of state bodies; and longer lead times for delivery of new capacity

consultation also) must be undertaken in the wider context of system flags and the Balancing Market.

- **Interdependencies of revenue streams in the market:** A radical holistic re-think of the existing revenue streams that considers interdependencies between the relevant streams is required. Energy, system services and CRM markets together provide the suitable investment signals for generation new and existing. Where expected returns in one area are eroded, this will have an impact on prices for generation in the other related markets. Indeed, the recent EirGrid consultation on reduced tariffs for DS3 products underlines the limited extent that existing and future units can have confidence in sufficient system services revenues to develop business cases. It is critical to understand that the continued focus on cost minimisation for the short term is to the detriment of meeting the capacity needs of the future, for the benefit of future customers, our decarbonisation targets and future generation mix needed on the system.

Reform of the CRM

The EAI represents the vast majority of existing and prospective capacity in the all-island market and believes that the capacity market design is broadly fit for purpose, but there is significant room for improvement in its implementation. The report is clear that given the amount of capacity that has failed to arrive, largely due to the processes, design and framework of the CRM, the CRM has not performed well to date. We agree that the CRM would benefit from several improvements which should be implemented as soon as possible. We acknowledge that some of these improvements may require straightforward amendments to State Aid. However, considering the Government ambition that emergency measures will remain in place until new capacity arrives to replace it, as well as the ambitious target of 2GW of flexible gas-fired generation, improvements to address the shortcomings of the CRM cannot come soon enough.

To date only 100MW of the near 700MW of awarded new capacity (to January 2022) has the prospect of delivery within the terms of the relevant contracts. Almost 580MW of the cancelled projects are gas units, as per the EY consultant's review of the CRM market. In 2030 the system will require a greater volume of capacity to satisfy peak demand, yet the recently published GCS anticipates capacity deficits for each of the next 10 years, with the anticipated shortage more pronounced in the short to medium term. It is our view that the CRM

parameters need to be reformed to retain and maintain essential existing capacity and deliver the new generation capacity that is required if Ireland and Northern Ireland are to meet their respective ambitious decarbonisation objectives. Where generation is being expected to earn less in the energy and system services markets (and we note significant tariff reductions being proposed to the latter), the CRM is of critical importance for the retention of existing capacity and future investment in the all-island Market.

Retention of existing capacity and the absence of new capacity are key issues to address. The CRM market design at present is overly focused on providing exit signals through inter alia rigid price caps (ECPC and USPC), short duration contracts; new entrants not setting the clearing price when constrained on; further derating of specific plant that otherwise are needed on the system and a downward capacity requirement. For the CRM to be relevant for the future capacity ambitions and needs of the system, it needs to be far more dynamic. Existing capacity should be provided adequate remuneration not only on the basis of their ongoing costs but with a view to the potential for future development / refurbishment at such sites.

In respect of new capacity for future auctions, signals to investors to participate in the CRM need to be stronger. The current price cap, risk profile and contract terms i.e., duration, delivery timeframes have impacted participation. This is clear from the conclusions of the EY report. The opportunity cost for investors is high given the more favourable terms available for renewable projects, which is as it should be. But the lack of a symmetric signal in the CRM risks undervaluing the constant generation needed to support renewable intermittency and protect security of supply.

Existing plant are already highly incentivised to be available when called, and compares favourably with other EU markets, as per the EY report. In a system that is decarbonising, increasing penalties will make investing in gas plants riskier. We cannot support units being exposed to RO payments for reasons outside their control e.g., TSO decisions around constraint actions. Performance securities are already higher than other EU markets but the consultant's report is suggesting these could be increased. Incentives to be available and to deliver suggests double-counting of penalties. Penalties are not immaterial, though there is a sense that the report is of this view of low materiality (approx. €10mn vs + €1bn annual revenues). This view of immateriality is based solely on viewing the penalties against annual revenues, rather than considering the penalty against the actual volume of lost revenue. Of concern here is the frequency of amber alerts being called and the blanket fashion in which

ROs can be called simply when the threshold is triggered irrespective of whether it is a signal that a contracted unit can respond to at that time.

Price Caps

We note that the EY report considers the role of price caps and considers how the absence of price caps are treated in the GB capacity market. The absence of price caps in the CRM would allow for it to be dynamic and flexible to meet the demands of a decarbonising energy system with novel technologies and provide the potential for converting existing plant and bringing forth other offerings that can meet the climate challenge. The current price caps remain far too stagnant and have directly signalled and encouraged the type of technologies and unit types that are arriving at auction. EAI will comment separately to the Best New Entrant (BNE) consultation, but we are of the view that the existing price caps have failed to encourage entry of new CCGTs even at a higher return on investment via capacity contracts. The newly proposed lower BNE considering that it would be a suitable signal for CCGT entry is therefore completely counter intuitive.

The Balancing Market

The RAs appear to want to sharpen the prices in the BM to incentivise availability/TSO/demand, it is unclear which of these are the priority. This is not an appropriate mechanism to incentivise TSO behaviour given the resulting adverse financial impact on generation assets and future investments. We would argue that incentives for market participants to be available are already strong. We strongly urge the RAs not to interfere with BM prices without first identifying and understanding the underlying problem and whether the proposed solution addresses this, having due regard to any unintended consequences.

TSO incentives and IC trades

The EAI believes that TSO incentives need to be reviewed. TSO actions that are based on a perceived value of interconnectors as a source of generation, fail to realise that interconnectors are sensitive to the price effects of the neighbouring market and in effect where traded, import the price effects of the neighbour market into the SEM as well as energy. When reviewing interconnector flows during the 42 most stressed periods over the last two years, the following can be seen:

- The average flow on the ICs in either direction is 13MW
- If accounting only for imports, we can see flows increase to only 130MW. This demonstrates the actual volume of benefit of the ICs at times of system stress.

Our members would not support the proposal to refine the principle of flagging interconnector actions from BM pricing, as above, it can be demonstrated that ICs cannot always be relied upon and do not face the same penalties as local generation. They have a large displacing effect in the market by virtue of their de-rating factors in the CRM and the fashion in which they are traded by the TSO. The TSO's Balancing Market Principles Statement has been clear that ICs are a last resort where all other options have been exhausted. Therefore, as has been demonstrated before in Mod 02_21, interconnectors are non-energy actions. Industry would welcome evidence to outline the specific scenarios where IC volumes were included in the BM stack to meet NIV at a time when no other on-island generation could have met the NIV. That analysis should demonstrate that the "pure energy stack" is the only feasible way of fairly bringing SO-SO trades back into pricing. Otherwise, we cannot support rolling back on the treatment of SO-SO trades given incidences like the September 2021 pricing events.

In our view, it is imperative that there is careful consideration to the expansion of interconnectors and their continued participation in the CRM. The following should be seen as guiding principles for further interconnection:

- Facilitation of increased development of renewable energy to support increasing local demand
- Supports and isn't detrimental to Ireland's domestic security of supply (where there is a risk that neighbouring system stress is likely to be imported to affect our market).
- Are not detrimental to the entry and retention of domestic generation (interconnectors should be assumed at zero to ensure sufficient domestic resilience and should remain separate from cashout given their impact)
- Provide a benefit to the consumer (incl. in relation to security of supply).
- Are located strategically to avoid network pinch points and to avoid displacement of local generation

- Are appropriately de-rated in the CRM to avoid displacement effect in auctions and markets.

We note the recent consultancy report relating to the Best New Entrant parameter in the CRM. CEPA are clear that interconnectors are in fact not ideal candidates for CRM markets. We would see the strong logic for this statement.

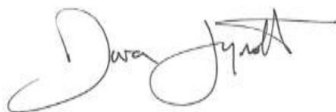
Conclusion

In summary, improvements to the CRM to improve delivery are to be welcomed but cannot be adequately commented on without understanding of the planned roadmap for implementation. We would encourage the RAs to provide this clarity.

At the same time, improvements to ensure that capacity is delivered (without resorting to additional penalties), that investment signals are clear, coordinated and strong, cannot come soon enough to address the capacity dilemma facing the country. This must be coupled with positive actions in the reduction of constraints, development of infrastructure, reflection of the true value of services to the system and consideration of the future climate ambitions that the CRM can play a part in encouraging to market.

We would ask for continued, open and constructive engagement with our members to help realise the needs of the CRM for the future.

Yours Sincerely

A handwritten signature in black ink, appearing to read 'Dara Lynott', with a stylized flourish extending to the right.

Dara Lynott,

Chief Executive

Electricity Association of Ireland