

## **EPUKI Response to SEM-23-093 – Proposal to Introduce Intermediate Length Contracts**

EP UK Investments (**EPUKI**) welcomes the opportunity to respond to this Consultation Paper. EPUKI broadly supports the introduction of intermediate length contracts in order to ensure that Existing Capacity can remain economically feasible and operational until such a time that it can be replaced by New Capacity procured through the Capacity Remuneration Mechanism (**CRM**).

While EPUKI support this policy change there is also an urgent requirement for amendments to the Capacity Market timelines which facilitate units opting out of participation in Capacity Auctions where they have received a Unit Specific Price Cap determination which does not allow them to recover their operating costs. In committing to refurbishment, Existing Capacity will forecast high capital investment costs. If these costs cannot be recovered through the CRM (through a single-year or multi-year contract), these projects need an option not to participate.

EPUKI is opposed to any policy changes which represent a departure from existing CRM rules for which strong rationale has been provided. As such, we are opposed to the introduction of Implementation Reporting, Long Stop Dates (**LSD**), and Termination Charges / Performance Securities. These mechanisms and their implementation in the CRM are already well established and understood.

If these timelines are not amended to facilitate the opt out of Existing Capacity, then existing projects which have an application for intermediate length contracts approved should be permitted to bid at the Auction Price Cap (**APC**). This is necessary to address the current negative market signal for Existing Capacity.

### **What is the appropriate maximum duration for the intermediate length contract?**

EPUKI believes that intermediate contract lengths should cover any period up to ten years. As outlined in the Consultation Paper, other regulatory jurisdictions provide more flexibility with the lengths of contracts that can be secured through respective capacity mechanisms depending on the investment associated with these contracts. We believe that a similar approach should be applied in the Single Electricity Market (**SEM**).

Introducing an unnecessary restriction to the maximum duration at this stage introduces two risks:

1. That the intermediate capacity contracts will fail to deliver optimal results and be unable to secure necessary investment in refurbishment or retention of Existing Capacity; and
2. That an amendment or modification of the design will be required in future years introducing uncertainty and confusion to the CRM.

Instead, intermediate contract lengths should be available based on the investment required and the necessity of the capacity undergoing that investment. If Existing Capacity requires investment which requires a recovery period of a specific number of years (greater than five) we see no reason why this should be excluded from the intermediate contract design. As the intermediate contracts are proposed through the Exception Application process, they would be subject to review and approval in any case.

### **What is the appropriate Intermediate contract Investment Rate Threshold (ICIRT) in €/MW for units to be eligible for the intermediate contract length?**

As outlined above, EPUKI believes that intermediate contracts should offer flexibility to optimise the impact that they will have on the CRM. This means that the ICIRT would also need to be flexible and likely depend on the length of contract being sought. EPUKI does not consider a 'one-size-fits-all'

approach to be optimal for intermediate contracts. Instead ICIRT should increase in steps according to the contract length sought. The increments used to determine the threshold should be based at an appropriate level to not act as a barrier to necessary refurbishments of Existing Capacity.

**Is gaming a material concern? What approaches should be taken to prevent the gaming of the new arrangements?**

EPUKI does not consider gaming to be a material concern particularly when considering the historic performance of the CRM. If an Existing Capacity unit is awarded an intermediate contract length for a certain number of years, then it will be undertaking a commitment to provide capacity for that duration. The retention of Existing Capacity will be critical for ensuring Security of Supply until New Capacity is procured through the CRM and delivered. In some cases, Existing Capacity may be procured on a more enduring basis depending on the extent of refurbishment undertaken.

Capacity contracts by design protect against gaming. If a unit fails to deliver on its obligations under an intermediate contract length, it will not receive Capacity Payments and be exposed to significant Reliability Options (RO) Difference Payments for non-availability.

The potential for gaming or for unintended consequences is limited due to the fact that the intermediate contract only proposes to change the duration of the contract. There is no change intended to the obligations associated with Awarded Capacity or the payment for same.

The only possible advantage through gaming would be for a Participant to underinvest on the ICIRT but given that they will be undertaking the same commitment for the same duration, there is limited benefit in doing so. This is particularly true in older plants where refurbishment or major works may be necessary to improve reliability and availability. Failing to make sufficient investment to support this refurbishment would be counterproductive as a Participant would then be less likely to be able to fulfil their obligations under a capacity contract.

Securing Existing Capacity on longer term contracts, or otherwise facilitating the refurbishment of existing units to operate more efficiently and effectively is a far better outcome than further reliance on Temporary Emergency Generation (TEG). This generation is significantly more costly for consumers, less transparent with respect to pricing, and contradictory to market design and best practice regulation. As such, any measures taken to mitigate against potential gaming should ensure not to obstruct on the efficient procurement of capacity through the CRM.

**What is your view on the proposed changes to the Existing Capacity Exception Application process and New Capacity Exception Application process?**

EPUKI is opposed to allowing intermediate length contracts for New Capacity. There is a risk of unintended consequences which may result in suboptimal outcomes for the CRM. Currently New Capacity can secure capacity contracts through the Exception Application process of ten years. There would be no practical reason for a New Capacity project to seek a shorter contract unless it is unable to fulfil the current investment threshold for New Capacity of €300,000/MW.

Making intermediate contracts accessible to New Capacity may result in a significant increase in the number of applications for smaller New Capacity units which otherwise would not meet this threshold. While these units would qualify as New Capacity, and subsequently secure a multi-year intermediate contract, they may be unable to deliver the same benefit to the system as a larger conventional generation plant.

Recent years have demonstrated the difficulties in delivering New Capacity through the CRM. External factors such as inflation and planning delays have resulted in Awarded New Capacity projects terminating. Meanwhile a low Auction Price Cap and de-rating factors has resulted in Capacity Auctions struggling to attract investment in material gas turbine capacity (T-4 2027/2028). Enabling intermediate contracts for New Capacity will incentivise Participants to deliver smaller, more deliverable projects which do not meet the current investment threshold for New Capacity. While this is not in and of itself a negative, the SEM Committee (**SEMC**) needs to consider whether this will achieve the correct balance for the system to ensure Security of Supply.

**Should Existing Capacity seeking a multi-year contract be required to submit implementation plans for consideration by the TSOs as part of the Qualification process, and are the same milestones employed for New Capacity appropriate?**

EPUKI recognises that the requirement for an Implementation Plan, similar to that required for New Capacity, is consistent with the Great Britain (**GB**) Capacity Market. However, it is also necessary to highlight the current obstacles to capacity delivery as outlined above. There is a careful balance to be struck between ensuring robust projects are awarded capacity contracts and not disincentivising the retention and refurbishment of Existing Capacity.

EPUKI does not consider it appropriate nor necessary to introduce an Implementation Plan reporting requirement for intermediate length contracts at this time. These plans are necessary for New Capacity projects which are often conceptual in nature and uncertain to materialise. Existing Capacity undergoing refurbishment is still providing capacity to the grid and so has already commenced delivery of this capacity.

EPUKI supports a simplification of the process of applying for intermediate length contracts to retain Existing Capacity for Security of Supply. This is necessary to reduce our reliance on TEG at significant cost to the consumer. The application process for intermediate contracts should be via an exception application which is an existing process. Under the existing process, units undergoing Undefined Future Investment (**UFI**) can apply for a higher price cap to recover the cost of this UFI. No implementation plans are necessary under this process and EPUKI sees no rationale for requiring them under an intermediate contract length exceptions application.

**What is the appropriate length of the Long Stop Date for Existing Capacity seeking an intermediate length contract?**

EPUKI is opposed to any change in policy associated with the LSD in the CRM. There is no rationale or reason to introduce an LSD for Existing Capacity which is planning refurbishment as this capacity is already available. Additionally, introducing this mechanism would act as a barrier and a disincentive for Existing Capacity looking to undergo works.

The LSD associated with New Capacity depends on the auction which New Capacity is contracting under. However, EPUKI sees no reason to depart from existing policy in relation to New Capacity.

**Should Existing Capacity with an intermediate length contract be subject to termination payments and performance security requirements?**

As above, EPUKI is opposed to any changes to existing policy on Termination Charges and Performance Securities. These charges are in place to deter speculative projects from entering the Capacity Auction. Currently, Existing Capacity is not required to pay these charges and there is no reason why this should change should Existing Capacity seek a multi-year contract.

Similarly, the rules and application of Termination Charges and Performance Securities are already well defined for New Capacity projects and EPUKI sees no reason why these should be different for New Capacity which has sought an intermediate length contract.

### **How could the design of intermediate length contracts promote investment in low carbon technologies?**

The most direct impact of intermediate length contracts on low-carbon technologies would be through facilitating the refurbishment of older conventional plant to operate more efficiently. Conventional units are necessary to support the energy transition and to support renewable technologies on days when wind and solar generation are unavailable. Facilitating works to increase the efficiency of conventional generation will enable this transition to take place in the least carbon-intensive manner.

EPUKI believes that intermediate length contracts should be available only to units which satisfy Part (a) of Article 22 (4) of the Clean Energy Package. This requires that an electricity generation unit emits no greater than 550g of CO<sub>2</sub> per kWh electricity generated. Including this clause would provide a signal for older and less efficient generation to exit the market and be replaced by less carbon intensive generation.

In the longer term, intermediate contracts could be expected to support greater refurbishment works, such as operation on hydrogen or other clean gasses. This facilitation of clean conventional generation is critical for securing a low-carbon energy future for Ireland.

An indirect benefit of intermediate length contracts is the retention of Existing Capacity to mitigate against a further reliance on TEG. These projects have a far higher direct cost for consumers and have second order impacts which undermine the energy transition. Namely, the allocation of funding and System Operator resources to TEG projects prevents the timely development of the network and market necessary to support low-carbon technologies.

### **Other Comments**

EPUKI believes that the SEMC should carefully consider the role of the CRM when considering the design of intermediate length contracts. The CRM has typically been seen as a means to pay for the availability of generation to produce electricity in the markets. The Capacity Auction itself has an APC which dictates the maximum that a unit can bid to provide capacity. The APC is determined by the 'Best New Entrant' analysis, which is calculated based on costs of delivery and operation of capacity minus expected Inframarginal Rent (**IMR**).

As greater volumes of renewable generation come online, the market revenues expected for conventional generation are expected to contract. Particularly for conventional units which are mid-merit or peaking. IMR will be reduced further as a result of the transition to competitive procurement for System Services. In a functioning market, older and less efficient units would be phased out and replaced with New Capacity, however the ongoing Security of Supply crisis means that this is unlikely for the SEM. Instead, these units will likely need higher Capacity Payments in order remain economically feasible and avoid closure.

In a recent SEMC Decision Paper (SEM-23-096) it was stated that in relation to factors such as lower IMR combined with higher operating costs of older units "*it is not clear that these should be addressed through the Capacity Market*". EPUKI is of the view that the Capacity Market is the only place to address these issues as they represent legitimate costs associated with operation and requirements for capacity to remain feasible.

Intermediate length contracts should be designed in a manner which acknowledges the cost of maintaining and operating capacity in the SEM and remunerate capacity providers accordingly. Failure to consider this as part of the intermediate length contract design will result in ineffective arrangements possibly resulting in the market exit of Existing Capacity. Proper remuneration of capacity providers through the CRM is a far more cost efficient and transparent approach to ensuring Security of Supply than the procurement of additional TEG. It is unclear why there is a seeming reluctance to enable units to cover their costs through a competitive market for capacity while simultaneously spending almost €1bn on externally procured generation.