



## **Energia Response to SEM-24-047**

*Workshop 37 Consultation Paper*

**02 August 2024**

## **Executive Summary**

CMC\_07\_24 seeks to facilitate the refurbishment of Existing Capacity, to align the introduction of Intermediate Length Contract's (ILCs) to the principle of prioritising shorter-duration offers in the constrained auction and can be implemented prior to the T-4 28/29 auction. Energia has sought to work constructively together with the Regulatory Authorities (RAs), System Operators (SOs) and market participants in bringing this revised proposal.

The introduction of ILCs through SEM-24-047 was a welcome decision from the SEMC and has the potential to bring substantial security of supply benefits. However, without the changes proposed in CMC\_07\_24, there is a high likelihood that these benefits won't be realised at the T-4 28/29 auction.

If a participant that has qualified for a refurbishment for the T-4 28/29 auction is not confident that it will clear ahead of a New Capacity bid in the constrained auction, it may decide that to bid at the price required for refurbishment would run too much risk of not winning a contract at all. In this case, the necessary and efficient refurbishment does not go ahead, and the security of supply and cost benefits of ILCs are not realised.

If the participant does decide to bid the refurbishment price, without the proposed change there is a risk that it will be displaced by a New Capacity bid with a longer contract duration. This would not represent value for consumers, as they would be paying for capacity above the auction clearing price for longer. If the relevant locational constraints were resolved as planned, they would be paying for the capacity for potentially much longer than it was needed for.

Furthermore, having displaced Existing Capacity, the successful New Capacity unit would bring far more delivery risk, and increase the likelihood of the need for short-term emergency generation or an out-of-market contract extension for an existing unit.

It is welcome that in the consultation paper SEMC confirms its support for prioritising shorter duration contracts in the resolution of constraints. This modification ensures that that principle, implicit in the CRM State Aid approval, is upheld with the introduction of ILCs.

Energia's view is that to realise the benefits of ILCs and avoid damaging unintended consequences, it is essential that this modification is introduced prior to the T-4 28/29 auction. Energia has modified its proposal based on feedback from the SOs to facilitate more efficient implementation. In our detailed response below we address comments raised at Workshop 37, and by the RAs in the consultation paper.

Energia believes that working proactively and collaboratively this modification proposal can be implemented prior to the publication of the FAIP, currently scheduled for the 7<sup>th</sup> of November. Energia urges the RAs and the SOs to collaborate in advance of the expected decision date for this modification, so that if it is approved it can be implemented prior to participants submitting bids for the T-4 28/29 auction.

Modification CMC\_07\_24 is essential to ensure that the work undertaken to introduce ILCs for the T-4 28/29 auction results in significant welfare benefits for consumers and long-term strengthening of security of supply as intended.

## **1 Introduction**

Energia welcomes the opportunity to respond to SEM-24-047. Energia will first address its own proposed modification, CMC\_07\_24, before addressing the remaining modifications that were discussed at Workshop 37.

## **2 CMC\_07\_24 - Treatment of Capacity Contracts of Varying Duration in Constrained Auction Solution**

The approval of modification CMC\_07\_24 prior to the T-4 2028/29 auction is critical to realising the aims of the introduction of Intermediate Length Contracts (ILCs) as per decision paper SEM-24-035.

Energia strongly supported the overall decision in SEM-24-035 to introduce ILCs for the forthcoming T-4 2028/29 auction. ILCs are essential to facilitate the necessary refurbishment of existing conventional generating units that underpin Ireland's security of supply.

Energia proposed modification CMC\_07\_24 with the intent of ensuring that following the introduction of ILCs shorter duration contracts are prioritised in the constrained auction. Energia's view is that not including such a provision in the original ILC decision was a highly significant omission. Energia welcomes that in this consultation paper SEMC confirms that it does agree with the principle of prioritising shorter duration contracts in the resolution of constraints.

### Need for the Proposed Modification Prior to the T-4 2028/29 Auction

Without the proposed modification, there is a significant risk that at the T-4 28/29 auction Existing Capacity that applies for an ILC could be inefficiently replaced by New Capacity in the constrained auction. Inefficiently replacing Existing Capacity with New Capacity will be more costly for consumers, as they will be paying for a higher price contract for longer (and potentially longer than necessary for capacity purposes, if the relevant locational constraints are resolved as anticipated).

Having failed to secure a contract at the T-4 28/29 auction, the Existing Unit would highly likely seek to exit the market. There would be substantial delivery risk involved in its replacement with New Capacity in less than four years' time. In this scenario, experience suggests that there is a high probability that the RAs would need to rely on short-term, out-of-market contracts to meet security of supply, with the associated costs and risks for consumers.

While the costs of refurbishment are less than the costs of building New Capacity, it does not follow that a refurbishing unit will always be able to bid lower than New Capacity and thus ensure that it is prioritised in the constrained auction. As New Capacity can spread the costs of its bid over ten years, whereas a refurbishing unit can spread costs over a maximum of five years, it is possible that refurbishing units will have to bid close to the Auction Price Cap to fully recover their refurbishment costs.

In addition to the risk that an existing unit is inefficiently displaced in the auction, there is also the risk that an existing unit decides not to carry out an efficient and necessary refurbishment and exits the market prematurely.

In this scenario, an existing unit that has qualified to bid for an ILC may choose not to do so due to the risk of being displaced by a New Unit. Therefore, the existing and necessary refurbishment that the introduction of ILCs was designed to facilitate does

not take place, the unit exits the market earlier than it would without the refurbishment and must be replaced by more expensive New Capacity with higher delivery risk.

With regards to delivery risk, Energia notes that SEM-24-047 is also consulting upon two modifications that seek to extend provisions for delayed delivery beyond the scope of the T-3 2023-24 and T-4 2024/25 auctions which took place shortly after the Russian invasion of Ukraine. This is further evidence of the heightened delivery risk of New Capacity, the difficulty of delivering New Capacity within four years (as emphasised in the EY Review), and that delivery risk for New Capacity is not remotely limited to auctions particularly impacted by geopolitical events.

#### Implementation of the Proposed Modification Prior to the T-4 2028/29 Auction

Energia updated its original modification based on the System Operator's (SO's) feedback at Workshop 37 on how the intent of the modification could most efficiently be introduced to the CMC and the auction software prior to the T-4 28/29 auction.

Under proposed modification CMC\_07\_24, in the constrained auction a bid's PQ pair will be multiplied by its offered contract duration for the purposes of calculating its impact on Net Social Welfare. This would have the effect of giving priority to shorter-duration contracts. It also has the advantage of not only prioritising between bids of one, five, and ten years, but also between any whole number within this range, thus consistently prioritising shorter-duration bids (a point raised by a participant at Workshop 37, addressed in this revised proposal).

CMC\_07\_24 makes no distinction between refurbishing and new units, basing the priority only on offered capacity duration. There is therefore no discrimination against New Capacity in the proposed modification, and New Capacity will still be incentivised to bid into the auction if it assesses that there is an underlying requirement. The constrained auction will continue to operate consistently with the underlying principles, included in the original EU State Aid approval of the CRM, that shorter duration contracts are prioritised.<sup>1</sup>

The revised modification should be relatively straightforward to implement in the auction software, as the proposed calculation is a simple one. It can also be implemented consistently with the structure of Urgent Modification CMC\_10\_24, which treats refurbishing capacity the same as New Capacity in the CMC apart from a small number of carve-outs.

As Energia has outlined, prioritising shorter duration contracts in the CRM auction is fundamental to how participants with ILCs will behave and be treated in the auction. As the T-4 28/29 is the first auction with ILCs, it is likely that multiple participants will have prepared ILC applications and will want to submit plans for efficient and necessary refurbishment. It is therefore essential, for the full benefit of ILCs to the CRM to be realised in the form of efficient and necessary refurbishments, that this modification is implemented in time for the running of the T-4 28/29 auction in November.

If the RAs agree with the underlying principles of this modification, it is essential that if it is approved it can be implemented prior to participants bidding in the T-4 28/29 auction. To that end it would be prudent for the SOs, communicating with the RAs, to

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<sup>1</sup> [Microsoft Word - SA.44464\\_2017N\\_WLAL\\_WLWL.docx \(europa.eu\)](#)

start working on the potential implementation of the modification so that there are no barriers to its timely introduction in the event that the RAs approve it.

#### Questions Raised in SEMC's Minded To Position

SEMC note in the consultation paper that it would be theoretically possible for an out-of-merit multi-year offer to clear ahead of an out-of-merit one-year offer in the constrained auction. For this to happen, a unit bidding for a two-year contract would have to have a bid price of less than half that of a unit bidding for a one-year contract (and a third-of-the-price if it was a three-year bid, etc.). This is extremely unlikely to occur and should not be a basis to oppose the modification.

Under the proposed modification the only way that a contract with a longer duration could be prioritised over one with a shorter duration would be if it had a far lower price and the total contract value was ultimately cheaper for consumers even considering the longer duration.

SEMC also note that participants have already submitted Exception Applications based on the original decision in SEM-24-035. Energia's modification proposes no changes to the qualification criteria or application process for ILCs – nothing in this modification should alter whether a participant chose to apply for an efficient and necessary refurbishment following SEM-24-035.

As set out, the proposed modification does have an impact on how participants might subsequently behave when submitting their final bids, and on the results of the auction. For this reason, the modification needs to be made prior to the publication of the FAIP, when participants should have all the necessary information to submit a final bid.

It should also be noted that CMC\_07\_24 was brought to Workshop 37 prior to the deadline for submitting exception applications. Therefore, participants applying for an ILC were fully aware prior to deciding whether to submit their applications that SEMC would be considering and making a decision on the constrained auction dynamics with relation to ILCs.

#### Other Aspects of the Proposed Modification

The key component of Energia's proposed modification is the prioritisation of shorter duration contracts in the constrained auction, which in the draft text is the amendment to F.8.4.4(f). However, in focusing on the dynamics of the constrained auction, Energia also proposed other amendments that sought to clarify the rules regarding Locational Capacity Constraints (LCCs), as set out in F.8.2.3.

F.8.2.3 states that violations of LCCs can only occur if no other solution exists that could be found by the software program. Separately, the current drafting of F.8.4.4(f) requires that one-year contracts are always cleared ahead of multi-year contracts. There is an ambiguity as to whether a one-year contract should be cleared ahead of a multi-year contract, even if that one-year contract would violate an LCC (as LCCs of varying levels can be overlapping) and a multi-year bid would not. Energia's modification resolves this ambiguity, clarifying that F.8.4.4(f) always applies prior to F.8.2.3.

As the introduction of binding minimum and maximum LCCs is a relatively recent and important development in the CRM, it is necessary that CRM auction participants have full clarity regarding the application of rules via the auction software relevant to LCCs. This modification seeks to achieve that. Furthermore, this aspect of the proposed modification can be implemented regardless of whether the proposed changes in

CMC\_07\_24 to F.8.4.4(f) are accepted, as in either case they provide necessary clarity over the interaction between F.8.2.3 and F.8.4.4.

### **3 CMC\_06\_24 – Performance Securities for Extended Projects**

Energia opposed modification CMC\_15\_23 that allowed for extensions to termination charges for delayed projects from the T-3 24/25 and T-4 25/26 auctions. Energia's view is that these changes were retrospective. Energia also supported the TSO's view that increased performance securities and termination charges for delayed projects were appropriate given the elevated risks to consumers.

Nothing has occurred since that original consultation response to SEM-23-060 to change Energia's view, and therefore Energia does not support the extension of the original changes as proposed in this modification.

### **4 CMC\_08\_24 – Widening of Longstop Extension Process to Awarded Capacity for 2023/24**

Energia opposed the original combined modification presented in SEM-23-080 which enabled a more permissive approach to extensions of New Capacity contracts. Energia's view is that the proposals were retrospective, and contrary to best practice in terms of incentivising New Capacity to deliver on time. Energia raised concerns, also expressed by the TSOs, regarding transparency.

Nothing has occurred since our original consultation response to SEM-23-080 to change Energia's view, and therefore Energia does not support the extension of the original changes as proposed in this modification.

### **5 CMC\_09\_24 – Amendments to J.5.7 and J.5.8**

Energia has no further comments on this modification.