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RE: SEM Capacity Remuneration Mechanism2024/25 T-4 Capacity Auction Parameters and Compliance with the Clean Energy Package Consultation Paper, SEM-20-006

Dear Kenny & Kevin,

Bord Gáis Energy (**BGE**) welcomes the opportunity to respond to this consultation.

We have provided a response to all parameters of this 2024/25 T-4 Capacity Auction consultation with particular attention paid to those on which comment was requested and the questions on how to facilitate compliance with the Clean Energy Package.

Our primary concern in this consultation relates to the suggestion to reduce the Existing Capacity Price Cap. BGE is not persuaded by the argument justifying its reduction and as such is concerned by the suggestion. The design of the auction was a detailed extensive process, and we believe altering it at this point is premature. Only one T-4 auction has been held to date and inferring from other short-term capacity auctions the successful functioning or not, of the T-4 is incorrect in our opinion. Taking further measures to increase competition to put competitive pressure on the clearing price would be a more acceptable market centric approach to reducing the clearing price and better aligns with SEM regulatory practice in our view. We expand on this point below as well as flagging the need for further details on Auction Format D before market participants can be expected to provide informed views on that issue.

1. Existing Capacity Price Cap (ECPC)

BGE, for reasons outlined below, has considerable concerns about the suggestion that the Regulatory Authorities (**RAs**) may reduce the ECPC from 0.5 to 0.4 of Net CONE.

Firstly, the RAs' focus appears to be on the capacity auction outturn price and dissatisfaction with bidding strategies rather than the real problem which is, in our view, the fact that the majority of the capacity in the market is concentrated in the hands of one market participant. The results of the only T-4 auction held to date serve to highlight the extent of the incumbent's capacity market share[1]. In principle, a competitive market results in competitive price outcomes and where competition is lacking those price outcomes will not materialise. We therefore contend that the RAs' price outcome concern will perpetuate so long as such a concentrated capacity market share exists, as competitive pressures will be limited in the auction. This impacts not only the functioning of the capacity auctions but will likely impact competition in the broader energy market. BGE must also flag the significant competitive advantage the incumbent holds due to the legacy sites in its ownership and, the significantly lower costs involved in repowering these relative to the likely green field sites other companies will be utilising. Allowing participants with large market shares to further entrench their market position compounds the existing problem and ensures the problem will continue. The results of the sole T-4 auction to date indicate that this legacy sites issue is a serious concern. BGE urges the RAs to avoid arbitrary regulatory intervention in the capacity market pricing regime and instead focus on the bigger issue of facilitating the entry of non-incumbent market participants to the capacity market, with a view to putting downward pressure on capacity clearing prices in a market-based manner.

Secondly, the rationale given for potential future reduction of the ECPC focuses on the outcomes of the five capacity auctions carried out to date and the clustering of bids close to or at the ECPC. However, only one of

[1] ESB generation secured capacity contracts for 3246 MW which is approximately 44% of the total all island capacity awarded, 1258MW of which was within the Dublin LCCA which equates to approximately 74% of the Dublin LCCA total.

these auctions has been a T-4 and BGE does not believe it reasonable to judge the performance or modify parameters of a T-4 auction based in part on the outcomes of T-1 and T-2 auctions. The competitive performance of the T-4 auctions should be judged only on the outcomes of previous T-4 auctions. The RAs themselves have in fact previously recognised (in SEM-16-010[2], section 4.4.2) that the outcomes of short-term versus long-term auctions can be expected to be different given that there would be “the lower chance of new entrants competing” in the T-1 and T-2 auctions which may limit competitive outcomes. The shorter-term auctions are not therefore a useful comparator.

Furthermore, the market is expected to be materially different in 4 years’ time with increasing interconnectors (**ICs**) and renewables dampening energy market prices and therefore making investors more reliant on capacity market revenues to provide them with investment stability. It would be incorrect at this stage to make changes to the capacity market that needs to reflect market dynamics in 4 years’ time as opposed to market dynamics today. This fundamental difference between the T-4 and other auctions with a shorter lead in time is another reason for not altering the T-4 parameters based on the outcomes of T-1 or T-2 auctions. The RAs need to look to the future, not the past, when examining price outcomes. In tandem with the increase in renewables and further interconnection the TSOs have flagged that in the same period, 2025/ 2026, capacity margins will be seriously depleting, with significant deficits ranging from -300MW to -960MW expected in 2026 under all but one scenario[3],which in itself increases the risk of a capacity provider holding a reliability option at all. This capacity deficit highlights the need for new capacity investment but also continued investments in existing plants to ensure their reliability. Certain generation capacity will remain essential to provide security of supply and to support the increasing penetration of renewables and our decarbonisation objectives, and we are concerned that even efficient generators will have to question their viability with declining revenues in both the energy and capacity markets. BGE urges the RAs to avoid unnecessary regulatory interference in the capacity market, which is still relatively speaking only in its infancy, particularly when in the context of the reducing spot revenues and capacity margins outlined above, it is the end consumer that could be negatively impacted.

Related to the second point above, is the fact that many smaller vertically integrated players are reliant on one or a small number of assets to hedge their customer portfolios. In addition to reducing spot market revenues, those units that can reasonably be viewed as having a central role to play in the low carbon transition, are also faced with the need to make necessary investments to at least maintain their current reliability, and even more investment if they are to remain competitive in the future market environment. The view could be taken that such investment costs should not be undertaken if the market “signals” so dictate, but that is often not a choice afforded to companies where there is a heavy reliance on a small number of assets to hedge a diverse retail portfolio. In the absence of a liquid forwards market, and with a highly concentrated spot market, smaller vertically integrated players have real concerns over threats to the future viability of their generation assets, especially the impacts of costs over which we have no control such as fluctuating TLAFs and GTUoS. The potential regulatory intervention in the ECPC mooted in this Consultation adds yet another layer of financial uncertainty, which is completely unnecessary at this point in the decarbonisation pathway. We urge the RAs to consider avoidance of adding further, avoidable, regulatory uncertainty to market participant’s businesses by halting any unilateral attempts to undermine capacity market revenues for the foreseeable future.

Thirdly, BGE sees the suggestion to reduce the ECPC as poor regulatory practice. The implementation of the ECPC was done as a measure to mitigate market power and when doing so the only statements made about potential changes to it were the possibility of its removal if experience showed it was no longer necessary[4]. The suggestion to reduce the ECPC is a significant departure from this point and raises concerns about how the capacity market will be governed in the future. Significant new investment is required in the coming years and as regulatory risk is a key criterion in assessing a project’s viability the suggestion to alter the ECPC, especially given the insufficient justification, may disincentivise the required investment. Finally, the RAs’ insinuation that existing generators not happy with a reduced ECPC can submit USPCs for consideration by the RAs due to the RAs’ better administrative capability to review more USPC applications[5] is also in no way a satisfactory argument to interfere with the ECPC. It is almost tantamount to admitting that the capacity market is fundamentally broken and only adds to regulatory uncertainty and risk. A capacity market that sees several units taking the USPC route on foot of regulatory price intervention is not an efficiently operating market

[2] Capacity Remuneration Mechanism Detailed Design: Third Consultation paper, SEM committee, SEM-16-010, 11/03/2016. Pp. 321-33.

[3] All-Island Generation Capacity Statement 2019-2028. Eirgrid & Soni. Pg. 69.

[4] Capacity Remuneration Mechanism Detailed Design: Third Decision Paper, SEM Committee, SEM 16-039, 08/07/2016, pg. 38, 3.3.18.

[5] As was highlighted in a previous consultation by the RAs themselves.

In conclusion if the over-riding concern of the regulators is to reduce auction clearing prices, any measures taken should be done using a market-based approach rather than direct regulatory intervention, given that such intervention is contrary to the general principles of liberalised markets. In summary, BGE believes that:

- The RAs' focus should be on addressing the underlying problem of market power in the capacity market rather than the symptom of high prices, and in so doing enhance competition such that competitive pressures in a less concentrated market drive down clearing prices over time. Encouraging further competition and facilitating new, non-incumbent, entrants should help ensure the auction clearing price is at the optimum level and that costs imposed on consumers for the provision of capacity generation are justified. In this regard we urge the RAs to examine the outcomes of recent capacity auctions in terms of market share and to seek to address the incumbent's legacy sites ownership which represents a serious risk of allowing them to further entrench their market share to the detriment of alternative market participants, with possible end consumer cost impacts;

- The RAs should not rely on the outcomes of short-term T-1, T-2 auctions to influence the parameters of T-4 auctions given the divergence in bidding considerations between short- and long-term auctions. Market conditions in four years' time will be very different to those in effect now and the auction outcomes need to be understood based on the expected future market. The capacity market needs to provide the correct signals to incentivise investment in efficient generation capacity, both new and existing, and to ensure that it does not provide exit signals to plants that are both efficient and required.

- The RAs should avoid creating regulatory risk where it is unnecessary and at a time when market dynamics are changing radically (in terms of the capacity delivery years 2025-2026). Interfering with ECPC for the reasons put forward reflects poor regulatory practice in our view and should be avoided.

In conclusion BGE opposes the suggestion to reduce the ECPC, as we believe that this proposal is short-sighted focusing solely on past capacity auction outcome prices and is a crude tool to try and enforce a lower clearing price. The capacity market plays a crucial role in the wider energy market and BGE believes that addressing the market power issue is the best pathway to reducing costs to consumers of providing sufficient and reliable capacity. We view the market power risk to competitive auction price outcomes is heightened by the fact that while there are increasing plant closures, simultaneous repowering of legacy (strategically well-situated) sites owned by the incumbent is occurring. Addressing this competitive advantage and the overall market power issue is especially important at this juncture as some plants close and there is a need for significant investment to prevent a capacity shortfall. Decisions made now will have serious ramifications on the functioning of all aspects of the electricity market, most notably if the incumbent generator is allowed to gain an even greater proportion of the generation capacity.

2. CRM compliance with the Clean Energy Package (CEP)

Which of Option 1 (allow high CO2 emitting plant to participate in the CRM, but be subject to additional derating) and Option 2 (make no changes to the CRM, but ensure that any unit with emissions exceeding 550g CO2 / kWh comply with CEP annual run-hours limitations) is your preferred approach?

For the long-term provision of capacity and security of supply BGE believes option 1, additional derating of generators who breach the emission limits, is preferable. High-emission inefficient generators that are not central to security of supply need to receive a strong signal to exit the market and the reduction in capacity payments under option 1 would provide this. Simultaneously however the opportunity to submit a USPC remains open to the unit should it be necessary. The exit of inefficient, non-compliant plant would also create more space for new and efficient capacity to enter the market.

BGE believes that Option 2 is unintuitive from the perspective that if you allow such run-hour limited units to enter the auction with no further de-rating applied, yet expose them to difference payments beyond their run-hour limitations, then in effect the customer is paying for the "reliability" of a generator that may not in fact physically be in a position to reliably respond to a scarcity event. While there would be a financial penalty imposed on a generator who could not respond to a strike event this does not mitigate the underlying risk of a shortage in generation at a critical time and, in the worst case, a blackout which considering our narrow capacity margin from 2025 onwards is a possibility. The T-4 auctions must provide the right signals for investment, especially given the diminishing capacity surplus, and a clear signal should be sent to inefficient and polluting plants to exit the market.

If the additional de-rating is applied, should it be applied for the 2024/25 capacity year, or held until the 2025/26 capacity year? Alternatively, should the duration of the 2024/25 capacity year be reduced to nine months?

BGE is of the opinion that the additional derating should be applied for the entire 2024/25 capacity year. Re-iterating our above point, high emitting plants need to receive a clear signal to exit to allow for new efficient entry that better contributes to decarbonisation objectives. SEM will require significant new capacity generation in the coming decade and encouraging its entry in the 2024/25 year will be beneficial to system security and decarbonisation aims for the latter half of the decade. The capacity market needs to provide the correct and time-appropriate signals for plants to both enter and exit while ensuring adequate capacity is provided. Applying the additional de-rating for the entire of 2024/25 better achieves this in our opinion.

Should the Long Stop Date be reduced from 18 months to (for example) 12 months or 6 months?

BGE assumes the concern about the long stop date is in the context of the capacity shortfall facing SEM in 2026. New capacity will need to be contracted to ensure that our electricity supply is secure. If new capacity in the 2024/25 auction is not energized on time, we may face capacity shortages. However, delays in construction and development of new capacity are unplanned and decreasing the longstop date will not necessarily mean delays do not occur, it only increases the punishment for it. We therefore support the retention of 18 months but to ensure that new capacity is available in 2026, when it will certainly be needed (the shortage of capacity in 2025 under the low availability projections is also concerning), it should be contracted sooner. This could be achieved by procuring more capacity in the T-4 auction for 2023/24 or by holding the 2024/25 T-4 auction sooner.

3. Multi-year contracts in constrained areas

From the perspective of BGE new capacity within a LCCA should continue to be eligible for multi-year contracts at a minimum. Our rationale for this is straight forward, the situation at present gives existing capacity in constrained areas scope to extract large payments from the capacity market. One of the few ways to minimize potential abuse of this position is new capacity, and for new capacity a multi-year contract is a de facto requirement. While understanding the reluctance to enter into higher priced long-term contracts there is a trade-off in terms of constraining potential predatory behavior. With no clear deadline for when the locational constraints will be removed new capacity is the most effective way of enforcing competitive outcomes within the constraint areas. In the longer term, as the new capacity comes out of contract and falls into the "existing" capacity realm[6] this will heighten competition and competitively reduce the auction clearing price for existing capacity without regulatory intervention and the risk that introduces. In line with our long-standing position, BGE suggests that a new capacity unit, seeking a long-term contract, should be accepted ahead of existing capacity if its offer price is lower. The acceptance of such units should help alleviate the risk of LCCA market power as well as drive down clearing prices in the medium to long term.

However, importantly, as explained in some detail in our comments under section 1 above, it is critical that the competitive advantage the incumbent has with legacy well-situated sites is addressed as a matter of priority. Attention must be given to who is providing the new capacity. Steps need to be taken to ensure that the new capacity is not concentrated in the hands of the incumbent, as further entrenching one participant's market power will undermine competitive pressures on the capacity auction price with knock-on negative impacts in other aspects of the wider energy market. We urge the RAs to give consideration to this market power concern as early as practicable.

4. Changes to the auction format

In principle BGE understands the desire to move to combinatorial auction format D but we cannot lend our support to it given the current lack of detail on its workings. The documents covering its functioning discuss it at

[6] Which could be the case after just 2 years given that new contract durations are for anywhere between 2-10 years

a high level but provide an insufficient level of detail to truly understand the implications of adopting the auction D format. A detailed description of the auction function similar to the Eirgrid/SONI paper on the Interim Auction Solution Methodology[7] which covers the exact functioning of auction format C should be published to give market participants a deeper understanding before asking for comment or agreement on the change. Maximising social welfare is a good principle for the auction but accepting out-of-merit bids will impact consumer and producer surplus and how the choices are made between marginal generators needs to be explained in detail. We have seen with the issues in the balancing market how difficult it can be for markets to deliver the right outcomes. We need transparency to bring accountability to market outcomes and as it stands, there is no transparency on the mechanism that will determine the combinatorial auction format. Parties cannot be expected to compete in a vacuum. Until such time as the detail can be clearly provided and worked through with participants through industry consultation, we do not believe it would be appropriate to change the auction format.

5. Capacity rating – tolerance factors

BGE fails to see what benefit consumers can gain from allowing capacity generators to decrease their capacity factor, with the exception of DSUs. Doing so will only dampen the exit signals that inefficient and unreliable units receive and by corollary undermine the entry signals for the types of capacity needed for the low carbon transition. With regard to capacity units increasing their tolerance BGE is not opposed to this in principle - if generators are willing to invest more to increase their efficiency, they should be allowed to increase their capacity revenues. The de-rating factors used provide a minimum efficiency requirement but incentivizing generators to improve efficiency is a cost-efficient way of increasing available capacity and should reduce the end cost to consumers of ensuring sufficient reliable capacity. Permitting an increasing tolerance and encouraging investments to maximise efficiencies of existing plant could also provide additional MWs for a much-needed secondary capacity market.

6. De-Rating Factors

BGE has requested before and maintains that increased transparency around the methodology for calculating derating factors would be beneficial. Maintaining efficiency can require significant investment and if a plant will be de-rated regardless then the incentive for doing so is removed. A proper understanding of the methodology used to calculate de-rating factors is important and should be made available to market participants.

7. The final Capacity Requirement for the Capacity year to be used in the Capacity Auction

BGE notes the RAs' continued use of the current methodology to calculate the capacity requirement.

8. Indicative Demand Curve

BGE supports the continued use of the demand curve utilized for CY2022/23 and proposed for the CY2023/24 T-4 capacity auctions.

9. The Auction Price Cap

BGE accepts the RAs' decision to maintain the auction price cap at 1.5 Net CONE, €138,450/de-rated MW/year, though again we must raise the point that this figure is at the lower end of the international range benchmarks.

10. New Capacity Investment Rate Threshold

Subject to our concern immediately below, in general BGE accepts maintaining the NCIRT€300,000 / de-rated MW for the 2024/25 T-4 auction at a minimum and would suggest adjusting it for inflation to maintain as level as playing field as possible between refurbished and new units.

BGE is concerned about the functioning of the NCIRT and particularly the type of capacity that it is incentivising. In the sole T-4 auction held to-date, the incumbent secured a number of multi-year contracts for new capacity. The clearing price for these units was low, relative to what other new investors were seeking for new capacity, which on the face of it looks positive for customers in securing capacity at a low price. However, the efficiency

[7] Interim Auction Solution Methodology (IASM2223T-4) – Eirgrid/SONI – 25/03/2019

of some of the units that secured the capacity contracts is very low, which in the long term will not deliver the desired flexibility for the system and/or value for the customer. The fact that only the incumbent secured multi-year contracts emphasises the point we have made under Section 1 (ECPC) above, that legacy sites confer a significant competitive advantage on the incumbent and yet they do not seem to be incentivised to build the most efficient and flexible capacity to earn revenue streams across the energy, capacity and DS3 markets in a bid to recover their costs. Although we do not believe that the NCIRT is itself driving the issue at present it is not providing for optimum new investment in our future capacity generation.

11. Annual Stop-Loss Limit Factor

BGE supports retaining the Annual Stop-Loss Limit Factor at 1.5 for the 2024/25 capacity year.

12. Billing Period Stop-Loss Limit Factor

BGE supports retaining the Billing Period Stop-Loss Limit Factor at 0.5 for the 2024/25 capacity year.

13. The indicative Annual Capacity Payment Exchange Rate

BGE notes the continued use of the approved methodology for determining the Annual Capacity Exchange Rate.

14. Performance Securities and Termination Charges

BGE notes the decision to retain the Termination Charge Rates and the Performance Security Fess for the 2024/25 capacity year.

15. Full administered Scarcity Price, Reserve Scarcity Price and Strike Price for the 2024/25 T-4 Capacity Auctions – values

BGE supports the SEM Committee's proposal to retain these parameter values for the 2024/25 capacity year.

16. Conclusion

In conclusion, a key concern of BGE's (discussed in some detail in Section 1 above) is about the proposal to review the ECPC after the next T-4 auction. We believe that the RAs should instead focus on addressing the real issue of market power and concentration in the capacity market as opposed to seeking to arbitrarily influence price outcomes which only heightens regulatory risk. In this regard a key concern we have relates to the fact that while plant closures are occurring, simultaneous repowering of legacy sites is also occurring. These well-situated legacy sites are owned by the incumbent enabling the further entrenching of market power which in turn will not facilitate the entry of new, non-incumbent, market participants. Without such new participants, the competitive pressure on auction clearing prices will not be forthcoming. Only a market-based approach to the issue should be pursued, in line with the principles of competitive liberalized markets and addressing this site ownership concern could be a first step in the approach.

Alongside this concern, our main views on the remainder of the consultation are in summary:

- Option 1 - further derating- is our preferred approach to **complying with the CEP**. This provides the most direct signal to those that breach the emission limits to exit the market, while freeing up capacity payments for needed new capacity. For similar reasons we believe that the derating should apply for the entire capacity 2024/25 capacity year. We see no benefit in reducing the longstop date from 18 months – to mitigate the non-delivery concern, earlier procurement of capacity could occur.

- Allowing **multi-year contracts within the LCCAs** should be continued as a method to minimise the exercise of market power within them. However, this comes with the caveat that consideration must be given to the current market share of those gaining these contracts and the competitive advantage the incumbent's ownership of legacy sites is providing. This is essential for the future functioning of our capacity and energy markets.

- Moving to **Auction Format** D at this point is premature. Until the exact functioning of the auction solution is understood by market participants, on foot of industry consultation, and after sufficient testing and trialling, we cannot endorse the change from Auction Format C.

- Increasing **tolerance factors** can incentivise investment in existing plants to provide further capacity at lower costs benefitting consumers and secondary capacity trading potential. It should be encouraged. As a corollary allowing plants to decrease their tolerance incentivises inefficient plants to remain in operation and we cannot see the benefit to consumers or market function in allowing it.

- We also request better information to better understand the **methodology used to calculate de-rating factors,** as if the factors can change regardless of existing unit's investments, such investments are undermined.

- On the **New Capacity Investment Rate Threshold**, the current threshold at a minimum needs to be retained but we have a significant concern that it is not providing for optimum new investment in our future capacity generation. This is in light of the low efficiency factors of the newly procured capacity in the Dublin area on legacy sites, which we urge the RAs to look into further. Please see sections 1 and 10 above for further context.

I hope that you find the above comments helpful. BGE would urge the RAs to take our considerations about alterations to the ECPC into account in particular, given the impacts that market power have on the functioning of the wider market.

Please do not hesitate to contact me at any time should you wish to discuss any of the above.

Yours sincerely,

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(By email)