

Capacity Market Code Consultation

A response by SONI and EirGrid

24 February 2017



Introduction

EirGrid and SONI

EirGrid holds licences as independent electricity Transmission System Operator (TSO) and Market Operator (MO) in the wholesale trading system in Ireland, and is the owner of the System Operator Northern Ireland (SONI Ltd), the licensed TSO and MO in Northern Ireland. The Single Electricity Market Operator (SEMO) is part of the EirGrid Group, and operates the Single Electricity Market on the island of Ireland.

Both EirGrid, and its subsidiary SONI, have been certified by the European Commission as independent TSOs, and are licenced as the transmission system and market operators, for Ireland and Northern Ireland respectively. EirGrid also owns and operates the East West Interconnector, while SONI acts as Interconnector Administrator for both of the interconnectors that connect the island of Ireland and GB.

EirGrid and SONI, both as TSOs and MOs, are committed to delivering high quality services to all customers, including generators, suppliers and consumers across the high voltage electricity system and via the efficient operation of the wholesale power market. EirGrid and SONI therefore have a keen interest in ensuring that the market design is workable, will facilitate security of supply and compliance with the duties mandated to us and will provide the optimum outcome for customers.

EirGrid and SONI are responsible for operating the capacity market through our TSO licences. We are also responsible for administering the Trading and Settlement Code, which contains the rules for settlement of the capacity market under our Market Operator licences. This response is on behalf of EirGrid and SONI in their roles as TSOs and MO for Ireland and Northern Ireland, including as operators of the Capacity Market.

Structure of the Response

This document sets out EirGrid and SONI's response to the SEM Committee's consultation to the seventh consultation on the Capacity Market, the Capacity Market Code published on 12 January 2017.

Section 2 of the response provides an overview of the key points that EirGrid and SONI would like to emphasise as being of most importance.

Section 3 of the response provides our response to the issues raised in the SEM Committee consultation.

Section 4 of the response contains some comments on the detailed drafting of the code.

We would be happy to meet with the RAs to discuss any aspect of this response or drafting issues raised in other responses.

Key Points

As the key document governing the Capacity Market Auctions, the Capacity Market Code should provide a sound basis for the operation of the capacity market forming part of the new I-SEM trading arrangements. In general, we consider the Capacity Market Code to be meets these criteria and to be generally consistent with our understanding of the applicable SEM Committee decisions. It also reflects input from participants through the working group process.

We include detailed comments on the issues raised in the consultation paper. These cover the following key themes:

- The requirements placed on participants, particularly with regards to the prevention of market manipulation, should be proportionate, workable and not add unduly to the administrative burden of running the market;
- It is important to recognise the role of certification in providing assurance to RAs and market participants. Certification is being applied to imbalance pricing and capacity market functions. While Certification will primarily lead to changes in functional documentation, it could also highlight potential issues in the codes (e.g. errors or conflicts).
- We agree with the proposed approach to dispute resolution which focuses the regulatory approval to the end of the qualification process.
- We understand the concern of the RAs regarding the impact of a delay to State Aid approval and suggest that it could be addressed by giving the RAs greater powers to modify the Capacity Auction Timetable in respect of transitional auctions, or to cancel a transitional auction, in the event of specific circumstances arising.
- We agree that it is essential that the CMC and the TSC work well together, and the two codes have been drafted with this in mind.
- The CMC as currently drafted contemplates a significant number of RA approvals. We agree with the principle set out in the consultation that this is appropriate where the matters have a policy dimension or where the matters have a material commercial impact; however, where these conditions are absent or where the CMC is unambiguous on what is required, additional approvals may add unnecessary administrative overhead.
- We agree with the proposed approach to the transitional arrangements. In particular, it is important that Capacity Payments are funded from Capacity Charges over the Capacity Year or part thereof to avoid exposing the market to significant cash shortfalls in the first few months of its operation. Recovering capacity payments for the initial four months through capacity charges in those four months avoids this issue.

- We are aware of concerns raised by Participants on the renegotiation of intermediary agreements ahead of the 28th July 2017 deadline for Capacity Market registration and qualification. If all units must qualify for the Capacity Auction, it may give rise to a large volume of accessions, registrations and qualifications of units that do not intend to offer capacity above 0MW into the Capacity Auction. In order to assist in mitigating risks around intermediary renegotiations, we propose the some transitional arrangement to be applied to the first Capacity Auction only.

Response to the Consultation Topics

General Observations

As the key document governing the Capacity Market Auctions, the Capacity Market Code should provide a sound basis for the operation of the capacity market forming part of the new I-SEM trading arrangements.

While the Capacity Market Code will develop over time, based on experience of the auction process and in response to issues as they arise, it remains important at this stage to ensure that the CMC is fit-for-purpose, legally robust and does not introduce any undue risks to Parties. In general, we consider that the Capacity Market Code meets these criteria and is generally consistent with our understanding of the applicable SEM Committee decisions. It also reflects input from participants through the working group process.

In order to deliver the first auction in December 2017 we now need to focus on consolidating and concluding the Code development process, in anticipation of the Capacity Market becoming operational in June of this year. While it will be important to address any significant issue identified in the responses to this consultation, any changes that are not completely necessary at this stage should be considered Day 2 changes to be dealt with after the market goes live to avoid putting the timelines for the first auction in December 2017 at risk.

Financial Regulations

We are currently undertaking a review of the extent that financial regulations may apply to the TSC and CMC. In order to ensure compliance with relevant legislation, we may need to propose changes to Part B of the TSC and/ or the CMC to ensure the trading arrangements are on a sound legal footing prior to their coming into effect. We hope to be in a position to submit any proposed updates to the RAs for consideration in the coming weeks.

Certification of Market Systems

Certification is a process being performed to first ensure alignment of vendor functional documentation with the rules, then (later) to verify alignment of systems to vendor functional documentation. Certification is being applied to imbalance pricing and capacity market functions. While Certification will primarily lead to changes in functional documentation, it could also highlight potential issues in the codes (e.g. errors or conflicts). As Certification is a longer term process its outputs are not available at this time.

Capacity Requirement and De-Rating Methodology Decision

The functionality required to deliver the Capacity Requirement and De-Rating Methodology Decision (SEM-16-082) has not yet been incorporated into the Code and the CMC will need to be updated to reflect this Decision. This would replace the notion of a Unit Specific Price Cap with a Unit Specific Price Cap curve. This curve would need to be monotonically increasing in Unit Specific Price Cap for increase in De-Rated Quantity and would be used to validate offers submitted in the Capacity Auction.

We have included the functionality in our systems, based on the SEMC decision, to provide for Unit Specific Price Caps that vary with De-rated Capacity as required for Dual Rated and Auto-producer Units.

Locational Signals

We support reasonable requests from Participants at the meeting of the Rules Working Group in Dec 2016 for transparency in relation to the algorithm for clearing the auction. It is important that the trust established in the SEM arrangements in relation to the use of complex algorithms is maintained through this transition. Certification of these systems can provide considerable value in this regard.

Use of Director's Certificates to Support Information Submitted under the CMC

We would support any measures that strengthen the integrity of the Capacity Market, provided they do not place an unreasonable or disproportionate burden on Participants and/or the System Operators in terms of providing and processing these requirements. Given the implications of the Capacity Market Auctions for consumers, a level of assurance should be provided by Participants that they will act appropriately at all times.

The impact on smaller participants should also be considered. When determining the requirements, the RAs should be cognisant of the level of protection that is already provided for under European legislation, for example REMIT.

Disputes Process

A robust review process covering qualification decisions should aim to resolve any issues in advance of the running of the auction. It is in the interest of all stakeholders to

ensure adequate time is afforded to this process, as resolving issues after an auction is significantly more complex than beforehand.

We agree with the proposed approach which focuses the regulatory approval to the end of the qualification process. As currently drafted, the code contains two regulatory approvals, one for the Provisional and one for the Final Qualification Decisions. There are also two review periods for participants to submit an Application for Review (during which the System Operator must consult with the RAs). We would agree with the SEMC proposal to remove the regulatory review of the Provisional Qualification Decisions.

We support the notion of a 'fast-track' dispute resolution process in principle; however, it needs to be recognised that the Dispute Resolution process currently runs over a longer period than would be available between the Final Qualification Decisions and the Capacity Market Auction and therefore the following issues should be considered to expedite the process:

- the consideration that the review of Qualification Decisions would remove the need for the amicable dispute resolution component of the process;
- the Panel members may need to be bound by the CMC to ensure that they conclude their review in line with the required timelines;
- the scope of a 'fast-track' dispute resolution process would need to be contained sufficiently to ensure that disputes raised under this process can be brought to resolution in sufficient time.

State Aid Approval

Staggering the application of different sections of the CMC after it comes into effect would be a highly complex undertaking and, in the absence of a detailed impact assessment, we would view it as a high-impact change to the CMC. While a number of distinct phases exist in the Capacity Market (e.g. qualification, auction, etc.), it is difficult to apply all paragraphs required for accession, registration, qualification, pre-auction readiness (e.g. CCQT) from one date and apply auction related requirements from a later date. It would be difficult to isolate all the relevant obligations without introducing significant changes to the CMC and these changes would only be required on a transitional basis.

The CMC is structured around the publication of the Capacity Auction Timetable. This sets in motion a number of activities that must take place by specific deadlines and these can only be changed under particular circumstances (e.g. D.2.1.12 where the RAs can cancel an auction, if they consider that sufficient capacity has already been procured for the Capacity Year; however, this must occur not later than five working days prior to the Capacity Auction Submission Commencement date).

We understand the concern of the RAs and suggest that it could be addressed by giving the RAs greater powers to modify the Capacity Auction Timetable in respect of

transitional auctions, or cancel a transitional auction, in the event of other specific circumstances arising, including a delay to state aid approval.

Market Manipulation

The integrity of the capacity market is essential to provide system security for the island of Ireland and to obtain the full benefits of the new I-SEM arrangements for consumers. We therefore welcome any measures that strengthen the provisions designed to prevent market manipulation.

These benefits will only be obtained if the provisions introduced are proportionate, workable and not add unduly to the administrative burden of running the market.

Modifications Process for Agreed Procedures

Section B.12.12 faithfully reflects the proposal discussed at meeting 13 of the RWG, where it received positive feedback, as noted in the Consultation Paper.

We consider that there are sound reasons for a more flexible approach in relation to amendments to the Agreed Procedures, which differs from the CMC process, and consider the proposed modification process to be workable.

Cross code issues

We agree that it is essential that the CMC and the TSC work well together, and the two codes have been drafted with this in mind.

Given the responses the RAs received in response to the TSC consultation, it is likely that this question in the Consultation Paper will raise a number of responses on the issue of so-called 'cross-default'.

In our view, the capacity market and the balancing market are so interconnected, that a participant who is suspended or terminated from the balancing market is not in a position to perform the obligations it has assumed in relation to Awarded Capacity, and should also be suspended/ terminated under the Capacity Market Code.

By way of example:

- Registration of units under the CMC 'piggy backs' on the TSC registration process;
- Under section I.2 of the CMC, participants are required to satisfy their obligated capacity quantity associated with Awarded Capacity by bidding that quantity into the ex-ante markets or the balancing market; and
- The capacity market is 'settled' under the TSC.

It is also worth noting that:

- ‘Cross default’ between documents which are effectively part of the same overall set of arrangements is normal commercial practice;
- An event which gives rise to a suspension event or termination event in an ex ante market or the balancing market is an early warning of a possible problem with that participant that needs to be considered, and are analogous to Insolvency Events which may already give rise to suspension or termination;
- ‘Cross default’ is not automatic: suspension/ termination under the TSC or the NEMO rules is only a trigger, RA approval would be required for a participant to be correspondingly suspended/ terminated under the CMC (B.13.3.1 and B.13.6.1).

Allocation of Responsibilities in the Code

The CMC as currently drafted provides for a significant number of RA approvals. We agree with the principle set out in the consultation that this is appropriate where the matters have a policy dimension or where the matters have a material commercial impact; however, where these conditions are absent or where the CMC is unambiguous on what is required, additional approvals may add unnecessary administrative overhead.

It is worth noting that the System Operators will be subject to monitoring by the Capacity Auction Monitor and subsequent audit by the Capacity Market Auditor to ensure that they carry out their responsibilities in compliance with the Capacity Market Code. Both monitor and auditor will report to the RAs at key times in the Capacity Market process to provide assurance and evidence that the CMC is being complied with. In addition to this, establishing robust oversight from the start is an important way to promote confidence in the new arrangements.

In our view there is likely to be a significant additional volume of work for the RAs to undertake as a result of the requirement to process the number of approvals contemplated under the current drafting of the CMC. We would suggest that all requirements for RA approval that are currently set out in the CMC are reviewed to ensure that they are strictly necessary and that the RAs have sufficient resources available to them to ensure smooth and timely operation of the Capacity Market.

Our views with regard to the areas specifically referred to in the consultation are as follows:

- determination of whether a unit is on long-term planned outage or has been mothballed (E.3.1.1(b)) might sit more comfortably with the SOs than the RAs;
 - System Operators view: Mandatory participation is required for market power mitigation, and potentially to be obliged through licence. While there are Grid Code requirements in relation to any unit becoming unavailable for any duration, we suggest that this remains with RAs to

decide on whether the Opting Out is permissible in the context of market power mitigation and licence obligations.

- as noted above (see section 3.5), RA approval of the Provisional Qualification Results (E.8.2.3) should be removed to allow the review and disputes processes to operate;
 - System Operators view: We would agree with this proposal (as discussed above).
- if the RAs do not provide the Demand Curve as required (F.3.1.7) it may not be appropriate that the auction is automatically cancelled: deferral or substitution may be a better option;
 - System Operators view: we agree that deferral may be a better option. Substitution would require a clear set of rules on the detailed workings of substitution and we would consider this to be less appropriate considering the importance of the demand curve in determining the auction outcomes.
- changes to the Allowed Timeframe for auction solution (F8.4.8/9) are likely to need stronger governance given the potential impact on auction outcomes;
 - System Operators view: We would agree with this proposal. We suggest that the System Operator proposes a value that is subject to regulatory approval.
- the design, review, variation and suspension of the products traded through Secondary Auctions (sub-section H.2) would reasonably require RA approval in H.3.1.6;
 - System Operators view: the final products and any changes to them (including suspension) could reasonably require regulatory approval; however, the design and review are processes that feed into those proposals and should not be subject to a specific regulatory approval.
- RA oversight of changes to the calendar for Secondary Trade Auctions (H.4.1.2) may be appropriate;
 - System Operators view: We would regard the management of the calendar for Secondary Trade Auctions as an operational matter which should not require regulatory approval.
- RA oversight of the waiving of milestones in the Implementation Plan (J.2.1.4) may be appropriate;
 - System Operators view: We regard the waiving of milestones in the Implementation Plan (J.2.1.4) as an operational matter which should not require regulatory approval. These interim milestones do not impact on the Substantial Completion date.

- the requirement to provide additional information in J.4.3.6 should be subject to the request being reasonable;
 - System Operators view: We note that an important aspect of verification process is that the System Operators should be able to satisfy themselves that the Milestone has been met, and it would be inappropriate to be having arguments about whether a particular item of information is reasonable at this stage.
- consultation with the RAs before terminating Awarded New Capacity (J.6.1.5) may not offer sufficient oversight; and
 - System Operators view: We may need to terminate Awarded New Capacity swiftly to prevent payments to a defaulting party under the TSC. As such, we would suggest that the current requirement to consult the RAs is sufficient.
- the freedom of the SOs to re-determine exchange rates in K.1.2.8 may be too great.
 - System Operators view: as we would be determining these values in line with a pre-approved methodology, we do not believe that additional regulatory approval is needed here.

Force Majeure

In principle, EirGrid and SONI are comfortable with this proposal, as it could be a sensible way of managing everyone's exposure in the event of a prolonged Force Majeure event. If it were to be introduced, it would be important to deal with the following items:

- The trigger for the termination right (i.e. what reduction in capacity (presumably something significant, like at least 50%) over what period (presumably long, like 6 months) would give rise to the termination right);
- Clarity on who gets to exercise it;
- A statement to the effect that no compensation is payable.

Suspension or Annulment of Auctions

As set out above, in relation to State Aid, we would support broader powers for the RAs to delay or cancel a Capacity Auction. Situations can arise where it would no longer be

appropriate to proceed with an auction and the CMC in our view should provide for these eventualities.

We would, however, caution against the adoption of partial reruns of any of the pre-auction processes as this would be highly complex from both a rules and an operational perspective. Alternatively, we suggest that any delayed auctions proceed on the basis of the outputs leading up to the auction (prior to the delay). Alternatively, where time is available prior to the delivery year, it may be possible to annul an auction and re-run the entire auction cycle for a new auction.

Impact of Stock Take - Transitional Arrangements

We agree with the proposed approach to the transitional arrangements. In particular, it is important that Capacity Payments are funded from Capacity Charges over the Capacity Year or part thereof to avoid exposing the market to significant cash shortfalls in the first few months of its operation. Recovering capacity payments for the initial four months through capacity charges in those four months avoids this issue. It is also important that the System Operators are able to recover their costs and expenses of performing their responsibilities under the Code.

As part of the final review of the CMC, the timing of some events under the code may need to be relaxed for the initial Capacity Auction, for example the Capacity Auction Timetable should be published ten months prior to the Capacity Auction.

Impact of Stock Take - Indicative Auction Timetable

We broadly agree with the RAs proposals set out in the indicative auction timetable. On the basis of the transitional plans being developed for the I-SEM and the timings set out in the Capacity Market Code, the auction process from issuance of the Capacity Auction Information Pack to running the Auctions is approximately six months.

- One month to consider auction pack and submit information to Qualification.
- Two months to run the Qualification process.
- Two months for review of Qualification Decisions.
- One month to run the Capacity Auction.

While we are still working through the detailed sequencing of activities at an operational level, it would appear that a T-4 auction in Sept, four years prior to the Capacity Year and a T-1 auction in March, six months prior to a Capacity Year would result in the most efficient sequencing of the Auctions as it would avoid overlap in the above six month cycle.

Establishing a clear annual process in relation to Capacity Auctions should assist Participants, the RAs and the System Operators in the business planning by identifying clear windows during the year where particular activities are likely to take place.

Other Comments

Physically Settled Obligation

The text of Capacity Market Code should be strengthened in a number of areas to clarify the physical nature of the obligations. It should be noted that the below additions are simply to clarify the nature of the arrangements and do not change the underlying Qualification, Auction or Settlement processes.

The text in paragraph F.1.2.1 should be strengthened to include the requirement that only Capacity Auction Offers from Capacity Market Units that have Qualified should be placed in the Capacity Auction.

F.1.2.1 The System Operators must do all things necessary to operate and administer Capacity Auctions in accordance with this Chapter including:

- a) providing facilities for the receipt and processing of Capacity Auction Offers;
- b) validating **and placing** Capacity Auction Offers **in the Capacity Auction based on Qualification Decisions**;
- c) providing and managing the Capacity Market Platform for the purpose of conducting Capacity Auctions; and
- d) determining and publishing Capacity Auction outcomes, including Awarded Capacity and prices.

The text in Chapter I should be strengthened to clarify that the Obligation Associated with Awarded Capacity is a physical load-following one and is subject to physical settlement. In paragraph I.2.1.1 (c)(ii), the text should be amended as follows:

“for each Capacity Market Unit comprising one or more Generator Units, through its participation in the day-ahead market, intraday trade, and/or Balancing Market, schedule or provide sufficient energy for each Imbalance Settlement Period to satisfy its Obligated Capacity Quantity (as may be modified for settlement purposes under the Trading and Settlement Code), and shall **otherwise** be subject to Difference Charges **and, to the extent that it does not satisfy its Obligated Capacity Quantity, Imbalance Settlement**, in accordance with the Trading and Settlement Code”.

Please note, this does not change the settlement rules for the Capacity Market in any respect. The reference to Imbalance Settlement relates to the fact that the Capacity Market Unit must settle at the Imbalance Price for Non-Performance Difference Quantities. The change in emphasis here is important to clarify the physically settled nature of the arrangement.

Local Capacity Constraints

Where an Aggregated Generator Unit or a Demand Side Unit satisfies a Local Capacity Constraint and secures Awarded Capacity due to its contribution to meeting the minimum requirement of the Local Capacity Constraint, restrictions are required on the unit to ensure that any changes to the generators and/or demand sites that make up the unit also reside within the area associated with the Local Capacity Constraint. This could be given effect in paragraph I.2.1.2.

Registration of smaller participants

The current CMC does not fully align with CRM1 decision in that CMC states in E.2.1.2. that variable, demand side, de-minimis and non-dispatchable units may voluntarily apply for Qualification (and by implication they may also choose not to). This is not strictly in line with CRM1 decision, which stated that all generation above the De-Minimis Level must qualify and that intermittent units can opt to submit an offer for 0MW in the auction.

The System Operators are aware of concerns raised by Participants on the renegotiation of intermediary agreements ahead of the 28th July 2017 deadline for Capacity Market registration and qualification. If all units must qualify for the Capacity Auction, it may give rise to a large volume of accessions, registrations and qualifications of units that do not intend to offer capacity above 0MW into the Capacity Auction.

In order to assist in mitigating risks around intermediary renegotiations, the System Operators propose the following transitional arrangement to be applied to the first Capacity Auction only.

For Units which meet the requirement of 'may apply' under E 2.1.1 they shall not be required to accede to CMC, register or qualify for the first capacity auction where they are not intending to offer capacity. However, the unit owner must provide unit registration and qualification information as defined by the System Operator by the 28th July 2017. [in order to ensure the TSO and RA's have sufficient information for the auction parameter setting]

The advantages of this interim measure would be:

- Capacity registration will not be on the critical path for intermediary negotiations (assuming the unit is not planning to offer capacity in the auction)
- It avoids a deadline for finalisation of intermediary agreements that may not be achievable to meet.
- It avoids the potential for unit owners to have to accede, register units and qualify for an auction they have no interest being involved in.
- It avoids potentially a 100+ transfers of obligations between the unit owner and the eventual intermediary.

- It avoids significant workload from participants and the System Operator in processing accessions and formal registrations/qualifications for units that are not planning to offer capacity in the first auction.

This proposal would mean that all Units that want to actively participate in the capacity auction will have to accede, register and submit qualification information by the 28th July 2017. This may be through an approved intermediary or the unit owner (if no intermediary agreement is in place).