Capacity Market Code Modifications Workshop 29 – Supplementary Consultation Paper

EP UK Investments (**EPUKI**) welcomes the opportunity to respond to this Consultation Paper. We believe that the SEM Committee's (**SEMC**) position in respect to CMC_03_23 is a positive step, however the proposed legal drafting has shortcomings which need to be addressed in order for this modification to be functional.

We welcome the SEMC's acknowledgement of the Security of Supply benefits which can be realised through the extension of the Long Stop Date (**LSD**), as well as the onus on facilitating the delivery of Awarded New Capacity.

The Security of Supply challenges in the Single Electricity Market (**SEM**) have evolved to a state where capacity has a role to play year-round. While previously, it was most critical to have New Capacity in place during the winter months, this is no longer the case. EirGrid triggered System Alerts as recently as 12 June 2023 as a result of low wind generation and unplanned outages. This follows a number of System Alerts in April, May, July & August 2022, and September 2021. These instances demonstrate that even during lower demand months, system tightness is at critical level. It is our understanding that of the last 17 System Alerts, only two have been during the traditional winter period.

As such, we believe that it would be detrimental to Security of Supply to prevent available generation from providing essential capacity on the basis of that generation being unavailable for a portion of the winter period. While the SEMC's proposed drafting seeks to address this issue, it creates a significant risk exposure for New Capacity projects in the event that a project does not receive approval for an extension from the RAs.

Under the current drafting, a New Capacity project may incur delays and subsequently request an extension to its LSD. If this request is rejected, the project will likely face termination of its Awarded Capacity contract and incur Termination Charges. This creates a high level of risk which means that the benefit of this modification cannot be realised.

One potential benefit of this modification is to incentivise multi-year Awarded New Capacity projects to accelerate delivery if possible. We believe there is an opportunity for this New Capacity to enter a single-year capacity contract to provide capacity for the months preceding the start of its capacity contract. Such New Capacity would provide essential security to the grid and mitigate against system tightness. This is of benefit to the consumer through lower electricity prices and increased security of supply. It is highly unlikely that a New Capacity project would be delivered 12 months early, however greater flexibility with the LSD would enable the project to provide capacity for a significant portion of the year. However, the currently proposed application process for extensions, combined with Termination Charges, make this very risky for investors.

For a 200MW (de-rated) Capacity Market Unit, the potential Termination Charges would be €8m in the event that the project did not reach Substantial Completion by the Long Stop Date. This is a significant level of exposure and without the certainty of an extension, the developer would be taking on an unfinanceable level of risk in the T-1 Capacity Auction. Under the current drafting, a project would need to enter the Capacity Auction and commit to an €8m Termination Charge, with no confirmation or assurance that an LSD extension request will be approved. This risk exposure would make it impossible to secure the investment required to incentivise New Capacity projects to deliver before the start of the Multi Year Capacity Contract.

Because of this risk, EPUKI is supportive of an industry-wide change to the LSD. This reduces risk exposure for investors and increases the likelihood of delivering New Capacity through the 2023/2024

T-1 Capacity Auction facilitating Security of Supply and the interests of consumers. We recognise that an industry-wide change to the LSD has ramifications for other Participants, particularly in the event that a project reaches Minimum Completion but not Substantial Completion (in which case it will not receive Capacity Payments until the LSD). However, we understand that a modification (CMC_13_23) has been raised in order to address this issue.

SEMC have stated their view that an industry-wide extension may have a ‘weakening’ of the delivery incentive for New Capacity. However, this is not true as there is a strong incentive on timely delivery through Capacity Payments which do not start until the project reaches Substantial Completion. If a project delivers its capacity three months after the beginning of a Capacity Year, it has already lost 25% of its expected annual capacity revenue. This a substantial downside and one which a rational investor will have taken all possible steps to avoid. The LSD does not offer any additional incentive or opportunity to deliver New Capacity faster. It does, however, create a risk that New Capacity which could contribute to Security of Supply for a significant portion of the year is terminated.

EPUKI is proposing that the LSD is amended to fall six months after the beginning of the Capacity Year (i.e., first day of March). This would enable New Capacity projects to contribute to Security of Supply through the T-1, and aligns with the LSD as applied in the UK Capacity Auctions. Additionally, it is a further incentive for Multi-Year New Capacity to delivery early on their contractual obligations.

If the SEMC is not prepared to amend the LSD as a whole, then we believe steps should be taken to reduce the risk exposure associated with uncertainty around the application process. EPUKI has considered the following proposals as possible means to reduce this risk.

1. **Exemption from Termination Charges where an extension request is denied.**

Under this proposal, the modification drafting would include an amendment which would waive Termination Charges from New Capacity projects which are refused an extension to LSD. This approach addresses the risk of significant and prohibitive Termination Charges for a project which may deliver after the current one-month LSD.

We also believe that this approach offers flexibility to both the project developer and the SEMC. If this mechanism was introduced, a project with potential capacity would apply to the SEMC for an extension to their LSD. At this point the SEMC can decide, using specified criteria (such as volume of capacity offered, location of capacity, Security of Supply etc.), whether to grant the extension to the LSD.

If the SEMC decides, using the specified criteria, not to grant the extension to the LSD then this will result in the New Capacity project terminating, but the investor will not incur Termination Charges. This mechanism will remove the risk of significant downside for New Capacity projects which may be available to contribute for a portion of the year. Simultaneously, the SEMC will be able to decide whether to avail of all available capacity using specified criteria.

2. **Removal of the Application Process**

EPUKI do not consider there is benefit to having any application process in the modification. We believe that the best approach would be one in which the Participant can trigger a fixed LSD extension and inform the TSO accordingly. The triggering of an LSD extension by a Participant could be linked to an independent engineer's report confirming that the project timeline and expected delivery date are feasible.

This approach retains the benefits of ensuring that all New Capacity can deliver, while removing the risk exposure which makes the current drafting of CMC_03_23 unworkable. This aligns with the relevant Capacity Market Code objectives including facilitating the efficient, economic, and coordinated operation, administration and development of the Capacity Market and the provision of adequate future capacity in a financially secure manner and facilitating the participation of undertakings seeking to be engaged in the provision of electricity capacity in the Capacity Market.

If a New Capacity project scheduled for delivery incurs a delay and requires a minimal extension to its LSD, e.g., one-month or two-month extension to its LSD, we consider it disproportionate to prescribe an application process in such cases, both in terms of the burden and uncertainty for the project and the burden on the RAs to process the application where it is unnecessary to do so. Furthermore, we would consider it irrational for the SEMC to reject such a request and instead choose to terminate the Awarded Capacity contract. It is clear that there is no upside to this, while the downside is significant for consumers through a continued reliance on expensive emergency generation and increased risk of lost load.

Previously, termination has been posited by the SEMC as an incentive to deliver capacity in a timelier manner, however as outlined above, there is already an incentive for Participants to deliver their project as soon as possible. The additional penalty of Termination Charges does not add any further incentive for Participants to deliver New Capacity but instead is a disincentive to investors in taking a risk on early delivery of projects. This termination risk becomes detrimental in the context of the Security of Supply crisis.

3. Facilitation of the extension application process prior to the Capacity Auction.

Under this proposal, the modification drafting would be amended to facilitate applications for extensions prior to the Capacity Auction taking place. This would require the legal drafting to amend references to Awarded Capacity as the extensions would apply to projects which had not yet been successful in the Capacity Auction.

It is important to note that pre-auction applications for extensions would not necessarily mean that a project expects to be late, but rather that a risk exists where a project may deliver after the beginning of the Capacity Year. Where the SEMC deems the potential value of this New Capacity to outweigh the downside of being delayed, an extension could be approved prior to the auction.

EPUKI expects that earlier sight of whether these projects can deliver, as well as their expected delivery date, would be beneficial to the TSO, as they would have greater foresight over expected capacity for an upcoming Capacity Year.

Conclusion

EPUKI welcomes the SEMC's acknowledgement of the value in this modification. However, it is essential that the SEMC recognise the significant risk which exists within the current drafting. In order for the system to benefit from this modification, we believe that the modification should be amended as set out above. EPUKI's preferred option is a global extension of the LSD by six months. However, should this not be possible, the exemption from Termination Charges, as we consider this proposal to offer the best balance of flexibility for the SEMC and certainty for New Capacity.

Under all of the proposals, we would still expect the significant majority of New Capacity to be delivered by the start of the Capacity Year. It is important to recognise, as outlined above, the incentive to deliver capacity is based on the start of Capacity Payments and not the LSD. Additionally, we expect this modification only to be relevant in specific circumstances where potential additional capacity can be brought on through the T-1. These points should alleviate any concerns the TSO may have on certainty of delivery of New Capacity projects.

This modification was originally proposed to ensure that all possible capacity which can contribute to Security of Supply would be enabled to do so. We believe that a worst-case outcome would be New Capacity being terminated or choosing not to enter the Capacity Auction when it would otherwise be available to provide capacity for the majority of the relevant Capacity Year.