
Integrated Single Electricity Market

CRM 2023/24 T-4 Capacity Auction Parameters Consultation Paper SEM-19-023

Response from



June 2019

1 Context & Recommendations

Bord na Móna welcomes this opportunity to respond to this consultation. We note that this consultation, in respect of the next T-4 auction gives rise to many similar concerns and comments as for the preceding parameters consultation on T-1 2020/21 and T-2 2021/22 capacity auctions, with perhaps the most important relating to the Existing Capacity Price Cap. This response includes additional comments relating to Reserves, Transmission Constraints, Auction Format, Strike Price and on the envisaged participation of Interconnectors.

We have highlighted in previous responses that for ‘existing’¹, as well as ‘new’ providers of capacity, related capacity payments very much remain a key component of service remuneration, alongside energy and ancillary service payments, as a key mechanism which underpins secure supply.

In this regard, while we acknowledge SEMC’s stated intention within the current consultation that it is not proposing to amend the Existing Capacity Price Cap for the 2023/24 T-4 capacity auction we remain, nonetheless, particularly concerned, that there is an intention to potentially reduce the Existing Capacity Price Cap below its current value of 0.5 X CONE.

This concern arises from SEMC’s position set out within the preceding consultation 2020/21 T-1 and 2021/22 T-2 Capacity Auctions².

Within the current consultation we note SEMC’s provision to:-

‘continue to keep the value under review, taking account of participants’ bidding behaviour in auctions and the number of USPC applications received.’

We explain in the body of our response that these criteria which might be used to support a reduction in ECPC are inappropriate, and a faulted logic.

Our concern arises from the inappropriate proscribing of the provider to recover any financial recognition of their sunk costs should they be forced to make a USPC³ exception application. It is taken as a given that a reduction in the ECPC will inevitably lead to an increase in the number of USPC applications.

The remuneration of sunk costs is a legitimately recognised and vital element of cost recovery in a competitive market. A change such as being considered is a radical change from an investor perspective in that it would represent a very significant and damaging retrospective change to the business investment model of existing plant.

We recognise how critically important it is for the RA’s to ensure, at a most fundamental level, that there is a secure level of supply, and, to ensure this supply, there needs to be a sufficient level of revenue certainty to financially support the supply base business model – be it for ‘existing’ or ‘new’ capacity providers. In this context, we would note the dynamic nature of increasing demand going forward driven by datacentres, electric vehicles, the electrification of heat, etc. As a commercial endeavour, there needs to be an opportunity for the provider to make a normal financial return.

We recognise, in parallel, that there is a system need for an increasingly efficient economic delivery to maximise social welfare, but we realise that that this needs to be achieved by following a path, ie., on an incremental basis so as to ensure ‘security of supply’ as priority on this transitional journey, and to ensure that the likes of sufficient inertia are maintained on the system at all times.

¹ ‘Existing’ capacity taken to mean capacity which exists, which is required for energy and/or ancillary services & inertia

² SEM-19-010 CRM 2020/21 T-1 Capacity Auction and 2021/22 T-2 Capacity Auction Parameters Consultation, March 2019

³ Unit Specific Price Cap

We fully understand and embrace that that new technologies, of which BnM will be a provider, will become more prevalent in the future, and our responses encompass this context.

A key point which we wish to communicate to policy makers is to urge them to recognise that this journey will be a transition which prudence would suggest should involve a degree of caution and surety of foot on the part of the System Operators/Regulatory Authorities – which needs to reflect the equal relevance of both ‘existing’ as well as ‘new’ capacity providers.

So, our most fundamental recommendation is to advocate a no regrets approach which allows a sustainable supply delivery model for both the System Operator and the Supplier/service Provider, while ensuring value to the consumer.

Notwithstanding SEMC’s stated proposal to not amend the ECPC for the 2023/24 T-4 Capacity Auction we believe that any future consideration to reduce the ECPC to a value less than its current level of 0.5 x CONE totally contravenes this no regrets approach, and for more detailed reasons outlined within this submission, we strongly recommend that any future consideration to reduce it be taken off the table indefinitely.

We have highlighted in our response, that, in fact, there is substantial rationale for the ECPC to be revised upwards, ie., for it to be increased, rather than decreased.

2 Response to Proposals

The format of our response is to comment in the following order:-

- 1. Existing Capacity Price Cap**
- 2. Tabulated Values – pages 2, 3 & 4 of the Consultation incl Reserves and Capacity Withholding**
- 3. Transmission Constraints**
- 4. Auction Format D**
- 5. Strike Price**
- 6. Participation of Cross Border Generation Units**

1. Existing Capacity Price cap

BnM is totally opposed to consideration of any reduction in the ECPC from its current level of 0.5 x BNE in respect of any future auctions. In fact, we are fully aligned with the EAI⁴ position which, in its response to SEM-19-010⁵ argues that the case for the value of ECPC being raised has been vindicated by events such as the unforeseen cost exposure to industry from a series of RO Difference Payment events to which Capacity Providers have been exposed, though no fault of their own.

There are other reasons which support its increase. The determination of ECPC as a multiple of 0.5 x Net CONE was based on an estimate by the RAs considered sufficient to cover the Net Going Forward Costs (NGFC) for the majority of capacity required to meet the capacity requirement. However, this estimate was based on analysis of Non-Fuel Operating Costs (NFOC) from historical generator financial reporting which did not include capital costs associated with ongoing operations. Thus, according to this methodology, ECPC set as a multiple of 0.5 x Net CONE would have underestimated these costs – substantially supporting the case for the ECPC to be raised.

⁴ BnM, as a member of the EAI

⁵ SEM-19-010 CRM 2020/21 T-1 Capacity Auction and 2021/22 T-2 Capacity Auction Parameters

At a more fundamental level the consideration to reduce the ECPC takes absolutely no account that those capacity providers which are forced to submit USPC⁶ applications within the exception application route will thereby be precluded, within the USPC application rules, from recovering any financial recognition of their sunk costs, not to mention the rigorous cost and time based USPC process to which the applicant will be exposed, without compensation. As a commercial endeavour there needs to be an opportunity for the provider to make a normal financial return, as is the case when tariff setting under regulated arrangements. While we recognise that the purpose of the ECPC is to limit the market power of existing generators, this must be balanced with the need for generators to be given an opportunity to recover their total costs if there is demand for their product, consistent with a competitive market process. To do otherwise is totally inappropriate.

In a similar vein, we note that 'The rationale for originally setting the ECPC at 0.5 is that:'..... '*It is consistent with relevant international benchmarks*'. If this is the case, and if security of supply will inevitably be reduced, while also risking future investment decisions, then we objectively fail to see the balanced reason for any consideration of reduction.

Furthermore we recognise that the level of interference in regulation from such an initiative would undermine investor confidence as a result of increased uncertainty and raised cost of capital.

The remuneration of sunk costs is a legitimately recognised and vital element of cost recovery. Such a change would be viewed negatively from an investor perspective in that it would represent a radical and damaging retrospective change to a 'standard' & respected business investment model.

The independent observer would have to ask 'why?' An independent observer might surmise that the reason for the Authorities considering the reduction reflects an improved capability to process the potential volume of USPC applications, rather than a market based approach, such as is supported under the relevant State Aid approval. We do not believe that an improved capability to process applications is appropriate reason for a change.

In addition, the paper itself highlights that the RAs have gained experience in handling USPC applications, which, of itself, clearly supports the position that the ECPC is, in fact, too low.

Furthermore, from the paper: '*It is important that the ECPC is not set at a level significantly above where the market is expected to clear in current market conditions*'. In this regard, we would highlight that the first T-1 auction cleared above the ECPC, the second one, just below. The T-4 auction cleared at the ECPC. The principle of lack of sunk cost recovery should be front and centre in taking priority with regard to i) security of supply, ii) normal commercial practices (and avoiding potentially totally unacceptable approaches with undetermined unintentional consequences from a loss in trust of the investment community).

We have outlined within 'Context & Recommendations', section 1 above, that a responsible approach in consideration of any parameter changes is to recognise that a transitional journey is required, supporting security of supply priority.

To conclude, we recognise that any proposal to reduce the ECPC to a value less than its current level of 0.5 x CONE within any future visible auction would totally contravene this approach.

We furthermore note that there is a strong case that the ECPC should be indexed upwards, given that the basis for the current value is a calculation relating to 2022/23, clearly a year before the 2023/24 T-4 Capacity Auction. We would query the absence of consideration of an equivalent BNE Net CONE costing exercise estimate for 2023/24, in the context of a likely higher BNE value setting a higher ECPC. It would not be unreasonable, in the absence of this review that the BNE would be indexed upwards, using an agreed methodology.

⁶ Unit Specific Price Cap

2. Tabulated Values – pages 2, 3 & 4 of the Consultation incl Reserves and Capacity Withholding

We select three parameters for comment:-

2.1 We note that the SEM Committee propose to retain the Billing Period Stop-Loss Limit Factor at 0.5 for the 2023/24 T-4 auction.

Consistent with our observations on the 2020/21 T-1 and 2021/22 T-2 capacity auctions we see merit in further consideration of the implementation of daily or event-based stop-loss limits. SEM 16 022⁷ Decision paper of May 2016 expressed that this decision will be kept under review. This could be another measure to contain ‘event’ exposure to providers against the type of events which occurred in October ‘18 and January ‘19, in the main.

2.2 The SEM Committee proposes to retain the following Increase and Decrease Tolerance levels for the 2023/24 T-4 capacity auctions.

Technology Class	Increase Tolerance (%)	Decrease Tolerance (%)
All except DSUs	0	0
DSUs	0	100

As we expressed in our response to SEM-19-010⁸, while we do not have an issue with the proposal, we recognise the provisions, whereby under SEM-18-030⁹, where satisfactory evidence is provided to the SOs, the decrease tolerance shall be 100% for a Candidate Unit that, due to relevant emissions legislation, has its running hours restricted to an extent that would reasonably be considered to prevent reliable delivery of their De-Rated Capacity at times of scarcity.

2.3 Reserves and Capacity Withholding

BnM supports the inclusion of reserves within the demand curve for the 2023/24 T-4 capacity auction. We recognise the importance that the process of setting the appropriate level of reserves, and of withheld capacity, is simple, transparent and bears in mind that it is considerably less costly to have surplus capacity (Expected Unserved Energy priced at the BNE price), than to have a shortage, which is priced at the considerably higher Value of Lost Load (VOLL).

3. Transmission Constraints

BnM supports the proposal that transmission constraints will continue to be included in the 2023/24 T-4 Auction, and favours Option 1 from the three Options presented, ie., the decision made within SEM-18-155 in respect of the 2022/23 T-4 Capacity Auction.

4. Auction Format D

BnM does not have any issue with the continued use of Auction Format C and in fact believes that it would be more appropriate to continue with Auction Format C until such time as the combinatorial Auction Format D approach is fully tried and tested – especially so, given its complexity.

5. Strike Price

BnM does not have a concern with the approach indicated.

⁷ SEM 16 022 ISEM CRM Detailed Design Decision Paper 2

⁸ SEM-19-010 CRM 2020/21 T-1 Capacity Auction and 2021/22 T-2 Capacity Auction Parameters

⁹ SEM-18-030 Capacity Remuneration Mechanism (CRM) 2019/20 T-1 Capacity Auction Parameters and Enduring De-rating Methodology

6. Participation of Cross Border Generation Units

We seek clarification regarding SEM Committee's current view on Cross Border participation of Generator Units for this Consultation, noting from SEM-18-00910 SEMC's stated intention for Cross Border participation to occur for this auction.

We hope that you find these comments of use and submit them for your consideration. We would be pleased of course to discuss any aspect of our responses should you so wish.

For and on behalf of Bord na Móna



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¹⁰ SEM-18-009 Capacity Remuneration Mechanism (CRM) State Aid Update, 2019/20 T-1 Capacity Auction Parameters and Enduring Storage De-rating Methodology Consultation Paper