Energy for generations

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ESB Generation and Trading Response:

Capacity Remuneration Mechanism 2024/25 T-4 Capacity Auction Parameters and Compliance with the Clean Energy Package (SEM-20-006)

20th March 2020

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1. INTRODUCTION

ESB Generation and Trading (ESB GT) welcomes the opportunity to respond to the Capacity Remuneration Mechanism 2024/25 T-4 Capacity Auction Parameters and Compliance with the Clean Energy Package Consultation Paper (SEM-20-006). The purpose of this Consultation Paper is to consult on the auction parameters for the 2024/25 T-4 Capacity Auction and the implementation of the CEP Emissions Threshold.

ESB GT's response is broken into two sections; the first is an executive summary of ESB GT's response to the Consultation Paper and the second section provides greater detail to ESB GT's response to the Consultation Paper.

2. EXECUTIVE SUMMARY

Firstly, ESB GT would like to take this opportunity to welcome the six weeks consultation period. The four week consultation period for SEM-19-010 was an issue and ESB GT fully agrees that as this Consultation Paper is once again consulting on a potential reduction to the Existing Capacity Price Cap (ECPC) the six weeks consultation period is appropriate. As stated in ESB GT's response to SEM-19-010, a reduction to the ECPC is a substantial change that can have ramifications for all participants in the market and requires careful consideration. ESB GT does not agree with the potential reduction in the ECPC. Below is a summary of the key issues ESB GT has with the proposal with greater detail provided in Section 3.

ESB GT believes caution must be exercised when interpreting the results from the interim auctions as supporting evidence for a change to the enduring auction design. ESB GT is of the view that further evidence from the enduring T-4 and T-1 auctions is required before proposing substantial changes to the market design that could have unknown detrimental consequences to the financial viability of market participants (existing and new).

Considering the SEM Committee's (SEMC) view that the ECPC "*may have become materially price affecting, rather than a bid limit within the auction*" and the Capacity Market Code (CMC) rules that successful long term contracts have to be in-merit, ESB GT is concerned that new builds may effectively be squeezed from the T-4 auction if the ECPC is reduced to 0.4XBNE. It is unclear if the notional savings from a reduced clearing price in the next auction along with the retention of inefficient old units at the cost of a new fast acting flexible efficient unit is in the customers long term benefit. Retaining the integrity and confidence in the market remains key as we transition to a low carbon economy that may be dependent on a greater degree of electrification as the industry shoulders the lack of change in other none ETS sectors. This solution should not be put at risk with a short term view.

From the lack of detailed assessment provided in the Consultation Paper and the SEMC opinion that "*The results of five capacity auctions (one T-4 auction and four transitional auctions) are now available. In all of these auctions, a considerable volume of capacity has bid at or just below the auction price cap. The SEM Committee is of the opinion that the ECPC may have become materially price affecting, rather than a bid limit within the auction*", it is ESB GT's opinion that the above statement indicates the current SEMC proposal to reduce the ECPC from its current level of 0.5 times the APC appears to be a price setting exercise which contravenes the Electricity Regulation 2019/943. In terms of Article 3(n), the Electricity Regulation states that the "*market rules shall allow for entry and exit of electricity generation, energy storage and electricity supply undertakings based on those undertakings' assessment of the economic and financial viability of their operations*". The published data on the Unit Specific Price Cap (USPC) process clearly identifies that market participants market revenue will be forecasted by the RAs and that if there is a difference between the participant's and RAs forecast that a 10% adjustment will be applied to the RAs forecast and this will be used for the USPC process. In light of the process of the RAs imposing their own assessment on participants

appearing to be in conflict with Article 3(n) of the Electricity Regulation 2019/943, a reduced ECPC will push more units into this regulated process where a participant's assessment is replaced with that of the RAs.

One of the key assumptions for the RAs modelling is the valuation of the product at Net Going Forward Costs (NGFC) only. In markets that are free from distortion, prices should be able to form at the true value of the product which includes an opportunity cost. The value of the product should not be viewed solely as the Short Run Marginal Cost (SRMC) or NGFC of a unit. Unlike the DAM, the product being sold in the CM has significantly more risk associated to it, most obviously is the 4 year lead time frame. This needs to be recognized and an opportunity cost allowed to be reflected in the price of the products. Considering the material uncertainty in the market at this point given the amount of wind to be brought on line, the variability of the wind, demand forecasts and portfolio mix, the impact of this forecast risk on the viability of thermal assets (forecasted four years in advance) must not be underestimated or worse prohibited.

ESB GT believes the current financial regulatory impositions (MAR, REMIT or B.9 of the CMC) are effective in managing any market manipulation without the need to change auction parameters. The application of the ECPC, USPC and APC were to prevent market manipulation while allowing bidding to occur within these price caps for different units. The design intent of CRM auction was to allow free price formation in an unconstrained auction and that the only units that would be subject to a price cap would be those required for LCCA reasons. In light of the High Level Design and the competitive nature of the auctions it is to be expected that participants may deviate from their NGFCs as different units face different risks. For example, some units may take the approach to be price takers in the hope of a rosy future later on whereas others may assess their financial viability as requiring a higher value than the RAs forecasted NGFC of that unit. If there are concerns or queries that need to be raised of the bidding applied the RAs should use the powers available to them prior to changing the auction parameters as not to do so would appear to be purely a move to further regulate the CRM auction and an attempt to distort the free formation of the price through supply and demand fundamentals.

In relation to the Clean Energy Package (CEP) Emissions Threshold, ESB GT wants to take this opportunity to raise an issue that the SEMC need to address when considering the recommendation for applying either option. For self-dispatch systems the ability to stay within the emission limit threshold is predominately within the capability of the generating unit. However, for a central dispatch system the ability to limit the number of run hour limits is not within the control of the unit owner. This issue is even more pronounced for generation unit owners in the SEM market where units that are required for system reasons are scheduled of the Complex offers which are subject to a Bidding Code of Practice (requires Commercial Offer Data to be reflective of the Short Run Marginal Cost of the unit). If the intention is to stop CRM payments to generating units once they have breached their annual run hour limit the SEMC need to allow market participants to reflect this opportunity cost in their complex orders. To not allow participants to mitigate the risk of lost CRM revenue while only allowing the recovery of cost for just SRMC is a clear breach of the Electricity Act 1999[1]. Considering the start of the capacity year is October, it is most likely that the TSO will have used the run hour limit of units within the first few months of the capacity year. The approach of non payments and SRMC bidding can only lead to the disorderly exit of units and resulting system security issues before/during the months when it is most needed. This does not lead to a sustainable nor efficient outcome.

[1] 9BC 2(b)

3. RESPONSE TO CONSULTATION QUESTIONS

In this section ESB GT has listed its response to the proposed CRM Auction Parameters in the Consultation Paper.

3.1 Existing Capacity Price Cap

ESB GT strongly disagrees with the SEMC's minded to position to reduce the ECPC as it appears to be based purely on the RAs' workload and a very small subset of auction outcomes and interpretations without any clear evidence. In light of the data provided ESB GT does not believe the minded to position of reducing the ECPC is proportionate as the risks from such a move do not appear to have not been fully laid out or assessed nor is it transparent how this minded to position advances the efficiency of the capacity market as it appears to be more of a price setting regulation[2]. In response to SEM-19-010, ESB GT set out a number of concerns a reduced ECPC may have on market participants and also highlighted why the ECPC needs to be increased from its current 0.5 times the APC. We restate a few of these here and welcome any commentary that you may have on them.

The comments in this section are organised in a manner to review a proposed change to the ECPC in light of the rationale for the original level. As per this Consultation Paper, the rationale used to originally set the ECPC at 0.5 was that;

1) It was estimated that the vast majority of plant required to meet the Capacity Requirement could bid at its Net Going Forward Cost without needing to apply for a unit specific bid limit;

2) It is consistent with relevant international benchmarks[3]; and

3) It strikes an appropriate balance between the objectives of protecting consumers from the potential for bidders to exercise market power, and not placing an excessive workload on market participants and RAs from having to respectively submit and review significant volumes of USPC applications.

- <u>Issues with RA modelling of NGFC</u>

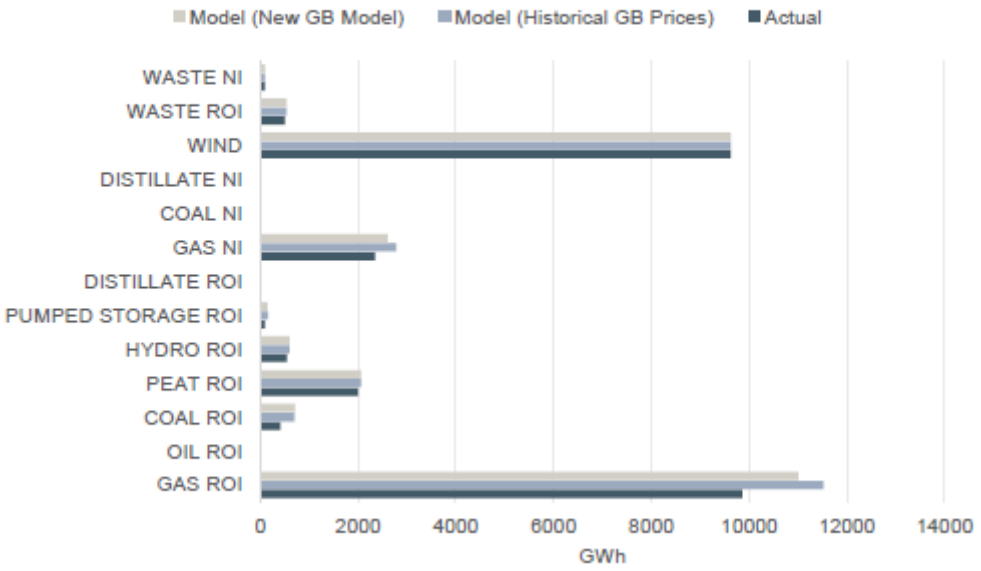
  Similar to ESB GT's response to SEM-19-010, there are still major concerns with the modelling assumptions used to forecast the T-4 capacity year. Considering this was one of the three factors for determining the ECPC[4], it is crucial that the model to determine the NGFC is acceptable to all market participants. Even though the SEMC have published a backcast report (SEM-20-004) on the model being applied there is still limited information for participants to replicate the model. ESB GT has responded to previous workshops on the potential limits of the PLEXOS model and ESB GT's response to SEM-19-010 had a non-exhaustive list of issues with the PLEXOS model that still exist. For this response, two additional key areas of concern that ESB GT has with the model are (1) the inaccurate and extremely distortive interconnector flows from SEM to GB and (2) the resulting forecast of grossly excessive generation for SEM generators.

  In Annex A1.2 the actual flows from and to GB were 2,572GWh and 1,600GWh respectively. However, the model used to determine the market revenue of generating units had forecasts of 1,503GWh and 2,353GWh for flows from and to GB respectively. These forecasts are

[2] ESB GWM's response to SEM-18-009 highlighted our concern that the current ECPC methodology was a creation of a regulated auction price rather than allowing the formation of a market drive price under competitive conditions in the CRM auctions>
[3] Values which ESB have suggested caution when using as well as the outstanding issue of non-recovery of sunk costs.
[4] It was estimated that the vast majority of plant required to meet the Capacity Requirement could bid at its Net Going Forward Cost without needing to apply for a USPC;

approximately a 71% decrease in imports and a 47% increase in exports. As a result of this significant flaw in the model, the knock on affect is the excessive forecasting of generation from SEM units. In the figure below it can be seen that the forecasted ROI coal generation has effectively doubled. This is also an issue as the reported values are ROI coal metered generation which is higher than the cleared volumes in the market. So in effect the forecast error is more than double. The Gas ROI values show an extra 1,000GWh of forecasted generation above the metered generation. To put this into context 1,000GWh is effectively an extra gas unit running at 114MW 24hours x 365 days. Considering the model poor fit with historical data it is questionable how well correlated the model could be with the future.

Figure 26 Annual total generator dispatch outcomes by plant type (comparing new GB model to actual historical and model with historical GB prices)



Considering the manifest errors in the backcast model and over forecasting of SEM generation, a further improvement of the model is required in order to justify a reduction in the ECPC level. It is questionable if the current model is calculating a market revenue that is actually setting too low a ECPC and not meeting one its objectives i.e. *the vast majority of plant required to meet the Capacity Requirement could bid at its Net Going Forward Cost without needing to apply for a USPC*.

A reduced ECPC places an even greater number of generating units at the exposure of the USPC modelling and under the direct price control of the RAs. The potential impact is that even more generating units are at the financial risk of the RAs assumptions. The implications of these assumptions on the financability of generating units in the T-4 capacity year is still unknown. Without having any evidence of the potential impact of the current process the decision to reduce the ECPC and force more units into this process will only truly be known in 2022/23.

- <u>Evidence for deviating from international benchmarks</u>

  Considering all of the SEMC's previous international analysis[5] and the importance of the ECPC, it is not proportional to make a decision to change the ECPC based on the evidence provided in this

[5] SEM-16-073

Consultation Paper. To reduce the ECPC would be to deviate from the internationally benchmarked[6] Non-Fuel Operating Costs, Fixed and Variable Operating and Maintenance costs[7] without any analysis having been performed or not having been made available. ESB GT would wish to see the new evidence used to support the deviation from the previous position in a consultation document with an appropriate regulatory impact assessment.

- The existing ECPC = 0.5xAPC is already creating too much of a burden on market participants.

  The way in which the RAs' consultants have developed the exemptions process, with the use of historic cost & revenue data as a means to assess future capacity requirements, the subjective recovery periods over which required investment can be recovered for different units and the application of continually changing modelling methodologies, has only increased an already significant burden on market participants.

  As a participant that has a large number of generation units participating on an annual basis, any number of unforeseen changes will impact widely across our entire organisation in order to meet the timelines set, the minded to proposal appears to suggest that this is inconsequential without engaging with participants on the change in workload that will occur. Some examples of key processes impacted include:

  - Annual generator financial submission formats and timelines have been severely impacted as these submission now form the basis of any application. This was decided without any engagement with participants as to how this impacts on an established process.

  - Long Term Asset Planning has now been materially impacted by the discussion regarding recovery periods and allowable cost that have made investment approval and scheduling increasing difficult to manage.

  - Generation unit revenue modelling for each individual participant is an increasingly difficult exercise in the new market arrangements. It has become increasingly difficult for a participant to develop strategies and model the outcomes when all decisions are based on the RAs' own model output. These interventions into the market mean that a participants modelling capability becomes irrelevant and more time and resources are spent attempting to replicate a changing set of RA modelling assumptions, chosen scenarios and averaging methodologies that have never been consulted upon, or are deemed commercially sensitive. The approach taken appears to be one that attempts to replicate a perfect market, as was the approach under the previous SEM with a merit order stack based on SRMC, and one that does not reflect or acknowledge that the new market accommodates a wide range of strategies. In addition, the idea of prefect competition, in a market where side contracts already exist or where there are unhappy winners, is redundant and can actually reduce efficiencies as it may affect investments in other services such as DS3 that will be increasingly more valuable.

  The Capacity Market Code (CMC) currently does not allow for any appeal of the USPC and considering the iterative nature of the exception qualifications[8], market participants are left exposed to applying for USPC for the wrong plant due to the lack of transparency on the assumptions employed during the determination of the exception qualifications. Taking this to its logical

[6] SEM-16-073
[7] ESB GT's response to the consultation highlighted that this analysis needed to be viewed with a degree of caution due to currency issues and lack of other factors taken into account (plant age, unit availability etc).
[8] SEM-18-024 CRM Exception Application and Opt-Out Notification Process for T-1 2019/20 Capacity Auction

conclusion, the outcome would be to have all unit submissions as USPC candidates as the lack of transparency and governance (not codified in the CMC) creates uncertainty as to which units the RAs view as requiring a USPC.

ESB GT has requested, in responses to previous CRM Auction Parameter Consultation Papers, that a review of the participants feedback on the section E.5 of the CMC should be performed as it would assist the SEMC in determining both the RAs and participants view of the burden. Currently, as this process is confidential there is no manner in which participants can voice comments on the process if they wanted to. Transparency is key when there is a desire for a market to improve efficiency, however, the confidentiality clause and lack of an audit prevents any transparency or effective governance being provided on the USPC process. Monitoring and reporting participants' experiences of the USPC process is an extremely important process in assessing the USPC process and determining an increase or decrease to the ECPC. This is not just in the amount of workload but also the commercial implications of the decisions.

As shown above, ESB GT does not believe there is sufficient evidence to move away from the previous rationale for setting the ECPC. Furthermore, there are a number of additional unintended consequences and topics (investment signals, compliance with Electricity Regulation 2019/943 and existing Market Manipulation powers) that need to be addressed prior to reducing the ECPC.

Firstly, ESB GT believes the impact of the SEMC's decision to hold and timetable the interim auctions around the first T-4 auction has to be considered when reviewing the first five auction outcomes as the basis of changes to future enduring auctions. This concern and risk was raised at the time of market design but was not acknowledged. It has to be acknowledged that the decision to impose this significant risk on market participants may have impacted on the bidding strategies for the interim auctions. ESB GT believes caution must be exercised when assessing the results from the interim auctions as supporting evidence for a change to the enduring auction design. ESB GT is of the view that further evidence from the enduring T-4 and T-1 auctions is required before proposing substantial changes to the market design that could have unknown detrimental consequences to the financial viability on these parties' projects.

Below are the comments on the impact on investment, Electricity Regulation 2019/943 and existing Market Manipulation regulatory interventions.

- <u>Impact on signal to new investment</u>

  The recent RA/SEMC decisions to (1) apply LCCAs for Dublin and Northern Ireland, (2) a locational scarcity scalar in Dublin and (3) grid connection offer for Dublin(CRU-19-124a and b) have provided clear signals to any new entrant to locate in the Dublin and Northern Ireland zones. However, the B.9 of the CMC rules clearly state that a long term contract can only be awarded in LCCA zones if they are in-merit. Therefore, to bid in-merit, in a market with over supply in the LCCA zones, a new build has to have an auction offer lower than the clearing price (which in the SEMC's view the ECPC "*may have become materially price affecting, rather than a bid limit within the auction*"). It is not unreasonable to assume that if the ECPC is reduced from its current level it will in effect reduce the auction clearing price.

  Considering the SEMC's view that the ECPC "*may have become materially price affecting, rather than a bid limit within the auction*" and the CMC rules that long terms contract have to be in-merit, ESB GT are concerned that new builds are being effectively squeezed from the T-4 auction if the ECPC is reduced to 0.4XBNE. It is unclear if the notional savings from a reduced clearing price in

the next auction along with the retention of inefficient old units at the cost of a new fast acting flexible efficient unit is in the customers long term benefit. ESB GT would welcome clarification on this interpretation to ensure that such risks are not presented to investors or that the consumers long term interests are not compromised with some short term vision. Retaining the integrity and confidence in the market remains key as we transition to a low carbon economy that may be dependent on a greater degree of electrification as the industry shoulders the lack of change in other none ETS sectors. This solution should not be put at risk with a short term view.

- Undermining of investor confidence (Treatment of sunk costs from T-1 auction)

  The SEMC's option to reduce the ECPC from 0.5xBNE to 0.4xBNE is potentially putting market participants in a perverse situation where they could have implemented a strategy for recovering investment costs through their offers in the first four transitional auctions but are now going to be potentially prevented from recovering those costs in the third and fourth transitional auctions because of the requirement to enter the exemption process which would treat the investment as a sunk cost and prevents it from being included in the calculation of NGFC (or potentially only allows a portion to be recovered). Such a perverse regulatory intervention that prevents commercial strategies from being effectively deployed under normal circumstances is not a reflection of a working and efficient market and could lead to unintended consequences and an increase in outside of the market contracts (LRSA).

- Price setting regulation.

  Considering the lack of detailed assessment provided in the Consultation Paper and the SEMC opinion that "*The results of five capacity auctions (one T-4 auction and four transitional auctions) are now available. In all of these auctions, a considerable volume of capacity has bid at or just below the auction price cap. The SEM Committee is of the opinion that the ECPC may have become materially price affecting, rather than a bid limit within the auction.*", it is ESB GT's opinion that the above statement indicates the current SEMC proposal to reduce the ECPC from its current level of 0.5 times the APC appears to be a price setting exercise which contravenes the Electricity Regulation 2019/943. It appears that the role of the USPC has changed from one which was designed to manage the market power of plants behind known constraints to becoming one to only put downward pressure on market outcomes through regulatory determinations which is, in the long run, detrimental to the consumer as the RAs appear to be focussed on short term outcomes rather than efficient long run equilibrium. This investment appraisal based on myopia raises the threat of inefficient exit (costly side contracts) and additional costs for the consumer. ESB GT has not to date seen any evidence provided by the RAs to the contrary. In the absence of any real information of market power concerns and a limited historical data set (four interim auctions and 1 enduring auction), a reduction of the ECPC can only be viewed as the SEMC actively seeking to control participants auction bids rather than cultivating an auction that enables fair competition that organically creates a competitive auction clearing price with efficient exit/entry signals. As in any market, the outcome of price is not perfect but is revealed through many iterations and is dynamically determined. A static model that attempts to model this and to direct future prices can only be seen as having limited capability and an intervention that is not required if we believe that price signals are effectively being determined in the markets.

- Compliance with the Electricity Regulation 2019/943.

ESB GT has concerns that the proposed change could have unintended consequences for compliance with the Electricity Regulation 2019/943 in terms of free price formation (Article 3(b)[9]), appropriate investment incentives (Article 3(g)[10]) and allowance for entry and exit of generation via the undertakings' assessment (Article 3(n)[11]).

In markets that are free from distortion, prices should be able to form at the true value of the product which includes an opportunity cost. The value of the product should not be viewed solely as the Short Run Marginal Cost or Net Going Forward Cost of a unit. Unlike the DAM, the product being sold in the CM has significantly more risk associated to it, most obviously is the 4 year lead time frame. This needs to be recognized and opportunity cost be allowed to be reflected in the price of the products. Considering the material uncertainty in the market at this point given the amount of wind to be brought on line, the variability of the wind, demand forecasts and portfolio mix, the impact of this forecast risk on the viability of thermal assets (forecasted four years in advance) must not be underestimated or worse prohibited.

It is ESB GT's view that participants, as per the CEP, must be provided the opportunity to reflect the value of the product free of restrictions. Failure to allow participants to reflect the cost of the product and formation of price from supply and demand free from regulatory restrictions could lead to CRM non-compliance with the Electricity Regulation because of an enforced price cap.

As discussed above, the continuous threat of a change to the ECPC removes any incentive for existing units to invest in flexibility services encouraged via DS3 due to the regulatory risk that the unit could end up in the USPC process after having sunk an investment cost (which is not recoverable). The lack of regulatory certainty is not conducive to long term investments as per Article 3(g) of the Electricity Regulation 2019/943. Without any sufficient evidence or assessment presented to industry this potential proposal creates a lack of transparency and consistency required for future investment.

In terms of Article 3(n), the Electricity Regulation states that the "*market rules shall allow for entry and exit of electricity generation, energy storage and electricity supply undertakings based on those undertakings' assessment of the economic and financial viability of their operations*". The published data on the USPC process clearly identifies that market participants market revenue will be forecasted by the RAs and that if there is a difference between the participant's and RAs forecast that a 10% adjustment will be applied to the RAs forecast and this will be used for the USPC process. In light of the process of the RAs imposing their own assessment on participants appearing to be in conflict with Article 3(n) of the Electricity Regulation 2019/943, ESB GT believes a review of the USPC needs to be performed as soon as possible rather than a reduction in the ECPC.

- <u>EU antitrust rules / Capacity Market Code B.9</u>

  As highlighted in the CRM 3 Decision Paper (SEM-16-039)[12] there are a number of existing financial regulations (MAR and REMIT) and CMC obligations (B.9) to prevent Market Manipulation behavior. It is unclear from the Consultation Paper what the SEMC's concerns are with "*a considerable volume*

[9] *market rules shall encourage free price formation and shall avoid actions which prevent price formation on the basis of demand and supply;*
[10] *market rules shall deliver appropriate investment incentives for generation, in particular for long-term investments in a decarbonised and sustainable electricity system, energy storage, energy efficiency and demand response to meet market needs, and shall facilitate fair competition thus ensuring security of supply;*
[11] *market rules shall allow for entry and exit of electricity generation, energy storage and electricity supply undertakings based on those undertakings' assessment of the economic and financial viability of their operations;*
[12] 3.3.30 "*The Regulatory Authorities, the Independent Auction Monitor and independent Auction Auditor will be monitoring for signs of market manipulation (including predatory pricing) and will, where appropriate, apply anti-manipulation rules within the REMIT framework, the Capacity Market Code and wider competition law provisions*;"

of capacity has bid at or just below the auction price cap" in the previous auctions. If there is a Market Manipulation concern with the bidding in the previous auctions ESB GT suggests that an RA published document with details on Accepted Market Practices (AMPs) for capacity auctions would provide clarity and transparency for market participants.

Considering the implications with a breach in MAR, REMIT or B.9 of the CMC, and to the best of our knowledge there has been no investigation, ESB GT believes the current financial regulatory impositions are effective in managing any market manipulation. The application of the ECPC, USPC and APC were to prevent market manipulation while allowing bidding to occur within these price caps for different units. The design intent of CRM auction was to allow free price formation in an unconstrained auction and that the only units that would be subject to a price cap would be those required for LCCA reasons. In light of the High Level Design and the competitive nature of the auctions it is to be expected that participants may deviate from their NGFCs as different units face different risks. For example, some units may take the approach to be price takers in the hope of a rosy future later on whereas others may assess their financial viability as requiring a higher value than the RAs forecasted NGFC of that unit.

If there are concerns or queries that need to be raised of the bidding applied the RAs should use the powers available to them prior to changing the auction parameters as not to do so would appear to be purely a move to further regulate the CRM auction and an attempt to distort the free formation of the price through supply and demand fundamentals, which as highlighted in this section has a wide range of consequences.

3.2 Other Auction Parameters

Indicative Demand Curve

It is unclear from the Consutlation Paper if it the intention is to retain the adjustments to the Demand Curve from previous T-4 auctions. Can greater clarity please be provided?

3.3 Compliance with the Clean Energy Package

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?

Before commenting on the two options, ESB GT wants to take this opportunity to raise an issue that the SEMC need to address when considering the recommendation for applying either option. For self dispatch systems the ability to stay within the emission limit threshold is predominately within the capability of the generating unit. However, for a central dispatch system the ability to limit the number of run hour limits is not within the control of the unit owner. This issue is even more pronounced for generation unit owners in the SEM market where units that are required for system reasons are scheduled of the Complex offers which are subject to a Bidding Code of Practice (requires Commercial Offer Data to be reflective of the Short Run Marginal Cost of the unit). If the intention is to stop CRM payments to generating units once they have breached their annual run hour limit the SEMC need to allow market participants to reflect this opportunity cost in their complex orders. To not allow participants to mitigate the risk of lost CRM revenue while only allowing the recovery of cost for just SRMC is a clear breach of the Electricity Act 1999[13]. Considering the start of the capacity year is October, it is most likely that the TSO will have used the run hour limit of units

[13] 9BC 2(b)

within the first few months of the capacity year. The approach of non payments and SRMC bidding can only lead to the disorderly exit of units and resulting system security issues before the months when it is most needed. This does not lead to a sustainable nor efficient outcome.

As highlighted in the consultation paper, the proposal to subject units that are in breach of the 550gCO_2 limit to additional de-rating would appear to have a number of material impacts that would render the option undesirable. Additional de-rating would appear to (1) increase the cost of the generating unit in the auction and subsequent increase to the consumer, (2) potentially increase the number of USPC applications and the unwanted associated burden, (3) potentially increase the likelihood of further DMILC/LRSA type contracts and the associated market distortion effects, (4) increase the number of units to provide the same MW capacity, and (5) increase complexity on defining a methodology for the additional de-rating factor.

In light of the above, ESB GT does not see any benefit from layering additional complexity on top of the ACER guidance and Electricity Regulation by applying additional de-rating factors. The most transparent, efficient and proportionate approach would be Option 2. However, Option 2 needs to be carefully considered in light of the issues for generator units in a central dispatch system.

<u>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?</u>

As stated above, ESB GT does not support the application of an extra de-rating on units that are subject to the annual emission threshold.

In the interest of clarity and consistency the capacity year for 2024/25 should not be reduced to nine months. ESB GT does not believe this proposal has been fully assessed in the consultation paper and that greater impact analysis should be performed. It is unclear how the SEMC propose to deal with issues such as (1) the USPC process (will 24/25 be assessed over 9 months or 12 months), (2) implications for the new build deadlines, (3) is there a change to the ECPC required due to no summer months running and (4) efficient entry and exit signals (is it harder to enter the market in the 9 month capacity year).

Before the Oct 2018, it was envisaged that market participants would have to deal with the regulatory uncertainty for the interim capacity years. It now appears that once again market participants are being asked to accept regulatory uncertainty when it isn't required. ESB GT does not believe the benefits, none of which have been suggested in the consultation paper, outweighs the costs from the unintended consequences of introducing a nine month capacity year for 24/25.

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

Other than an unvalued prediction of the "*scale of new entry likely to be required*" ESB GT is unclear why this has been proposed. The Consultation Paper has not clearly identified what the issue is and what reducing the long stop date from 18 month to another value achieves. ESB GT believes the shortening of the Long Stop Date it is an additional unnecessary risk on participants especially as the current clauses within the CMC to terminate/non delivery payment for new builds is sufficient to incentive participants to deliver on time.

Bringing the Long Stop Date closer does not guarantee the delivery of the capacity. Instead it will just increase the deficit for the capacity year and next capacity year as it will be too late to procure the replacement capacity (T-1 auction to be held 6 months in advance of CY). For example, if a project is delayed for 7 months due to no fault of the developer and the LSD is reduced to 6 months, rather than the TSO being

exposed to not having enough capacity for 7 months it will now face the possibility of not enough capacity for 24 months as it will have missed the T-1 auction for the second CY.

If there is a fear that participants will not deliver on time, then a consultation on the termination fees / non delivery payments need to be consulted upon. The other element of the CMC that assist in mitigating against the non-delivery is the requirements for Substantial Financial Completion. It should be at this point that the RAs can determine if a unit is unlikely to built on time and put in place procedures to mitigate the impact i.e. re-auction the volume in the T-1 or a T-2 auction.

ESB GT had expected that this Consultation Paper would have consulted upon more topics within the application of the ACER guidance, for example is the intention to take a three year rolling from the point of qualification or the previous 3 capacity years, the consequences in future auctions of a unit running over the annual limit in a capacity year, the wording of the declaration to be signed by all existing units, etc. Can guidance be provided as to when the consultation of such items will occur?