



Electric Ireland Response:
Capacity Remuneration Mechanism Detailed Design
Locational Issues Supplemental Consultation Paper

SEM-16-052

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General Comments

Electric Ireland (EI) welcomes the opportunity to respond to this Capacity Remuneration Mechanism (CRM) Locational Issues Consultation. Consistent with our previous responses, Electric Ireland views these consultation proposals from the perspective of a standalone supplier and as a representative of the consumer.

Given the current oversupply situation in the SEM, EI welcomes the intent of the CRM to provide a stronger exit signal than currently. This will ultimately deliver an efficient capacity situation for the benefit of consumers. However the next four transitional years may see, among other changes, the completion of the 2nd N/S tie line and the limitation or closure of NI units in order to comply with emissions legislation. EirGrid are forecasting a generation deficit by 2020 in NI under their median demand scenario. It is likely, in order to address locational issues, that consumers may incur extra costs during this period to maintain capacity in NI (beyond the plant life extension cost currently being borne by NI consumers). However, it would seem short-sighted to apply a strong exit signal to competitive plant (resulting in closure) that would be needed to deliver economic capacity post transition. From a consumer perspective, the costs of security events would be much greater. Consequently EI believes that a managed transition to an efficient capacity situation is required and supports option B (for the four year transition period only) combined with a shallow sloping demand curve.

Some of the key points for Electric Ireland and our customers are discussed below:

Transmission Solution Cost Benefit Analysis

The CRM 1 Decision dismissed full locational price adjustment as not being deliverable by go-live. As a result this consultation has been silent on this while considering less robust ways of addressing locational issues. All of the options presented are defective in that they do not consider the possibility that a transmission solution to resolving constraints may offer greater benefits to the consumer. In our answer to question 4.4.3, we propose a transmission cost benefit analysis process (and a specific auction price cap measure) to operate contemporaneously with the CRM auctions to provide some protection to the consumer.

Longer Term Considerations

The measure described above is necessary to avoid the situation whereby a new entrant might obtain, in low competitive circumstances, an out-of-merit 'must run' 10-year Reliability Option (RO) for which the constraints may only be reliably forecastable for a couple of years. This is unlikely, but not impossible, in T-1 auctions but certainly a serious possibility in T-4 auctions. Consequently, we believe that the treatment of local issues should be strictly limited to T-1 auctions during the 4 year transition period and not included in T-4 auctions.

Mitigating the Potential for Gaming

The identification of designated constraint zones in advance of the auctions in options B-D means that gaming strategies are available to units within those zones especially where multiple units are under the same ownership. EI believes that ROs awarded to such out-of-merit units that are successful need to be pay-at-cost rather than pay-as-bid at the level of their Net Going Forward Costs in order to protect the consumer. This is a less interventionist approach than capping the bids of all such potential units in advance of the auction.

EI believes that there needs to be restrictions on secondary trading of ROs from units in constraint zones in order to maintain (local) security of supply.

Section 2:- Outline of Issue and Proposed Solution

2.6.1 Do you agree with the assessment of the potential for exit and lack of new entry during the transition period set out in this section, and do you think that the potential for exit creates a security of supply issue given locational constraints?

A key benefit of the move from the SEM CPM to the I-SEM CRM will be the strengthened exit signals to capacity providers who are not successful in the auctions. These strengthened signals will make the capacity market more efficient than it is today and are of key benefit to the end-user with exit a potential consequence, for the least efficient plant, of moving to the CRM.

Electric Ireland understands that over the transitional 4-year period, where capacity will only be procured in annual year-ahead auctions, the incentive for new capacity provision to enter the I-SEM market will be limited and thus a balanced approach must be taken to ensure the competitive nature of the new CRM whilst ensuring an adequate level of capacity provision going forward. The CRM2 Decision, whereby the transitional period capacity requirement will be set at the 2020/21 requirement should mitigate the potential for excessive plant exit during this transitional period i.e. mitigate the risk that the 2020/21 requirement is not met.

Locational constraints will be a continuing and evolving issue over the course of I-SEM. The risk of a locational constraint not being accounted for could increase the potential for blackouts to consumers. Thus it's paramount that these constraints be considered in the transition. The principle proposed is that only locational issues which are 'clear and large' should be taken into account. It is imperative that under all options (with the exception of option E) the relevant constraints are identified in advance of each auction. It would be better to define a threshold for 'large', possibly in terms of contributions to imperfections costs, to avoid the situation of two constraint zones always being identified for inclusion e.g. even if the 2nd N/S tie line is completed during the transition period and I-SEM constraints are significantly reduced. Electric Ireland expands on the transmission analysis required before auctions in its answer to question 4.4.3 below.

Locational constraints in the transition should not allow for the CRM exit signal to be significantly diminished - consumers should expect significant efficiencies over the transition period to the new Capacity Market.

Electric Ireland's preferred approach

2.6.2 Do you agree that locational constraints should be incorporated in the CRM? Please elaborate your rationale in your response.

Locational constraints should only be incorporated in the CRM during the transition period as the consequence of not factoring in these constraints could potentially lead to (involuntary) load shedding for consumers. A key pillar of any capacity mechanism is to guarantee an adequate security standard on the system and not addressing these locational constraints could impinge negatively on the actual, rather than the theoretical, loss of load.

Electric Ireland are of the view however that these constraints should only be considered in the T-1 auction timeframe. The practicality of delivering alternative transmission infrastructural improvements within these timelines is dubious and thus their incorporation in the nearer time auctions is a sensible approach.

In terms of the T-4 auctions, the real difficulty in determining longer term transmission constraints could mean that plant is artificially seen as necessary due to a forecast locational constraint which turns out to be

temporary or of smaller magnitude and thus is successful in winning an RO. The issue is exacerbated due to the potential for awarding longer term contracts to new entrant plant against constraints that may turn out to be temporary and which might be more economically resolved via transmission reinforcement. Consequently, only incorporating potential locational constraints within short-term auctions offers greater protection to consumers.

2.6.3 Feedback in relation to the specific Grid Code requirements are sought in respect of the following:

- **The extent to which the Grid Code requirements can be relied upon to manage exit of plant which does not obtain a Reliability Option;**
- **Whether it is appropriate to provide assurances that generators which do not obtain a Reliability Option in the transitional auctions (which happen on a T-1 basis) be released from their obligations to give 3 years notice in accordance with the Grid Code; and**
- **Whether the Grid Code requirement should be extended from 3 years notice, to say 3 years 6 months to align with T-4 auction timings.**

The competitive element of the CRM will mean that certain plant will not be successful in winning a RO. For these plants, their financial viability going forward may be put in jeopardy and within certain instances, they may face exit from the market.

This would call into question the effectiveness of the Grid Code requirement going forward. Where a capacity provider was unable to secure their missing money, the grid code will become secondary to the financial solvency of that unit and can not be relied upon to manage exit of plant. Given this position it would not be appropriate to extend the notice time.

However, if a plant was unsuccessful in a T-1 auction during the transition period to 2020/21, then it may be appropriate to reduce the notice time to 1 year (rather than release the obligation) so that there remains some advance notice of exit and that such notice is available before the next auction.

2.6.4 Do you agree with the key principles proposed for any locational capacity framework within the CRM?

The key principles in which the framework is defined under the CRM mechanism is as follows:-

- 1. Any locational constraints taken into account within the CRM mechanism would only be used to represent local capacity deliverability constraints.*

Electric Ireland is in agreement with the RAs that the CRM's primary deliverable is capacity provision including local capacity delivery. The separate DS3 market will address the need for ancillary services provision. Although it is sometimes difficult to separate constraints arising from local capacity delivery from those arising from ancillary services requirements, inclusion of stability constraints (because of their highly locational nature) would seriously dilute the concept of capacity being an homogenous system-wide quantity. EI took the view in our response to the CRM3 consultation that a combinatorial auction in which ancillary services and reliability options were auctioned together would be unworkable due to the complexity involved and agree with this principle with regard to locational constraints. Furthermore, by including additional transmission constraints outside the core deliverable of adequate capacity for the system, the competitive nature of the auction mechanism would be severely diminished as potentially significant additional plant could be deemed as "must-run".

II. A locational need would only be included in the CRM mechanism where the need is clear and large.

The competitive nature of the auction is one of the clear benefits of the I-SEM CRM. Anything which detracts from the competitive element of the auction needs to be minimised. We are of the view that locational constraints are of a concern but agree with the principle of addressing these concerns only where the need is “*clear and large*”.

To enhance transparency and to build credibility for CRM amongst participants, the rationale behind the selection of particular constraint zones would need to be made clear as well as quantification, perhaps in terms of the magnitude of the potential contribution to imperfections costs, of what constitutes a “large” locational constraint. Where transmission reinforcement (paid for by consumers via TUoS charges) reduces the overall level of system constraints, then this threshold should mean that fewer constraint zones should be included within the CRM auctions in order to avoid double payment by consumers.

III. The means by which local capacity deliverability constraints are identified and quantified would be simple and transparent to the maximum extent practicable.

Transparency will be essential in any option selected with regard to solving locational constraints. Where there is any level of post-auction processing in the determination of successful participants in the auction, the process and reasoning by which these participants are selected must be clear to ensure the auction is seen to be completely fair.

Electric Ireland are of the view that another guiding principle of the auction should be to solve locational constraints at the best value to the consumer. A rounded view of solutions should be considered with a transmission cost-benefit analysis to ensure that no RO can be awarded via an auction to resolve a constraint where a more cost-efficient transmission solution to that constraint is possible. This approach would strengthen the competitiveness of the auction, reduce the chances of plant being labelled as required and holding an evergreen status of “*must run*” while most importantly ensuring the consumer is getting value for their money.

2.6.5 Do stakeholders agree that clear and large existing capacity delivery constraints should be reflected within the CRM auction, for example limiting this to the North-South constraint and the Dublin area constraint?

Electric Ireland would agree that only the critical locational constraints be considered within the CRM auction and only applied during the T-1 auction timeframe. Any interference in terms of labelling plant as “*must-run*” diminishes the competitive nature of the auction. A balance must be struck to ensure that plant are only labelled as ‘must run’ where there is no more competitive alternative option.

The consultation proposes a sensible approach that during the transition, a maximum of two constraints be considered. As stated in our response to 2.6.4 a specific imperfections cost contribution threshold needs to be set to ensure that e.g. after significant transmission reinforcement that fewer than two may be required. As previously stated, a holistic view of solutions to locational constraints should be analysed to ensure that any constraint which is accounted for in an auction can be deemed to be absolutely necessary.

2.6.6 Do stakeholders agree with the high level proposed solution for dealing with locational capacity issues?

2.6.7 If you do not agree with or have further view any of the proposals or assessment set out in this section, please outline why and where relevant suggest alternatives.

The high level proposal selects out-of-merit bids to deal with specified local capacity delivery constraints. These out-of-merit bids would be rewarded at their bid cost (or their Net Going Forward Costs – see response to question 5.1.1) rather than the marginal price. In our appraisal of this high-level framework, Electric Ireland analyse the framework with reference to the following:-

- i. **Security of Supply** – since EirGrid are forecasting a deficit in NI towards the end of the 4-year transition period to 2020/21¹, if locational constraints are not considered, there is a risk of black-outs to consumers; thus it is critically important to include them in the design of the CRM.
- ii. **Volatility of Capacity Pricing** – Electric Ireland will generally favour economic options which lead to less volatile movements in capacity prices. Our preferred approach to setting the clearing price would mean the unconstrained (post-lumpiness stack) marginal bid should set the price. This is closer to the true marginal cost of capacity on the system and should mean the capacity price would be less prone to large scale movements.
- iii. **Managing Exit/ Entry** – In solving locational constraint concerns, an issue arises when plant that is more economic to the consumer is substituted by a less economic out of merit ‘must run’ bid. While substitution of the bids solves the locational capacity constraint concern, it may result in economic plant exiting that will be required by the end of the transitional period. Electric Ireland are of the view that a managed transition to an efficient capacity scenario is required to ensure adequate economic capacity is available by 2020/21 and so supports the proposal to use the 2020/21 capacity requirement for all transitional years and also to employ a shallow demand curve to promote a smooth transition.

The proposal presented in this consultation is that locational issues and the associated exit signals need to be dealt with through the CRM. Electric Ireland has no objection to the proposed solution, but would like to reinforce that this is a solution to a temporary problem and should not represent an enduring solution.

¹ EirGrid’s All Island Generation Capacity Statement 2016-2025 forecasts a generation deficit in 2020 in NI under the median scenario.

Section 3:- Auction Design Framework

Assessment of Options

3.6.1 Which option do you prefer for the Auction Design Framework and why?

While all of the options have deficiencies Electric Ireland supports Option B as a means of addressing locational constraints.

The unconstrained auction run will identify those plant that satisfy the capacity requirement at the cheapest cost. This stack represents the plant that should remain on the system in the long run, i.e., once locational constraints no longer bind. All of the options will result in additional costs to the consumer compared to the unconstrained run and compared to if locational constraints were not considered. By taking an additive approach to solve locational constraints in option B (or under option E), the cost is likely to be higher in the transitional period than the other options which would reduce capacity cost in the short-term, but the long-term advantages make Option B the preferable solution.

Option B leads to less medium term capacity market distortion than the other options proposed. Removing plant that were economic winners in the unconstrained auction gives the wrong market signal to capacity providers: that being sufficiently economic can be over-ridden by inadequacies of the transmission system. Each of the options presented remove exit signals for inefficient plant that are awarded ROs on the basis of locational constraints. The substitutive options A, C, & D may present an exit signal to economic plant which are displaced by out of merit must run plant. However, 'large and clear' locational constraints should not bind in the long term, thus once those constraints are alleviated, capacity should be procured through an unconstrained auction. If Option B is chosen, the appropriate market signals will be given to the otherwise "unsuccessful winners" to remain in the market and once locational constraints are addressed, they may compete to be successful in CRM auctions and the formerly constrained on plant given the exit signals.

By adding plant to the required capacity, the security standard is increased. Electric Ireland argued in its response to the first CRM Consultation that the security standard achieved should be based on a LOLE of 3 hours in order to achieve parity with neighbouring markets and so that consumers should suffer no more costly security events than those in the neighbouring markets. EirGrid estimated that an additional 220 MW of capacity would be required to move from an 8 hour to a 3 hour LOLE security standard. Option B would be likely to meet this increased security standard in the short-term and should lead to greater confidence in system security, which is of utmost importance as we move to a new market-based capacity approach. A greater security standard achieved by the market in the transitional period may lead to reduced cost of capacity to consumers in the long run. Avoiding the exit of competitive plant during the transition period delays the point at which new entry, at much higher prices for consumers, would be required. In addition retaining a modest (rather than excessive) over-supply of capacity across the transition period would assist with a managed transition rather than a boom and bust cycle and should also act to depress energy prices.

Another advantage of retaining the most efficient plant on the system may be seen through lower energy market prices. This is in addition to the downward pressure of increased competition due to a modest over-supply of capacity in the transitional period.

Option B is a superior alternative to 'Option C with compensation' as the additional capacity procured under B will hold an RO and must provide capacity to the grid including the payment of differences to suppliers during

administered scarcity. Option C with compensation would cost the same to consumers but would not deliver the same security of supply² and would increase the hole in the hedge for suppliers.

Option B requires regulatory intervention to prevent gaming by units within the designated constraint areas.

Brief assessment of alternatives

Option A requires regulatory intervention in advance of the auction – efficient must run plant are not permitted to compete in the CRM which would otherwise influence the clearing price – removing these plants ex-ante reduces the competitive element of the CRM due to the fewer plants participating in the auction – in effect, in-merit bids may be displaced by must run units raising concerns about early exit of economic plant – nevertheless, capacity is not overprocured and so delivers less cost for consumers in the short term than additive options B & E and promotes a faster transition to an efficient capacity solution.

Option C requires regulatory intervention to prevent gaming by units within the designated constraint areas – based around a competitive auction but requires (as yet undefined) heuristic rules to resolve lumpiness and locational constraints after the auction – depending on the complexity of the rules and the level of information published, participants may be able to understand why certain units have been successful and others not which is extremely important for the transparency and credibility of the CRM – in-merit bids may be displaced by must run units raising concerns about early exit of economic plant – however, the capacity requirement is met rather than exceeded delivering a lower cost to consumers over the transition period than additive options B & E and promotes a faster transition to an efficient capacity scenario.

Option D requires regulatory intervention to prevent gaming by units within the designated constraint areas – based around a competitive auction but requires a full combinatorial auction solution to achieve the ‘optimal’ solution – while this might produce a more theoretically correct result than e.g. option C it suffers from serious transparency issues: participants are highly unlikely to be able to unravel why which units were successful and unsuccessful – this is likely to be very damaging to the credibility of CRM as a whole given the complexity of the RO instrument itself – in-merit bids may be displaced by must run units raising concerns about early exit of economic plant – however, the capacity requirement is met rather than exceeded delivering a lower cost to consumers over the transition period than additive options B & E and promotes a faster transition to an efficient capacity scenario.

Option E could lead to a massive over-procurement of capacity and gives the TSO the ability to override market bids with unrestrained security considerations – by contrast under other options locational issues are limited to two large and clear constraint zones – the system security analysis required (considering just local capacity delivery and not stability constraints) is likely to be very complex and time-consuming given the number of permutations and modelling scenarios that would be required would mean a complete lack of transparency in the CRM – local market power concerns are also a serious concern where units in significant constraint areas may be able to anticipate their must run status and game the auction but this may be mitigated where must run ROs are pay-at-cost rather than pay-as-bid.

² The unit without an RO may respond to e.g. a BM price signal but this is not as strong an incentive as the need to cover difference payments. The unit may nevertheless exit breaching security of supply but a unit holding an RO and choosing to exit would be likely to secondary trade the RO thereby maintaining system security of supply obligations.

Clearing Price Determination

3.6.2 Should the capacity price be set equal to: a) the highest-priced bid accepted in the unconstrained merit order; or b) the highest-priced bid which is both: accepted in the unconstrained merit order; and selected as a winning bid after lumpiness and locational considerations have been resolved?

EI believe that the clearing price should be set by the highest priced bid accepted in the unconstrained merit order **after lumpiness constraints have been resolved**. The social welfare calculation for lumpiness will determine this to be the marginal bid (or the next highest, if it is rejected on social welfare grounds). It is particularly important that lumpiness is considered here since where a new entrant bid is at the margin, and say only 5MW of a 300MW CCGT is required of the marginal unit, that the much higher new entrant price **does not** set the clearing price for all where it does not maximise social welfare.

This approach is appropriate for all of the options A-E and should deliver the true marginal cost of capacity and potentially provide a more stable investment signal (not unduly influenced by locational constraint considerations).

This should help avoid boom and bust cycles and promote a smooth transition from the current overcapacity environment to an efficient capacity scenario from a consumer perspective. The alternative may promote early plant exit and hasten the point when new entry is required at a much higher cost (with that component continuing for up to 10 years). This is unlikely to provide the best deal for consumers in the long run.

Unsuccessful In-Merit Bidders

3.6.3 Should a bidder that would have been accepted in an unconstrained auction but which is not awarded an RO receive a “constrained-off” payment in the CRM? If yes, how should the “constrained-off” payment be determined, and why?

EI do not believe that ‘unsuccessful winners’ should be compensated.

If the compensation level is less than the required ‘missing money’ then there is no guarantee that the plant will stay on the system. Under this scenario, the consumer would have paid more but not received improved security of supply.

If the compensation level is equal to the Net Going Forward Costs, then the cost to the consumer is similar to that under option B but the security of supply is of lesser quality. A compensated plant on the system may respond to e.g. a price signal in the BM but the incentive is much stronger under option B where the plant would face the financial penalty of making difference payments in scarcity conditions. In addition, under the compensation scenario, suppliers would not receive difference payments (exacerbating the hole in the hedge). The NGFC compensation scenario is significantly inferior to option B.

Representation of Constraints

3.6.4 How should local capacity deliverability constraints be defined?

EI believe that capacity deliverability constraints should be defined in MW terms using the nested model.

All other options potentially overstate the locational constraint. There is clearly scope for whole unit defined constraints to do this. In addition, whole unit constraints are inconsistent with 5 part PQ bids. The non-nested

constraints have to be inflated so that the sum of the parts equals the whole system level – this does not work when it is not clear that constraints are additive and that e.g. only two constraint zones are selected out of eight.

Any overstatement of constraints increases the 'non-market' component of the solution (either under option A or via regulatory determination of NGFC in options B-D) and reduces the cost efficiency from a consumer perspective.

Section 4:- Longer Term Considerations

T-1 and T-4 Auctions

4.4.1 Should the inclusion of locational capacity delivery constraints in the CRM occur in T-1 auctions, T-4 auctions, or both?

EI believe that local capacity delivery constraints can only be included in T-1 auctions during the 4-year transition period for the following reasons:

- no generation solutions to constraints should be accepted without testing whether transmission solutions would deliver greater economic benefits to the consumer – inclusion in T-4 auctions would significantly increase the risk that a 10 + 4 year generation solution would be awarded to solve a 4-year ahead estimate of a constraints problem;
- the confidence in assessments of the extent of constraints 4-years ahead must naturally be much lower than a year ahead and an insufficient basis on which to commit to a generation solution e.g. these may not take into account new transmission reinforcement plans that may be authorised in the intervening transmission price review.

4.4.2 What circumstances or criteria should be considered in relation to the T-4 auctions being conducted without explicit consideration of locational capacity delivery constraints?

None – no T-4 auction should include consideration of locational issues.

4.4.3 Are there any further considerations that should be taken account of regarding the longer term management of locational capacity delivery constraints? If so please detail your rationale for these.

This topic raises a much broader question which challenges a central premise of the high level design: is the I-SEM a SINGLE market? The potential need to deal with locational issues beyond the 4 year transitional period begs this question. The RAs have kept options open by insisting that multiple capacity zones must be supported within (central market) systems although multiple zones were dismissed as a main option in CRM1. However it is hard to see how e.g. two capacity zones could work with a single energy (CACM bidding zone) price. The different capacity zones would allow different capacity prices to reflect local conditions. However a deficit zone in an overall surplus market may experience load shedding while the single market energy price failed to reach a sufficiently high price to trigger scarcity and ROs. If full ASP is defined to be triggered by load shedding in *either* zone but without any forewarning and no points on the piecewise linear ASP curve being reached on the way (in order to invoke a response), this would also be unacceptable. Consequently the I-SEM is only likely to be workable if capacity zones and energy bidding zones are the same. The forthcoming ACER review in 2018 under CACM of the efficiency of energy bidding zones across the coupled markets should shed light on which of these possibilities will endure.

The remaining important question is how to ensure appropriate cost / benefit analysis of potential transmission solutions to local constraint issues is factored into the CRM.

The CRM 1 Decision dismissed full locational price adjustment, where each bid may be modified to reflect the cost of constraints, on the grounds of complexity and delivery risk. Consequently this approach has not been discussed in this consultation but all of the options presented are defective in that they do not consider

whether any transmission solutions might deliver greater economic benefits to the consumer. Instead the options presented retro-fit generation solutions to locational issues without consideration of potential alternative transmission solutions. The need to further retro-fit a transmission CBA is unlikely to result in an elegant solution.

From a consumer perspective, the unacceptable scenario is that a new entrant is awarded a 10-year contract (potentially out-of-merit) in a constraint zone without the benefit of effective competition and at a high price. It is not impossible that this could happen under a T-1 as well as under a T-4 auction. Under the current proposals there would be no mechanism to test whether a transmission solution would be better.

EI proposes that a transmission analysis is carried out *before* each auction which will determine:

- a. the identity of the (up to two) 'clear and large' constraint zones to be incorporated in the T-1 auctions and the likely constraint zones relevant to T-4 auctions; and
- b. proposed transmission solutions to resolve these constraints and feasible plans within the T-4 timeframe; and
- c. reasonable costs of these plans to resolve the constraints in these zones.

Such analyses might be done in conjunction with the Ten Year National Development Plan or the Transmission Price Review where appropriate. The costs would be used to inform the determination of the Auction Price Cap so that no new entrant bid could be accepted at a higher level than the levelised cost of implementing a feasible transmission solution. This is not a perfect solution since there would be no competitive market testing of the transmission solution costs, however it would afford some protection to the consumer.

In particular such analyses should include credible and feasible plans for the completion of the 2nd N / S tie-line.

Section 5:- Local Security of Supply and Market Power

Additional Market Power Issues

5.1.1 Do you believe that the suite of market power controls set out in CRM Decision 3 are sufficient to address any additional market power issues raised by local security of supply considerations? If not, what additional measure would you propose, and why?

EI believe that the CRM3 market power controls are **not** sufficient to protect against the exercise of local market power. EI believe that the units within designated constraint zones who are awarded out-of-merit must run ROs should be paid at their Net Going Forward Costs rather than at their bids (existing plants) and the Auction Price Cap informed by the levelised price of alternative feasible transmission reinforcement plans (new plants).

Determining, in advance, constraint zones means that the units within these zones can afford to bid differently since they have two ways to win an RO: competitive bid, or out-of-merit 'must run' status. When multiple units within these zones are under the same ownership, then a number of gaming strategies are possible. It is essential that such gaming strategies are prevented.

Mitigation is necessary to avoid such units simply bidding at the Offer Cap. Capping such units' bids at their NGFCs would likely require an unacceptable level of regulatory intervention in the capacity market e.g. all units in NI would have to submit their NGFCs for approval. A less interventionist option would be to adjust the price of successful out-of-merit must run ROs after the auction: such ROs would be pay-at-cost rather than pay-as-bid. Only such successful out-of-merit must run bidders would need to submit their NGFCs for approval. Another benefit is that competitive must run plant would be able to receive the clearing price and would not be disadvantaged by the regulatory intervention as otherwise under the ex-ante capping approach. However, it also means that options B-E end up having some non-market component (as well as option A).

Although not a favoured EI option, this would also resolve a potential problem under Option E where units in 'large and clear' constraint zones may still be able to anticipate their must run status but where there would be no a priori reason to apply individual offer caps to such units. Paying-at-cost such successful units after the auction would resolve this problem.

As described in detail in our response to question 4.4.3, EI believes that the consumer needs the additional protection of not setting the Auction Price Cap higher than the reasonable cost of transmission solutions to the designated constraint issues.

There is an additional issue which needs to be addressed: the ability of successful competitive or out-of-merit bidders in constraint zones to secondary trade their ROs.

Given the indicative constraint rules, the auction may satisfy the '2 out of 3 large units' rules possibly by awarding ROs to out-of-merit bidders to supplement competitive bidders in each constraint zone. Such successful bidders have only a very limited list of potential secondary trading counterparties (by definition) with which to e.g. cover a scheduled outage while maintaining local system security. Trading with a counterparty e.g. in a different jurisdiction would most likely breach the constraint zone requirements.

Another concern would be where the unit gains an out-of-merit 'must run' RO in a T-1 auction but then shortly afterwards decides to close and transfers the remainder of the RO to the highest bidder who is outside the constraint zone. In this scenario the successful bidder has secured better exit value through secondary trading while the consumer has paid extra (out-of-merit) but (local) security of supply has been compromised and not delivered.

EI believes that restrictions must be placed on secondary trades of RO holders in constraint zones. EI believes that trades should be restricted to other units in the constraint zones except where the particular requirements of the constraint can be maintained over the (short) duration of the secondary trade e.g. ' 2 out of 3 large units when demand is above X' might be maintained if demand is expected to be below X.