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26th June 2018

RE: I-SEM Capacity Remuneration Mechanism (CRM), Parameters for T-4 2022/23 Capacity Auction, Consultation Paper, SEM-18-028 (the “Consultation”)

Dear Kevin and Karen,

Bord Gáis Energy (**BGE**) welcomes this Consultation and the opportunity to respond to it. Given the concerns outlined below, particularly with regard to the need for an enduring solution to address market power in locational constraint areas, BGE suggests an alternative approach to the long-term auctions (including T-4 March 2019) for CY2022/23 in Section 1 below. Our proposed alternative in our view helps to meet both aims of: a) complying with State Aid requirements, and; b) ensuring that the local market power held by units located in constraint areas in both jurisdictions, should not endure in the medium-long term. We would welcome further discussions with the Regulatory Authorities (**RAs**) before a final decision on this Consultation, specifically with regard to the timeline for procuring minimum MWs for constraint reasons, is made.

1. BGE's Proposed Approach to Long-Term auctions for CY2022/23

1.1 Context

BGE is very concerned from both consumer and market participant perspectives, that the proposed approach to dealing with constraints in the T-4 auction only serves to meet State Aid requirements with regard to future procurement of out-of-merit capacity. It does little to address the serious problem that units located in constraint areas, holding considerable market power, are exercising their market power to the detriment of consumers and investors alike. The outcome and subsequent developments since the T-1 2017 Capacity Market auction evidence this problem. Market participants, investors and consumers cannot accept the continuance of costly out-of-market capacity solutions.

A major concern is that, if a different approach is not taken to the T-4 capacity auction procurement for CY2022/23 to that proposed in the Consultation, further out-of-merit contractual solutions will be demanded by locational units with market power. Without additional competition in locational constraint areas, those units with current market power will once again have to be procured in the T-4 March 2019 auction at prices above the capacity auction clearing price. This will effectively lock those units into obtaining high priced capacity contracts / out of market solutions in each auction between March 2019 and CY2022/23, as due to locational needs they may be in a position to demand one-year contracts in the interim period to 2022. The unjustifiable cost of these outcomes would be borne by consumers. Prospective investors would also be dissuaded from investing to deliver capacity until post CY2022/23. Furthermore, otherwise competitive existing units may be displaced by more expensive, less efficient and less competitive out-of-merit capacity due to their less favourable location which may in turn also drive up energy market prices. Overall, these outcomes would undermine the valuable entry and exit signal attributes of the Reliability Option (**RO**) mechanism.

Given the material negative impacts of the locational constraint problem that have emerged since the State Aid decision was published, we believe it is prudent that the RAs re-consider the problem and apply an approach to procuring capacity for CY2022/23 that meets both objectives of: a) complying with State Aid requirements; and b) creating locational signals over the coming year to enhance competition in relevant constraint areas.

BGE understands that it will be difficult to determine appropriate locational signals to enhance competition from new entrants in these constraint areas ahead of the T-4 March 2019 auction. Furthermore, while the Consultation references potential signals of intent on locational reforms before the T-4 auction, practically speaking investment decisions regarding participation in next March's auction would likely need to be made in the next Quarter at least. We therefore urge the RAs to take the time to determine appropriately robust locational signals to mitigate the problem. We believe that the approach to procuring capacity for CY2022/23 is the optimum time for the RAs to introduce measures for enhanced competition in locational constraint areas, particularly in light of the current healthy capacity margin.

When determining the optimum locational signals, it will be necessary to ensure that the signals are targeted at new entry and do not also serve to inadvertently enhance the energy or capacity market position of existing units in constraint areas. One particular measure that we believe should be further considered by the RAs is the prospect of removing the pre-condition of grid connection for capacity market entry. As it stands, we believe that the regulatory process around grid connection may act as a barrier to entry to potential capacity providers. BGE firmly believes that grid connection offers should also be given to accommodate capacity market outcomes, i.e. those capacity providers that do not already hold a grid connection on entering the capacity auction should, if they are successful in the capacity auction, be offered a grid connection to fulfil their capacity market contract. This could be particularly helpful for incentivising entry in locational constraint areas. However, in order not to undermine the existing capacity commitment model, BGE suggests that market participants and the TSOs should have an understanding of their ability to obtain a grid connection contract before the auction is held: for example, the TSOs could determine during the pre-qualification process whether a grid connection can be accommodated and if the answer is affirmative, the offeror would at that point make the applicable financial commitments. BGE believes that there is scope within the existing ECP-1 policy to provide for such an approach. Lastly, we note that the connection arrangements in Northern Ireland and Ireland are not analogous. Given that the capacity market is an all-island mechanism, we urge the RAs to consider the need for all market participants to be facilitated capacity market entry on a level playing field.

Ultimately the approach to locational signals for new entry to long-term auctions for CY2022/23, should seek to balance: a) consumer costs; b) security of supply; and c) existing as well as future investment prospects.

1.2 BGE's proposed approach to long-term capacity procurement for CY2022/23

With the above context in mind, and given the time that the proper development of appropriate locational signals to incentivise competition in these constraint areas deserves, BGE proposes that the RAs adopt the following approach to the long-term procurement of capacity **specifically for CY2022/23**:

1. Run the T-4 auction in March 2019 for capacity delivery in CY2022/23 without specifically seeking to procure the entire minimum MW requirements for locational constraints:
 - a. This T-4 should not seek to procure out-of-merit contracts to meet 100% of the minimum MW locational constraint requirement. Only in-merit contracts should be permitted to fulfil the capacity requirement if their bids are competitive or below the auction clearing price. Consideration may need to be given to the design of the demand curve to accommodate this approach;
 - b. The usual market power monitoring of bids should apply – in particular, the submissions of units with Unit Specific Price Caps (**USPCs**) should be compared with T-1 2017 to ensure no arbitrary changes are made in bid compilations to reflect the desire that it may be preferable for an existing unit in a locational constraint area to obtain a capacity contract for CY2022/23 in a long-term auction held subsequent to the T-4 2019 auction;
2. Over the course of 2018 (from now on), develop locational signals that incentivise the development of competition in these constraint areas with a view to encouraging investors to participate in a second long-term auction for CY2022/23. For example, consideration could be given to offering grid connections to capacity providers that win an RO, as outlined in section 1.1 above;
3. Run another long-term auction for capacity delivery in CY2022/23 (e.g. a T-3/T-2 auction in early 2020): this auction would seek to ensure that any minimum MW requirement not met by the “unconstrained” auction run in T-4 March 2019 is procured, together with any other volumes perhaps un-procured at the T-4 March 2019 stage. The standard auction process (pre-qualification etc.) could apply.

BGE believes that the above suggested approach will help achieve what we see as key objectives in resolving the locational constraint market power problem, being: a) complying with State Aid requirements, while; b) creating locational signals over the coming year to enhance competition in relevant constraint areas.

This approach in our view:

- i. Would provide long term benefits to consumers: those units with local market power should no longer be in as strong a position to demand expensive out-of-market contracts to fill the one-year capacity gaps in the interim years to CY2022/23;
- ii. Complies with State Aid requirements as no out-of-merit capacity would be procured at the T-4 stage; instead the potential need for out-of-merit capacity would be provided for in a subsequent (e.g. T-3/T-2) auction;
- iii. Improves the entry and exit signals for the I-SEM capacity market (a key positive attribute of the RO mechanism), and helps to directly address the local market power in locational constraint areas problem;
- iv. Overall should add to the diversity and security of supply in the Irish electricity market.

We recognise that the above proposed approach to long-term procurement of capacity for CY2022/23 may not resolve the locational constraint problem for CY2022/23 in its entirety. However, what it will do is mitigate the extent to which market power of local incumbents can be exercised through their demanding of high priced contracts in the intervening period from 2019 to CY2022/23. Moreover, once appropriate locational signals are determined by the RAs, these should feed into investment decisions for prospective investors seeking to offer capacity not only for CY2022/23 but for CY2023/24 and thereafter. Over time, the results and benefits of heightened competition should become evident in lower capacity market costs for consumers.

While a second long-term auction (i.e. T-3/T-2 2020) for CY2022/23 may add an administrative burden for the TSOs and RAs, we believe the potential benefits as referenced above far-outweigh the possible burden. Furthermore, we would support the mitigation of any administrative burden by the application of as many parameters as practicable to the second long-term capacity auction for CY2022/23, as are applied in the T-4 scheduled for March 2019.

BGE has outlined above its view on how two long-term auctions to procure capacity for CY2022/23 should be held. For ease of reading however, we outline below BGE's view on the discrete questions raised in the Consultation mainly from the perspective of a regular T-4 (one long term) auction run as proposed in the Consultation. However, we urge the RAs to take on board our proposals above and if the RAs find merit in our suggestions, we believe that our responses to the various Consultation questions can be read as applicable to a "long term auction" in general – i.e. either a T-4 or 2nd long term auction for CY2022/23, as the context requires.

2. Treatment of Constraints in T-4 Auction

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| i. Do you agree with the SEM Committee's proposal to reflect transmission constraints in the T-4 auction? Please explain your rationale. |
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In general, BGE agrees with the SEM Committee's (**SEMC's**) proposal to reflect transmission constraints in the long-term auction. The reflection of transmission constraints is in our view necessary if the SEMC is to be deemed compliant with the requirements of the State Aid decision on the Reliability Option (**RO**) capacity mechanism.

As to the *approach* to reflecting transmission constraints in long term auctions, specifically for CY2022/23, BGE's view is as outlined in Section 1 above – i.e. withhold the requirement to procure the *entire* minimum MW requirement to meet locational constraints in March 2019's T-4 auction; over 2018-2019 develop and introduce locational entry signals to incentivise new entrants; run a second long term auction for CY2022/23 with a capacity requirement that takes into account the minimum MW constraint requirement.

Overall, BGE believes this to be a State Aid compliant approach.

- ii. Do you have any comment on the possible inclusion of multi-year pay-as-bid Reliability Options to meet the minimum Locational Capacity Constraint requirement?
- iii. Do you have a preference between the Options set out above in relation to pay-as-bid offers? Please explain your rationale.

BGE responds to both of these questions together.

In general, BGE supports the ability for multiyear ROs to compete against single year ROs provided that they are a cost-effective solution for consumers.

❖ **Options (a) – (c)**

Of the 3 Options put forward in the Consultation, BGE believes that Option (b) - i.e. permit multiyear ROs to compete against single year RO offers only if the multiyear offer was priced at or below NET CONE/ BNE – is the most appropriate Option. Our views can be summarised as follows:

- It is difficult to justify the need for a consumer to pay for capacity well above the cost of the Best New Entrant. That is not to say that these units cannot seek a USPC approval in the same manner as any other unit - it is important that there is consistent treatment in terms of the applicability of rules, to all prospective contracts be they single-year or multi-year offers.
- Allowing acceptance of these multiyear ROs at a price above NET CONE if there was no other way to meet the local MW requirement, should only be permitted if such bids are stringently monitored and evaluated by the RAs. Units should not be permitted to artificially use the BNE as a price floor for their own unit specific price caps.

Related to this, BGE believes that, but would welcome confirmation from the RAs, the “small tolerance” that may be permitted for pricing multiyear ROs at or below NET CONE referred to in the Consultation, would only be permitted if the unit goes through the approval process of the Unit Specific Price Cap (**USPC**) process? It is important that units are treated on an equal basis when it comes to bid submissions.

- We believe that option (a), (i.e. permit pay-as-bid multiyear ROs only where there are no other solutions to satisfy minimum MWs required in a constraint area), completely undermines the need for enhanced competition in constraint areas and risks embedding existing market power in these areas for the long term. This in turn undermines exit signals and is considered wholly unintuitive.
- Option (c), (i.e. allow multiyear ROs to compete with 1-year ROs at any price up to Auction Price Cap), in our view places potential unjustifiable costs on the consumer. The principle that should apply is the permission of multiyear ROs to compete against single year RO offers only if the multiyear offer was priced at or below NET CONE/ BNE or if the situation requires, allowing a tolerance for pricing above this subject to the unit going through the RAs’ USPC process.

❖ **T-1 constraint levels setting a “floor” on the minimum MWs constrained in T-4 2019**

BGE does not agree with the suggestion that the T-1 level of constraints could set a “floor” on the MWs constrained in different areas for T-4 2019. In the interests of competition, mitigation of existing market power issues and of respecting the need for efficient exit signals, those T-1 2017 level of constraints should instead be reference-able as a cap on the MWs procured for constraint reasons in the long-term auction(s) run for CY2022/23.

3. Auction Format

- i. Do you have any comments on the SEM Committee’s proposal to move to an auction format based on Auction Format C for the CY2022/23 T-4 auction, following the State aid decision?

In principle, we have no objection to moving to Auction Format C for long term auction(s) procuring capacity for CY2022/23. BGE understands that in order to meet the State Aid obligation, procurement of out-of-merit capacity in addition to in-merit capacity can no longer be permitted. It does not however improve the practical problem we face of the exercise of local market power in locational constraint areas.

Furthermore, we urge the RAs to consider further our proposal in section 1 in the context of the need to avoid undesired consequences and inefficient exit signals. Unless steps are taken towards signalling investment in

locational constraint areas, we believe that the T-4 auction for capacity could see the displacement of competitive generation in favour of less competitive more expensive generation required, simply due to them being located in constrained areas. This risks increasing costs to the consumer not only in terms of less competitive capacity being available to participate in capacity market auctions, but also in terms of the potential increase in energy market prices. An approach aligned with that which BGE proposes in Section 1, would in our view mitigate the risk of inefficient exit and high consumer costs as more competition would be introduced to compete down the energy and capacity prices of locational constraint located units.

ii. Do you have any comments on the TSOs proposed AASM for implementing the new auction format, as set out in Appendix A, or the RAs' proposed change to the N parameter?

BGE believes that the proposed Alternative Auction Solution Methodology (**AASM**) is reflective of the objective of providing for displacement of in-merit units with out-of-merit constraint area located units. As outlined in our immediately preceding answer, we support the need to observe the State Aid obligation with regard to not over-procuring capacity.

However, to determine the actual benefits of displacing in-merit capacity with out-of-merit capacity at the T-4 March 2019 stage in particular, BGE believes that the RAs should assess and take into account the counterfactual. The counterfactual should establish what the "unit cost" of reinforcing/ developing the network to alleviate the relevant constraint, is. While this unit cost would be expected to be relatively high, we suggest that the net social welfare function of the AASM should effectively recognise that if a constraint is expected to be in situ for a short period of time, displacing a unit in the auction results in order to accommodate more expensive but locationally better situated units, may not be the most efficient outcome from a consumer cost perspective. The social welfare function should incorporate the length of the constraint, as well as the ability and cost of it to be fixed by network investment. In effect, BGE is seeking to ensure that displacement of efficient capacity does not occur in favour of less efficient more expensive capacity, which in both the short and long term could be harmful for the consumer. The counterfactual approach should inform the decision as to whether we a) pay the extra cost of high priced out-of-merit units (whether 1-year or multiyear providers) or b) pay for lower priced in-merit units and invest in the grid needed to address constraints where possible.

We would also suggest that, in order to avoid the risk and cost of under- or over- procuring capacity at the long-term auction stage that consideration should also be given to the potential deviation in demand that can occur between the procurement and actual delivery of capacity. The TSOs annual Generation Capacity and Transmission Forecast Statements for example outline low, base and high scenarios for demand and provide a sound basis for determining the potential cost of over-procuring capacity at the T-4 auction stage.

BGE agrees with the RAs' suggestion that two separate N parameters (N1 for the number of offers below the base solution, N2 for the number of offers above the base solution) should be investigated. To mitigate the risk of inefficient exit signals a conservative number for N1 should be applied (at least in initial long-term auctions) otherwise competitive plant may be displaced in favour of more expensive but better located (constraint wise) plant. Depending on the level of capacity shortfall subsequent to the long-term auction if any, a higher N-1 number could be applied in subsequent auctions the closer we get to the relevant capacity year.

iii. Do you have any comment on the proposed change to the format to accommodate multi-year pay-as-bid Reliability Options?

It appears to BGE that the RAs' minded to solution for permitting multiyear ROs to compete with 1-year ROs, is Option 2 (i.e. accept multiyear ROs once they are at priced or below the NET CONE). As outlined in our answer above, BGE also supports this Option 2.

Option 2 in our view is a cost-effective solution for consumers and the auction format as we see it seeks to accommodate it as cost-effectively as possible. Where multiyear ROs need to price themselves above NET CONE, they should be subject to the USPC process akin to existing generators that seek to price above the existing capacity price cap. Equitable application of rules to single and multiyear RO offers should apply and in any event if the relevant offer is not competitive, the auction format should ensure the offer is not accepted. Please see our response to the immediately preceding answer also for further insight.

4. Capacity Requirement (CR)

- i. What are your views on the potential changes proposed to the CR methodology – incorporate some measure of Operating Reserves (OR) in the CR? What MW value?

In light of the fact that the current 8 hours LOLE is a theoretical, not a practical, standard and given the direction of travel towards low LOLE in Europe and towards increasing security of supply performance requirements of TSOs, we believe it prudent to make an adjustment to the CR to at this point in time.

BGE has considered all of the proposed levels of operating reserve put forward.

The pros and cons of each level of operating reserve are not definitive (one could view the varying levels of operating reserve as resulting in an increase or decrease in RO participation depending on the subjective view one takes). What is clear is that, in our view, including a 250MW operating reserve level in the CR reduces the risk of uncovered RO difference payments which bodes well for consumers and their exposure to high capacity (as a higher risk of uncovered RO difference payments would flow through capacity market bids) and energy prices. It should also have a positive effect in terms of reduced socialisation fund charges for suppliers. We note also that including 250MW of operating reserve in the CR or reducing the LOLE to 3 hours, has the same practical effect.

In our view, inclusion of 250MW of operating reserve in the CR is the optimum outcome when viewed on balance. Further considerations behind BGE's choice were to strike a balance between: a) mitigating the risk of inefficient exit of otherwise competitive plant on the margin materialising; b) ensuring that the much-wanted exit signals for inefficient capacity endure, and; c) ensuring consumers pay a cost-effective price for capacity procured as outlined above.

As the MWs of operating reserve in the CR increase, the LOLE reduces thus the demand curve would be less steep. This also bodes well for consumers who would pay less for capacity close to and above the capacity requirement at the long-term capacity auction stage.

Should the TSOs' estimated unit exit (825MW-1350MW) begin to materialise more quickly than expected however, the RAs should reserve the right to re-address the appropriate volume of operating reserve to include in the CR in particular, to avoid the negative consequences of sudden exit of otherwise efficient capacity.

- ii. What are your views on the potential changes proposed to the CR methodology – Whether the 8-hours LOLE standard should be tightened (reflecting the LOLE target). What level do you consider to be appropriate and why?

BGE understands that the choice with regard to the CR is to either include some level of operating reserve in the CR or to reduce the LOLE from 8 hours to 3 hours.

As adding a MW level of 250MW of operating reserve into the CR has the same practical effect of a 3-hour LOLE standard, we believe that one of these two options should be chosen. Given however the uncertainty in the expected level of exit from the capacity market in the short-term (which the TSOs estimate at 825MW-1350MW), should the risk of sudden inefficient exit from the market arise for example which requires a review of the CR, a review of the operating reserve level in the CR may be simpler to determine than a change in LOLE.

Regardless of whether the LOLE is reduced or the operating reserve MW level in the CR is increased, we do believe that it would be most conducive to consumer costs and efficient exit signals if the RAs' current demand curve (Option A in the consultation) was retained. We return to this point below but in essence, we strongly believe that a balance between: a) reflecting a realistic CR that ensures security of electricity supply b) cost-effective capacity for consumers, and; c) maintenance of exit signals for inefficient plant, needs to be achieved. The alternative Option B demand curve in our view would, compared to Option A, dampen exit signals and potentially procure capacity beyond that required to secure supply, and thus over-pay for capacity at the cost to the consumer.

Any concern that an addition of 250MW of operating reserve in to CR reduces exit signals is in our view more than outweighed by the reduction in the level of MWs procured through the auction design (as the auction

does not over-procure capacity given that it will either exclude in-merit units when the time comes, notwithstanding the increased OR in the CR).

Finally, the performance of the TSO in terms of security of supply as evidenced by its high standards achieved for example in its “system minutes lost” KPI throughout Price Review (PR4), arguably supports the ability to place an equivalent 3-hour LOLE standard on the TSO without over-burdening them.

5. Administered Scarcity Pricing (ASP) Parameter

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| i. Which of the options for the value of Full ASP do you consider most appropriate for the first T-4 capacity auction and why? |
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The ASP in I-SEM is effectively a price floor and should be seen as such whenever the operating reserve hits a certain low level. The VOLL on the other hand is generally seen as a price cap in electricity markets. The two are markedly different and this should be borne in mind when finalising this decision. We do not therefore believe that the full ASP (**FASP**) should be set anywhere near VOLL given that the market price may still tend to VOLL when market forces provide for it.

From a consumer perspective, if a decision to include operating reserve of 250MW/ reduce LOLE to 3 hours in the capacity requirement is made, then the consumer will be paying more for capacity. If a harsh FASP is chosen, the consumer is potentially paying more again. However, in reality with an increase in the capacity requirement, the probability of full ASP being triggered is reduced, and given that there is no obvious additional benefit of changing both the CR and increasing ASP, we do not support a large increase in FASP.

Regardless of any changes to the setting of the CR, we urge a cautious approach to setting the FASP. The point of the ASP is to signal availability and demand side response through high balancing market prices during times of scarcity. We do not believe that such signals need extremely high prices to incentivise such reactions. Furthermore, the current €1,000MWh price cap in SEM has very seldom been breached over the course of SEM’s lifetime and we suggest the RAs to take the regularity of which the existing price cap has been breached into account when making this decision.

From an existing and prospective investor perspective, we believe that the resulting impact on consumer costs that a FASP would result in due to the risk of high ASP prices being factored into capacity market bids, would outweigh any perceived benefit of setting a high FASP in the first place.

BGE thus supports a full ASP of 25% VOLL (€3,000) as an appropriate figure at least for the T-4 March 2019 auction. We caution against big step changes in ASP levels that would undermine regulatory certainty, heighten perceived market exposure, and shake investor confidence.

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| ii. Should we move to setting VOLL on an October- September year, rather than the current Calendar Year basis, so that a single value of VOLL pertains within a Capacity Year? |
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BGE accepts the proposal to set VOLL on a tariff year rather than a calendar year basis.

6. Auction Volumes and Demand Curve

On a principled level, BGE believes that there is sufficient rationale to withhold a degree of capacity and reflect this in the demand curve in the March 2019 T-4 auction. At the T-4 stage, it will be quite uncertain as to what the demand levels for the capacity delivery in CY2022/23 might be. We do not believe that any over-procurement of capacity should be required or permitted in T-4 March 2019 for CY2022/23 given that the results of T-1 2017 showed there is a comfortable capacity margin and that, according to the Consultation, a maximum of 850MW – 1,350MW may exit by CY2022/23.

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| i. Should the proportion of the CR the SEM Committee hold back from the T-4 CY2022/23 auction for the T-1 CY2022/23 auction be increased from 5% to 7.5%, and why? |
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From a Demand Side perspective, we support withholding a level of CR from the T-4 March 2019 to the T-1 for CY2022/23. This will maximise opportunities for increased participation and competition in auctions closer

to the delivery year CY2022/23 given the current uncertainty around to what extent demand side will be willing or able to participate in long term auctions.

Over procuring capacity at the T-4 2019 stage, when for example accurate demand expectations are quite difficult, would likely over price capacity which could be procured at a later (T-3/2/1) auction, at a more economic price. Consumers should benefit from capacity procured at efficient costs and in the case of demand side response; this would point to the need for scope for demand side response to participate in short term auctions.

BGE supports the use of recent expectations of DSU interest in market participation as a guide to the appropriate percentage portion to withhold for T-1. A level of at least 5% in our view is believed appropriate.

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| ii. | Should the minimum MW in each constrained area be adjusted for volumes withheld from the T-4 auction to the T-1 auction for CY2022/23? Which of Options 1, 2 and 3 do you prefer, and why? |
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As outlined in our proposal in Section 1, in order to provide sufficient time to develop and introduce locational signals in constraint areas, we do not believe that out-of-merit capacity to meet minimum MW requirement for constraint reasons should be procured in the March 2019 T-4 auction. Rather, once the approach for incentivising new entrants in locational constraints areas has been decided and introduced, a second-long-term auction for CY2022/23 open to all types of capacity, including demand side response (**DSR**), should be held to ensure that the minimum MW locational constraint requirement is met at that stage.

In principle, we support withholding a portion of the T-4 March 2019 requirement for DSR, to T-1. As to whether a portion for DSR reasons should be withheld on a locational constraint area basis, given our approach proposed in Section 1, we do not believe this necessary for next March. Consideration could however be given to withholding a certain portion for T-1, on a locational constraint area basis, in the second long-term auction we propose is held for CY2022/23 at which point specific provision would be made in the auction to ensure procurement of the minimum MW requirements for constraint areas.

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| iii. | Which of the demand curve Options A or B, in your view is the most appropriate for the first T-4 capacity auction, and why? |
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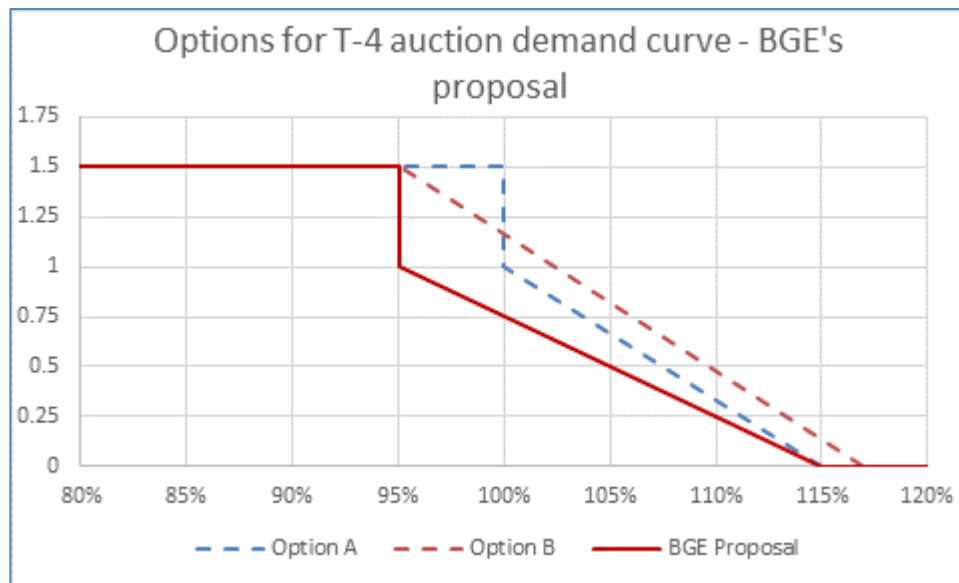
The role of the Best New Entrant (**BNE**) methodology has changed from SEM to I-SEM. In I-SEM, it plays a more practical role in having real potential impacts on the level of entry and exit signals for a relevant CY. With this in mind, it is important to ensure that the demand curve chosen does not undermine the actual BNE process into which significant regulators' and market participants' time is put in ensuring the correct BNE is chosen. The BNE is representative of what cost a new entrant in the capacity market would pay - it seems unintuitive to pay much more than this for capacity unless duly justified through the RA's USPC process.

The overarching principle is that consumers should not be unduly over-paying for capacity at a level above the NET CONE in the T-4 auction process. As outlined above, there is sufficient reason in our view for withholding a portion of capacity from the T-4 auction for procurement in later auctions closer to CY2022/23, to reflect that DSR is more uncertain the further out from a relevant capacity year one is.

For these reasons, BGE is very much in favour of retaining the RAs' current demand curve shape (Option A) whereby, once the appropriate level of CR for the T-4 March 2019 is determined, the level of capacity procured to that point can be procured up to the auction price cap. When that point is reached, the price paid would drop vertically and slope downwards at a softer angle to the CR level.

We believe that by applying the shape of Option A's demand curve, (but moving it to the left), should provide much needed signals for DSUs, storage and achieve low cost capacity for consumers. As alluded to in our capacity requirement discussion above, we believe that the Option B curve would result in over-procurement and over-payment of capacity at higher costs to consumers, especially given the uncertainty in exit signals and demand levels in the long term. This may unnecessarily dampen exit signals for inefficient plant.

By way of comparison to the RAs' Options A and B, BGE puts forward an Option which takes account of the possible volume of CR to be withheld for DSU reasons at the T-4 March 2019 stage:***



*** Please note that the above demand curve proposed by BGE does not take into account potential demand curve adjustments that may be required to accommodate: a) the 2-stage long term auction approach as proposed in Section 1 above; b) possible deviations in demand growth over the course of a 3 or 4-year period.

7. T-4 Auction Price Caps for T-4 for capacity year CY2022/23

- i. Do you agree with the proposal to keep the Auction Price Cap (APC) at 1.5 x Net CONE for the T-4 auctions? If not, please explain. Is your response in any way contingent upon the final value of BNE Net CONE for CY2022/23?

BGE supports the continuation of the APC at 1.5X NET CONE. We do not believe that regular changes to this level would be conducive to investor confidence. The final APC should reflect the outcome of the recently consulted upon BNE for CY2022/23.

- ii. Do you agree with the proposal to keep ECPC at 0.5 x Net CONE for the T-4 auctions? If not, please explain. Is your response in any way contingent upon the final value of BNE Net CONE for CY2022/23?

BGE supports continuation of the ECPC at 0.5X NET CONE which again should reflect the outcome of the recently consulted upon BNE for CY2022/23.

- iii. USPC setting: Do you agree with the proposed approach for UFI submissions?
iv. USPC setting: Do you agree with the proposal to apply 2% p.a. inflation projection for estimating costs for CY 2022/23?

BGE supports stringent monitoring of the USPC and related UFI submissions. Efficient cost outcomes for consumers must be ensured and units, particularly in locational constraint area, must only be permitted to put forward capacity at as competitive a price as reasonably possible. The suggested inflation projection seems reasonable.

8. Derating Factors

- i. Do you have any views on the proposal of EMDF value of 60% subject to review and update of the analysis for the decision paper?

As per BGE's response to the T-1 parameters for the December 2018 auction, BGE questions the choice of a value from a very wide range of values that seems to be justified only by relation to the fact that the previous year's value was in and around the same. Insight and foresight of likely regulatory decisions in any given area are important from a regulatory and investor certainty viewpoint. BGE would welcome further insight to the RAs' choice of de-rating factor - if the rationale is that the RAs do not want to deviate much from previous

year's de-rating factor, is this a precedent that we can expect the RAs to follow for this de-rating factor in future?

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| ii. Do you expect to be applying to qualify a new interconnector between the I-SEM and an external market other than GB? |
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BGE does not currently have any plans to make such an application.

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| iii. Do you have any feedback on the issues around transitioning from the interim to the hybrid solution for cross-border trading of capacity? |
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With regard to this transition, in the re-auctioning of interconnector capacity, any interconnector capacity volumes not taken up at the re-auction stage should in our view remain with the interconnector owner. This would help reduce the risk of uncovered RO difference payments which would be to the detriment of consumers in terms of exposure to high energy prices and possible socialisation fund costs.

To reflect the risk that the interconnectors would take in keeping any un-sold ROs, where the re-auction price is less than the original T-4 auction price, the differential should in our view be retained by the interconnector owners.

9. New Capacity Investment Rate Threshold (NCIRT)

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| i. Do you agree with keeping NCIRT at €300/kW, in the light of new evidence on BNE gross investment costs? Does your view depend on the choice of BNE reference plant resulting from the Best New Entrant consultation (SEM-18-025)? |
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BGE has recently commented on the proposed BNE for CY2022/23. We are strongly of the view that an OCGT rather than a CCGT represents the most likely type of BNE that any rational investor would decide on in the current market environment. We point the RAs to our views in that response but in essence submit that the NCIRT level may need to be updated to reflect any change in the BNE figure published in the final decision on the BNE consultation.

10. Miscellaneous comments on the RO design and BGE clarifications sought

BGE wishes to reiterate its view that CRMs are about securing electricity supply at the least cost to the consumer. Tolerance bands applicable to de-rating factors remain central to the success of the market in our view, help protect consumers from exposure to any potential hole in the hedge and retain exit signals for inefficient plant. We therefore urge the RAs to reject any suggestion that downward tolerances below existing de-rated factors of capacity should be permitted.

It is important for consistent entry and exit signals that tolerance band rules are maintained. Year on year tolerance band rule changes hinder investors' plans to little or benefit.

Another key design element of the RO that BGE feels strongly about is the point relates to the need for the potential for market power exploitation to be avoided in the context of opt-outs. Units must not be permitted to opt-out of a longer-term auction and opt back in to a T-1 for the same capacity delivery year unless there is a significant change with the unit (e.g. refurbishment that reflects the unit as "new").

Finally, BGE has a number of areas in which it seeks the RAs' views:

1. We would welcome some insight as to when the rules on secondary trading will be developed as this would assist in understanding the risks of RO payback when bidding into capacity auctions?
2. We understand, but would welcome confirmation around the situation, that if a party wins a T-4 RO contract and builds based on that contract but arrives early, it may participate in the T-1 auction for the year prior to the CY for which it was originally contracted?
3. To better understand the auction process, we would welcome some further insight into what volume of a unit would be procured to meet a constraint in the example of where a 300MW constraint existed in a constraint area, and a 400MW unit or a higher-priced 250MW unit could be procured?

11. Summary and Conclusion

In conclusion, BGE has outlined in Section 1 above its concerns around the continuance of market power in locational constraint areas. Our main concern is that while the RAs' proposed approach to address constraints in the T-4 auction for CY2022/23 addresses State Aid requirements, it does little to address the serious problem of the exercise of market power by units situated in locational constraint areas. Unless action is taken to directly address this market power problem as soon as possible, the same high-priced units that had to be procured pursuant to the T-1 2017 auction will have to be procured again in T-4 March 2019, and may be in a position to demand one-year contracts in the period 2019- 2022 regardless of whether they are competitive or not. BGE believes that consumers will pay the cost of such outcomes: a) due to higher out-of-merit capacity payments having to be made to these units, and; b) through a lack of development of competition in these locational constraint areas that could drive down these units' costs.

BGE believes that the solution to the issue lies in the development and application of entry signals for new units to locate in locational constraint areas. The reality however is that in order for such signals to have a real bearing and influence on investment decisions for next March's auction, such signals would likely need to be developed, agreed and implemented well before the end of Q3 2018. In this context, BGE has therefore suggested, in Section 1 above, that a 2-step approach to long term capacity procurement for CY2022/23 is adopted:

1. The T-4 March 2019 auction for CY2022/23 is run on an unconstrained basis only whereby no out-of-merit contracts are awarded. No specific procurement for meeting minimum MW requirements at the T-4 March auction would be made at this point. Consideration may need to be given to the design of the demand curve to reflect this approach;
2. A second-long term capacity auction for CY2022/23 would be run (at which point we anticipate the positive outcomes of locational signals should have materialised). This auction would ensure that the minimum MW requirement needed for a constraint area, that had not been fulfilled at the T-4 March 2019 stage, would be met, along with any other MW volume perhaps unprocured at the T-4 stage (excluding any volumes withheld for T-1 auctions).

Our justification for this approach is outlined in further detail in Section 1 but importantly we believe that it allows for both State Aid compliance and maximises the opportunity for the development of competition in locational constraint areas to the benefit of consumers in terms of costs.

BGE has additionally outlined the prospect of removing grid connections as a pre-condition for capacity auction participation and suggested that grid capacity be allocated simultaneously with capacity market outcomes. This should ensure the most efficient use of resources, prevent grid capacity hoarding and maximise competition, particularly in locational constraint areas. As outlined in Section 1, the capacity market commitment model would not be undermined if, at the pre-qualification stage for example, the TSOs confirmed a grid connection offer could be made subject to the unit winning an RO contract. At that point, unit financial commitments would be made. Lastly, we urge the RAs to consider this grid connection approach in the context of the need to ensure all-island participants can participate in capacity market auctions on as level playing a field as possible - application of a different grid connection process to participants in Ireland, as compared to Northern Ireland could undermine this level playing field.

BGE's views on the discrete questions in the Consultation can be summarised as follows:

1. **Treatment of Constraints in the T-4 Auction:** In general, we support the proposal but believe that the displacement approach does not address the locational constraint problem. We thus suggest that consideration of the 2-stage approach to the long-term procurement of capacity for CY2022/23 a outlined in section 1. BGE supports Option (b), i.e. a multiyear pay as bid RO to compete only if it is priced at or below NET CONE. Given the role of the BNE, it is difficult to justify procurement at a price above this from a consumer perspective (unless there is no other option and the unit has progressed through the USPC process);
2. **Auction Format:** The format reflects the need to avoid future procurement of out of merit capacity in addition to in merit capacity. We support the approach subject to our views outlined in Section 1 in terms of the 2-stage approach to long term auctions. We also suggest that the net social welfare function of the AASM should effectively recognise that if a constraint is expected to be in situ for a short period of time, displacing a unit in the auction results in order to accommodate more expensive but locationally better situated units, may not be the most efficient outcome from a consumer cost

perspective. The social welfare function should incorporate the length of the constraint, as well as the ability and cost of it to be fixed by network investment. In effect, BGE is seeking to ensure that displacement of efficient capacity does not occur in favour of less efficient more expensive capacity, which in both the short and long term could be harmful for the consumer. The counterfactual approach should inform the decision as to whether we a) pay the extra cost of high priced out-of-merit units (whether 1-year or multiyear providers) or b) pay for lower priced in-merit units and invest in the grid needed to address constraints where possible;

3. **Capacity Requirement (CR):** BGE supports inclusion of 250MW operating reserve (which we note has the equivalent effect of reducing LOLE to 3 hours), in light of a) the direction of travel of EU markets, b) expected enhanced performance of TSOs, c) the role it may play in avoiding inefficient exit signals at least in the short term, while d) not undermining existing exit signals or disproportionately increasing consumer costs;
4. **ASP:** We believe that the Full ASP should be €3,000/MWh. Setting it anywhere near VOLL overlooks the role of ASP as a price floor in the balancing market and its role in signalling availability and DSR through high prices during scarcity. Such signals do not require prices near VOLL to incentive reactions. Setting it at €3,000/MWh retains sufficient scope for the market price to tend to VOLL when market forces provide for it;
5. **Auction volumes and demand curve:** We believe that DSR should be incentivised and that at least 5% should be withheld for procurement at T-1 CY2022/23. Withholding a portion of the capacity requirement for DSR from the MWs required to meet locational constraint should only be considered in a long-term auction that seeks to procure a minimum MW locational constraint volume (e.g. the second long-term auction as proposed in Section 1). We support a demand curve that reflects the current Option A as Option B would likely over-procure and over-pay capacity particularly given uncertain exit levels, demand levels and DSR at the long-term auction stage;
6. **T-4 Auction Price Caps (APCs):** We support the current policy for the APC and the existing capacity price caps with a view to mitigating market power. The caps should reflect the BNE decisions;
7. **Derating factors:** BGE seeks further insight on the rationale for choosing the interconnector derating value from such a wide range of potential values, with a view to understanding the potential future regulatory direction in this area;
8. **New Capacity Investment Rate Thresholds:** We support the current policy provided it is updated in line with the BNE decision as relevant.

I hope that you find the above comments and proposals helpful. BGE urges the RAs to take our suggestions, particularly those with regard to the approach to long-term auctions as outlined in section 1 above, into account before finalising decisions on this Consultation.

Please do not hesitate to contact me at any time should you wish to discuss any of the above.

Yours sincerely,

Julie-Anne Hannon
Regulatory Affairs – Commercial
Bord Gáis Energy

{By email}