SEM committee

Integrated Single Electricity Market

(I-SEM)

Capacity Remuneration Mechanism (CRM)

Supported Capacity Mandatory Status Consultation

SEM-18-176

05 December 2018

EXECUTIVE SUMMARY

The I-SEM CRM Detailed Design has been developed through an extensive series of consultation and decision papers. This involved substantial interaction between stakeholders, including both System Operators and Industry. Decisions made during the Detailed Design were translated into auction market rules to form the Capacity Market Code (CMC) (SEM-17-033) which was published in June 2017. The CMC sets out the arrangements whereby market participants can qualify for, and participate in, auctions for the award of capacity. The settlement arrangements for the Capacity Remuneration Mechanism (CRM) form part of the revised Trading and Settlement Code (TSC) (SEM-17-024) published in April 2017.

The European Commission gave State aid approval for the CRM on 24 November 2017.

The Capacity Year (CY) 2018/19 T-1 Auction took place in December 2017. Following the completion of the CY2018/19 auction, the SEM Committee is now planning to proceed with the CY2019/20 T-1 auction in December 2018, and the CY2022/23 T-4 auction in March 2019.

Since mid-2017 the CRU has had correspondence with a number of different affected market participants in relation to concerns they have regarding an interaction between the REFIT rules (for transition to I-SEM) and their generation capacity's mandatory participation status in the CRM.

Market participants argue that they are exposed to all the downside of the additional exposure of the RO in the CRM for dispatchable REFIT 3 supported capacity, without receiving any corresponding upside, with RO revenue netted off in the REFIT revenue calculation. Affected market participants argue that there is a risk reward mismatch, without any corresponding reward for the extra risk/exposure of RO obligaions on supported capacity. Due to the mandatory status of this affected capacity participants cannot chose to not qualify this capacity in the CRM.

The purpose of this consultation paper is to look at this issue and propose possible options in relation to this.

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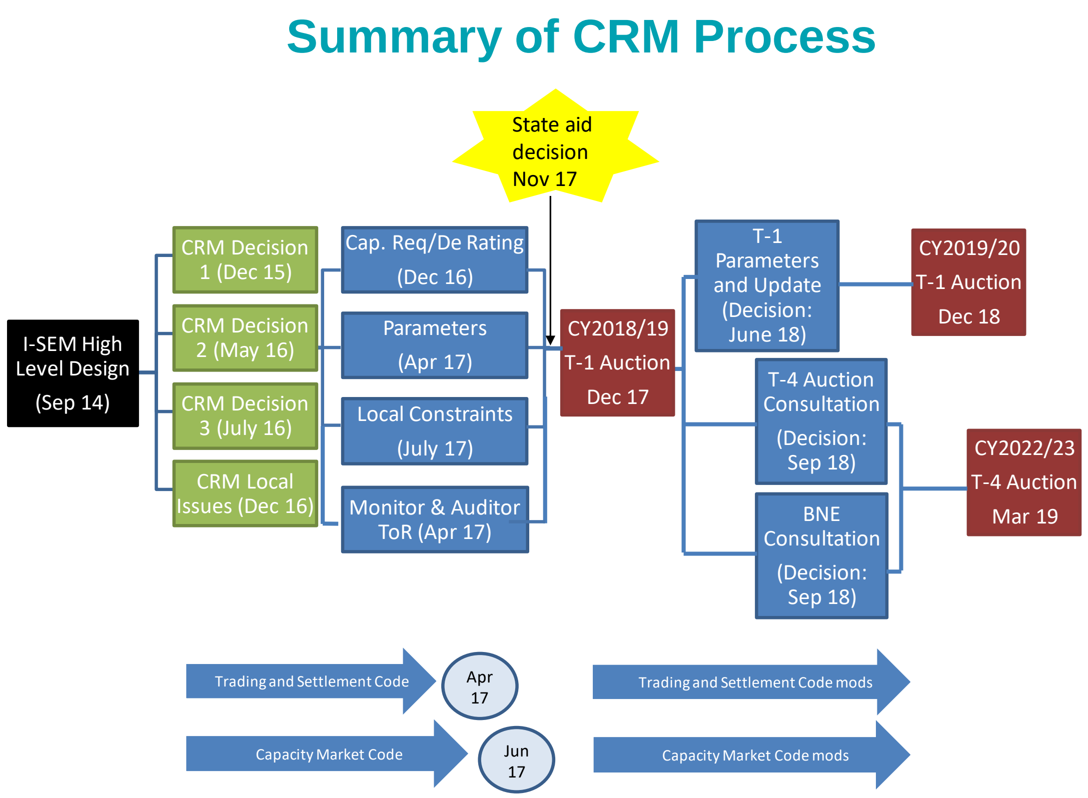
1. INTRODUCTION

1.1 BACKGROUND

1.1.1 The I-SEM CRM Detailed Design has been developed through an extensive series of consultation and decision papers. This involved substantial interaction between stakeholders, including both System Operators and Industry. This interaction took the form of numerous workshops and meetings in addition to the feedback from the consultations.

1.1.2 Decisions made during the aforementioned consultations were translated into auction market rules to form the Capacity Market Code (CMC) (SEM-17-033) which was published in June 2017. The CMC sets out the arrangements whereby market participants can qualify for and participate in auctions for the award of capacity. The settlement arrangements for the Capacity Remuneration Mechanism (CRM) form part of the revised Trading and Settlement Code (TSC) (SEM-17-024) published in April 2017. A summary of this process is shown in Figure 1 below.

Figure 1: Key CRM milestones



1.1.3 The introduction of the CRM involved formal notification to the European Commission (EC) of the proposed mechanism for purposes of State aid. This process was led by Department of Communications, Climate Action & Environment (DCCAE) and Department for the Economy (DfE) who together with the Regulatory Authorities (CRU and UR) engaged with the EC in advance of the notification and during the notification process.

1.1.4 The EC approved the CRM on 24 November 2017[1]. The first Capacity Auction took place in December 2017 to cover the period from I-SEM go-live to 30 September 2019, i.e. CY 2018/19. Following the completion of the CY2018/19 transitional auction, the SEM Committee is now planning for the next auctions.

1.1.5 The next T-1 auction for CY2019/20 is planned for December 2018. The first T-4 auction for CY2022/23 is planned for late March 2019, as set out in the capacity auction timetable published on the SEMO website.

1.1.6 This supplemental consultation paper describes an issue raised in relation to the interaction between REFIT 3 supported dispatchable capacity and its mandatory status under the CRM.

1.1.7 The DCCAE Electricity Support Schemes I-SEM Arrangements Decision Paper published in June 2018 set out that the market revenue calculation would not allow supported capacity to reflect capacity market costs (RO uncovered difference payments). DCCAE stated in this decision paper “the Department understands that the SEM Committee is reviewing the obligation on PSO supported generation to participate in the I-SEM capacity auction”.

1.1.8 The RAs in publishing this consultation paper are looking at the mandatory participation status of green REFIT 3 supported capacity in the CRM and proposes possible options in relation to this.

[1] http://ec.europa.eu/competition/state_aid/cases/267880/267880_1948214_166_2.pdf

2. INTERACTION BETWEEN CRM AND REFIT 3

2.1 BACKGROUND

2.1.1 Since mid-2017 the CRU has had correspondence with a number of different affected market participants in relation to concerns they have regarding an interaction between the proposed REFIT rules (for transition to I-SEM) and their generation capacity's mandatory participation status in the Capacity Remuneration Mechanism (CRM). Participants also contacted DCCAE voicing similar concerns in relation to REFIT transition to ISEM workstream.

2.1.2 These concerns relate to market participants which hold REFIT 3 supported dispatchable capacity and the interaction with its mandatory status under the CRM. These market participants argue that they are exposed to all the downside of the additional exposure of the RO in the CRM (for REFIT 3 supported portion), without receiving any corresponding upside, with RO revenue netted off in REFIT revenue calculation. Affected market participants argue that there is a risk reward mismatch, without any corresponding reward for the extra risk/exposure of RO obligaions on supported capacity. Due to the mandatory status of this affected capacity participants cannot chose to not qualify this capacity in the CRM.

2.1.3 These concerns can be described in an example say where a 70/30 split between peat and biomass (REFIT 3 supported) portions in a plant, the REFIT Total Market Revenue (TMR) calculation will reflect the CRM revenue for the circa 30% REFIT 3 supported portion but does not recognise any uncovered difference payments of the green (supported) portion of capacity. Affected participants argue that they are exposed to all the downside of the additional exposure of the RO in the CRM (for REFIT 3 supported portion), without receiving any corresponding upside (with RO revenue netted off in TMR calculation).

Mandatory status in CRM

2.1.4 In CRM detailed design decision paper SEM-15-103 the SEM Committee decided that existing dispatchable generators (above de-minimus) have a mandatory requirement to participate in the CRM. In making this decision the SEM Committee had to balance market power and competition concerns. It was described that the main reason to consider making participation mandatory was to mitigate market power.

2.1.5 However the SEM Committee recognised that the risk exposure faced by intermittent plant was different from that faced by dispatchable plant, in that output is more variable and less within the control of the generator.

2.1.6 The RAs considered that for a dispatchable generator, control of its output is largely manageable by the generator. The risk that would be placed on a generator by requiring it to bid would not be excessive, particularly when mitigated with "stop loss" limits.

Therefore market power concerns largely outweighed the additional risk placed on generators via mandated bidding.

2.1.7 SEM-15-103 also set out that supported generators were eligible to participate in the CRM. The SEM Committee favoured allowing supported generation to participate in the CRM to maximise competition in the CRM and to increase coverage of the RO hedge for suppliers (reducing any requirement for socialisation of any shortfall in RO difference payments).

State Aid decision

2.1.8 The State Aid decision text specified that any capacity participating in the NI ROCs scheme would not be permitted to also participate in the CRM scheme (on grounds of concerns of aid accumulation). These concerns did not apply to other support schemes, with the design of these other schemes meaning aid accumulation concerns did not arise.

2.1.9 In order to ensure compliance with DG Comp State Aid decision text the RAs modified the final qualification results for T-1 auction for CY2018/19 and subsequently made a modification to the Capacity Market Code (CMC). These changes reflected the DG Comp State Aid decision text requirement to not allow a unit to participate in both the CRM and NI ROCs schemes.

REFIT 3 scheme

2.1.10 The Renewable Energy Feed-in Tariff (REFIT) scheme is funded through the Public Service Obligation (PSO) levy which is charged to all electricity consumers in Ireland (not on a all-island basis). The PSO levy was introduced to support the objective of increasing the level of renewable generation in order to meet Ireland’s binding renewable energy targets.

2.1.11 The REFIT schemes are the primary financial supports provided to renewable electricity generators. REFIT offers a 15 year support period and backstop dates of 31 December 2027 for REFIT 1, 31 December 2032 for REFIT 2 and 31 December 2030 for REFIT 3.

2.1.12 The REFIT letter of offer issued to an applicant enables them to enter into a Power Purchase Agreement (PPA) with an electricity supplier. An obligation is then placed on the supplier to purchase the output from the electricity generation plant. The supplier is provided with a mechanism to recover the “additional costs” incurred by the supply company in fulfilling this obligation through the REFIT tariff. The supplier, in turn, is required to provide an assured price to the generation plant.

2.1.13 REFIT 3 is designed to incentivise the addition of 310MW of renewable electricity capacity to the Irish grid composed of High efficiency Combined Heat and Power (using both Anaerobic Digestion and the thermo-chemical conversion of solid biomass), biomass combustion and biomass co-firing.

Solutions proposed by participants

2.1.14 A number of market participants proposed two possible solutions to allay their concerns outlined above, these were:

1. Remove mandatory participation status of green supported capacity in the CRM; or

2. Allow the green supported capacity be immune from any penalty (uncovered RO difference payments) with a through up using R-factor in REFIT 3 scheme.

2.1.15 The DCCAE Electricity Support Schemes I-SEM Arrangements Decision Paper published in June 2018 set out that the market revenue calculation would not allow supported capacity to reflect capacity market costs (RO uncovered difference payments). DCCAE stated in this decision paper “the Department understands that the SEM Committee is reviewing the obligation on PSO supported generation to participate in the I-SEM capacity auction”.

2.1.16 The RAs in publishing this consultation paper are looking at the mandatory participation status of green REFIT 3 supported capacity in the CRM and are considering whether to amend this requirement.

3. POSSIBLE OPTIONS

3.1 INTRODUCTION

3.1.1 In considering the concerns put forward by market participants the RAs consider that there are two options in how to proceed, these are:

- **Option 1:** Following this consultation make a modification to the CMC changing the mandatory status of REFIT 3 supported capacity in CRM; or
- **Option 2:** Do nothing, make no change to mandatory participation requirements for REFIT 3 supported capacity in CRM.

The advantages and disadvantages of these two options are explored below.

3.2 ASSESSMENT OF OPTIONS

3.2.1 The RAs in making previous decisions during the detailed design phase of the CRM (SEM-15-103) in requiring existing dispatchable capacity to participate and allowing supported capacity to participate considered different factors such as market power concerns and competition.

3.2.2 The decisions taken on mandatory participation requirements in the CRM reflected certain elements of risk mitigation built into the CRM design. These included de-rating, load following and the use of stop-loss limits.

3.2.3 In decision paper SEM-15-103 the SEM Committee recognised that the risk exposure faced by intermittent plant was different from that faced by dispatchable plant, in that output is more variable and less within the control of the generator. For a dispatchable generator, control of its output is largely manageable by the generator. The risk that would be placed on a generator by requiring it to bid should not be excessive, particularly when mitigated with “stop loss” limits. Therefore it was decided that market power concerns largely outweigh the additional risk placed on generators via mandated bidding.

3.2.4 In looking at the concerns raised by some market participants in relation to the interaction between REFIT 3 supported dispatchable capacity and its mandatory status under the CRM, the RAs must consider the full consequences of changing any previous decisions. The mandatory participation status of dispatchable plant in the CRM is one of the key pillars of allaying market power concerns (along with the inclusion of prices caps and sloping demand curve), any amendment to this represents a potentially significant change. Any change to the mandatory participation status of this supported capacity could weaken this important market power mitigation measure.

3.2.5 The specific concerns raised relate to market participants which hold REFIT 3 supported dispatchable capacity and the interaction with its mandatory status under the CRM. Due to the mandatory status of this affected capacity participants cannot chose to not qualify this capacity into the CRM. These market participants argue that for this affected supported capacity they are exposed to all the downside of the additional exposure of the RO in the CRM, without receiving any corresponding upside. Affected market participants argue that there is a risk-reward mismatch, without any corresponding reward for the extra risk/exposure of RO obligaions on supported capacity (with RO revenue netted off in REFIT revenue calculation).

3.2.6 The RAs note that the control of dispatchable supported capacity's output is largely manageable by the participant. In contrast, the risk exposure faced by intermittent plant is different in that output is more variable and less within the control of the participant. As long as this supported capacity performs and meets its RO obligations it does not face any uncovered difference payments. The RAs note that it is largely within the participants control to meet these requirements.

3.2.7 The RAs note that the RO obligations provide additional incentives on supported capacity to be available and to perform. Removing the mandatory requirement for REFIT 3 supported capacity to participate in the CRM could weaken the overall incentives on this capacity to perform. Also removing this mandatory requirement would reduce coverage of the RO hedge for suppliers, increasing any requirement for socialisation of any shortfall in RO difference payments.

Making proposed changes

3.2.8 If it was considered appropriate to change the mandatory status of REFIT 3 supported capacity in the CRM, the RAs could propose a modification to the CMC. This modification could remove the mandatory participation status of REFIT 3 supported dispatchable capacity in the CRM.

3.2.9 In terms of a timeline to deliver any change if required, the urgent modification process allows the RAs to fast-track a modification proposal. The CMC sets out that if the RAs determine that a CMC modification proposal is urgent they shall determine the procedure and timetable to be followed in assessing the proposal.

3.2.10 Alternatively, if required a modification may not need to be put through as an urgent modification, as the RAs could change the final qualification results in early March 2019 to reflect any required change to mandatory status/choices of REFIT 3 supported capacity for CRM T-4 auction CY2022/23.

3.2.11 In 2017 the RAs changed the final qualification results to comply with DG Comp's SA decision text that capacity participating in the NI ROCs scheme could not also take part in the CRM. A modification was subsequently made reflecting this requirement in the CMC text.

3.3 SUMMARY OF CONSULTATION QUESTIONS

3.3.1 The SEM Committee seeks consultation feedback on the options presented in this Section and in particular do stakeholders have a preference between options 1 and 2:

- **Option 1:** Following this consultation make a modification to the CMC changing the mandatory status of REFIT 3 supported capacity in CRM; or
- **Option 2:** Do nothing, make no change to mandatory participation requirements for REFIT 3 supported capacity in CRM.

4. NEXT STEPS

4.1.1 Interested parties are invited to respond to the consultation, presenting views on the options set out in this paper.

4.1.2 The SEM Committee intends to make a decision in early Q1 2019 on this issue in advance of the T-4 capacity auction for Capacity Year 2022/23 due to take place in March 2019.

4.1.3 Responses to the consultation paper should be sent to Thomas Quinn (tquinn@cru.ie) and Karen Shiels (Karen.Shiels@uregni.gov.uk) by 17.00 on Friday, 11 January 2019.

4.1.4 Please note that we intend to publish all responses unless marked confidential. While respondents may wish to identify some aspects of their responses as confidential, we request that non-confidential versions are also provided, or that the confidential information is provided in a separate annex. Please note that both Regulatory Authorities are subject to Freedom of Information legislation.