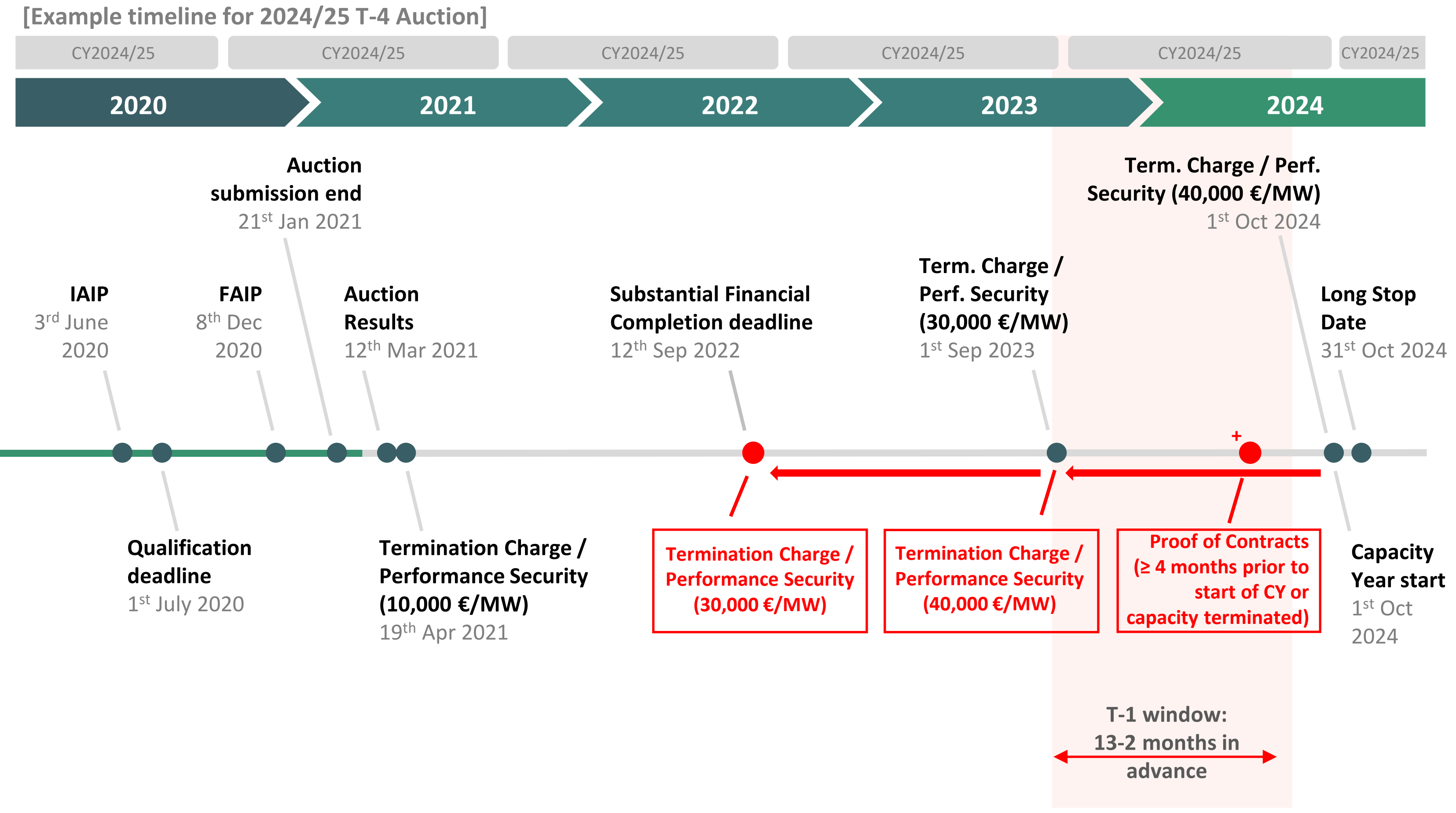
Capacity Market Modifications Workshop 20

CMC_03_21: Modification to the Substantial Financial Completion milestone for AGUs / DSUs

27th July 2021

Substantial Financial Completion – Proposed Modification v3

DRAI



Proposal: voluntarily increase to 30 k€/MW as an alternative for DSUs / AGUs to achieve SFC for 1 year Awarded Capacity

Plus, where a unit avails of this alternative route to SFC, also:

1. bring forward the 40 k€/MW rate to 13 months prior to the start of the CY, and
2. add new Proof of Contracts milestone, not less than 4 months prior to the start of the CY

- → SFC sets "end of sales" (deadline for aggregators to enroll all customers to meet their obligations)
- → Proof of contracts >2 years ahead is a demand side barrier, preventing full use of existing assets and associated end consumer benefits
- → "End of sales" deadline is later in other markets (e.g. 4 months ahead in GB)
- → Proposal allows voluntarily increase of Term. Charge & Perf. Security to 30 k€/MW as alternative to SFC
- → Proof of contract still required but later (≥ 4 months ahead)
- → Proposal retains very high delivery certainty prior to T-1 window, but improves aggregators' delivery flexibility
- → Proposal gives flexibility to recruit sites closer to delivery but incentive to deliver as early as possible
- → New Capacity with 1 year duration already makes higher financial commitment relative to Capacity Payments for only 1 year and 1 month Long Stop Date
- → CMC already recognises DSUs / AGUs able to deliver capacity more quickly and flexibly than new-build conventional power generation projects
- → Prudent to apply different requirements as long as all unit types ultimately provide the same level of commitment and delivery certainty

Clarifications / additional responses to consultation feedback (1)

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Performance Securities as ‘sunk costs’ once the 30 k€/MW rate becomes effective

- Performance Securities are **recoverable** = strong incentive to delivery New Capacity
- Fundamentally, these are **not a sunk cost**
- Stepwise increasing Performance Security = **continued incentive** to assess delivery confidence and terminate capacity if not
- **Rationale businesses** will strive to deliver capacity ASAP to recover bond exposure
- **Incentive to terminate** capacity prior to PS deadlines if it can no longer be delivered has been demonstrated as effective
- Clear evidence that Participants are **highly unlikely to post increased Performance Security** without high delivery confidence

Robustness to changes in the profile of Termination Charges

- CMC_03_21 attempted to be **agnostic** to the Termination Charges specified as part of the auction parameters for a specific auction
- J.7.1.9 must be **robust to changes to the 3-date structure** of Termination Charges / Performance Securities that isn’t in the CMC
- DRAI welcomes suggestions to amend J.7.1.9 **while leaving the intent intact**
- **Potential solution** may be to specify separately in the Auction Info Packs the Termination Charge / PS dates and rates that apply for DSU / AGUs electing to use alternative route to achieve SFC

Timing of the election to be made under J.2.1.3

- Timing of the election under J.2.1.3 should occur **as the SFC milestone approaches**
- Proposed to amend J.2.1.3.(a)(ii) to clarify the election shall take place “**prior to the end of the Substantial Financial Completion Period**”
- Retaining this as an **option** is critical to ensuring Participants are incentivised to only avail of the alternative process when absolutely necessary
- Requiring **commitment at Qualification** to use the alternative SFC route would remove the strong incentive not to do so, and would likely increase the volume of capacity doing so
- **RA approval should not be required** to use the proposed alternative SFC route
- Flexibility for aggregators to elect to recruit demand sites closer to the delivery period should be a **Participant’s choice**, as is the case in other capacity markets internationally

Clarifications / additional responses to consultation feedback (2)

Enhanced Implementation Progress Reporting

- DRAI **doesn't believe necessarily required**
- **Open to consider** enhanced Implementation Progress Reports for units which avail of the alternative SFC process if this is demonstrated as necessary to mitigate potential risks
- Should be limited to requiring Implementation Progress Reports to include **breakdown of the sites delivering New Capacity** (incl. expected MW contribution and status), as required as part of the existing qualification process

Volume cap for the amount of capacity using the alternative route to achieve Substantial Financial Completion:

- DRAI does not believe this is appropriate, or required
- Agrees with SEMC that it is not possible to apply such a cap fairly without creating a perverse incentive increasing the volume choosing to make the election
- SEMC notes lack of clarity r.e. what volumes may use the alternative SFC route and concern if volumes are large
- SEMC highlights **420 MW** of capacity awarded to DSUs in the T-4 CY2024/25 auction
- However, of this:
  - only 153.2 MW was New Capacity (needs SFC)
  - of which a further 33 MW was 10 yr duration (ineligible)
- Therefore, **maximum 120.3 MW Awarded Capacity would be eligible** for the proposed alternative route
- In reality, due to the strong financial incentive not to use this route, and the fact that a significant portion of DSU 'New' capacity is not new, but just moving between DSUs will mean the actual **volume will be significantly lower**

Appendix

Legal Drafting Change

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Change 1: CMC J.2.1.3 which sets out modified milestones for the delivery of Awarded New Capacity by AGUs / DSUs

J.2.1.3 Where the Awarded New Capacity is an Aggregated Generator Unit or Demand Side Unit, the Major Milestones set out in paragraph J.2.1.1 and the Additional Milestones set out in paragraph J.2.1.2 are modified as follows:

(a) the Awarded New Capacity achieves Substantial Financial Completion when either:

(i) a contract is in full force and effect between the Participant and the provider of the physical capacity and evidence of this is provided to the System Operators; or

(ii) the Participant has elected to voluntarily both

(A) increase the Termination Charge payable under section J.7, based on the next upcoming termination charge rate (€/MW) after the end of the Substantial Completion Period; and

(B) increase the Required Level of Performance Security under J.3.2.4(a) based on the Performance Security rate (€/MW) for the next upcoming Performance Security Posting Date / Event after the end of the Substantial Financial Completion Period, and posted Performance Security equal to or in excess of this revised Required Level with the System Operators in accordance with the requirements of J.3.

[(b)…(c)…(d)…(e)…(f)…(g)…(h)…]

(i) an additional milestone is added: Proof of Contract. This milestone only applies where Awarded New Capacity has achieved Substantial Financial Completion under J.2.1.3.(a)(ii), and is achieved when a contract is in full force and effect between the Participant and the provider of the physical capacity and evidence of this is provided to the System Operators.

Change 2: CMC J.4.3 which describes for how Substantial Financial Completion shall be verified

J.4.3.2 For the purposes of paragraph J.4.3, verification comprises:

(a) in respect of the Substantial Financial Completion Milestone, either:

(i) where a Participant has elected prior to the end of the Substantial Financial Completion Period to voluntarily increase its Termination Charge payable and the associated Performance Security under section J.2.1.3(a)(ii), notification to the System Operators confirming the Participant has posted Performance Security equal to or in excess of the revised Required Level;

otherwise:

(ii) a certificate addressed to the System Operators and signed on behalf of the Participant by a Participant Director certifying that, having made all due and careful enquiry and to the best of the knowledge, information and belief of the Participant Director, the Substantial Financial Completion Milestone has been achieved, and in particular that each of the statements in paragraphs J.2.1.1(a)(i) to J.2.1.1(a)(v) is true and correct in relation to the Milestone; and

(iii) a copy of the resolution, agreement or approval referred to in paragraph J.2.1.1(a)(iv);

Change 3:

J.6.1.3 The System Operators may, subject to paragraph J.6.1.5, terminate all Awarded New Capacity in respect of a new or refurbished Generator Unit or Interconnector if:

[(a)… (b) … (c) … (d) … (e) … (f) … (g) … (h) … (i) … (j) … (k) … (l) … (m) …]

…

(n) the Proof of Contract milestone, if applicable, has not been achieved by the date that is four months prior to the start of the relevant Capacity Year.

Change 4:

GLOSSARY (insert new definition)

Proof of Contract has the meaning given in paragraph J.2.1.3.(i)

→ **Legal drafting intended to be relatively straightforward to implement and builds on the existing scope and intent of CMC J.2.1.3 which recognises the inherent delivery characteristics of AGU / DSU capacity and reflects these in modified requirements for a number of Implementation Plan milestones.**

How is this considered in other capacity markets?

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Review of several established capacity markets:

	Auction Schedule	Delivery start	Registration deadline (vs. start of delivery period)
PJM (Pennsylvania-New-Jersey-Maryland Interconnection)	T-4	June 1	11 business days before
ISO New England	T-3	June 1, Nov 1	7 business days before
Ontario	T-4	May 1, Nov 1	14 business days before
NYISO (New York Independent System Operator)	6 month strips	May 1, Nov 1	18 business days before
GB	T-4	1 Oct	4 months before

Key for demand side participation is the effective "**end of sales**": whatever milestone sets the due date by which aggregators must have enrolled all customers they need to meet their obligations.

Substantial Financial Completion defines this currently, and it can be >2 years prior to delivery.

- **Reducing the time available for sales (labour and time intensive) is likely to reduce demand side participation volumes**
- **Performance Securities provide a very strong incentive:**
  - **a) not to bid speculatively,**
  - **b) to deliver Awarded Capacity secured,**
  - **c) to deliver ASAP, and**
  - **d) if you can't deliver, to buy your way out of the obligation ASAP while the system still has time to procure replacement capacity**
- **Existing Implementation Plan progress reporting and Performance Securities provide very strong delivery assurance**

→ **DRAI believe the current proposal strikes the optimal balance between delivery assurance and delivery flexibility**

→ **It gives providers the <u>flexibility</u> to recruit sites until close to delivery but the <u>incentive</u> to deliver as early as possible**

Justification / impact of not accepting proposed modification

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JUSTIFICATION

- **Removes unnecessary barrier** to the development of increased demand side participation in an efficient manner (promoting further competition in the market)
- **Recognises the ability of AGUs / DSUs to deliver New Capacity with high flexibility and short timelines**
- Removes requirement to comply with the Substantial Financial Completion milestone for unit types delivering New Capacity with different delivery characteristics
- Builds on existing intent and scope of CMC J.2.1.3 which **recognises the inherent delivery characteristics of AGU / DSU capacity** and reflects these in **modified requirements for a number of Implementation Plan milestones**
- Will enable **more optimal use of existing demand side assets**, improving competition and ultimately consumer prices

IMPACT OF NOT ACCEPTING MODIFICATION

- AGUs / DSUs (which can deliver New Capacity with high flexibility and short timescales) **required to have contracts in place >2 years in advance** of bringing new demand sites into the market
- Current Substantial Financial Completion milestone acts as a **significant barrier to the growth and development of demand side participation**
- This causes **less optimal demand side participation**, which reduces market competition and ultimately increases prices for consumers
- Substantial Financial Completion milestone doesn't fit for AGUs / DSUs which have **inherently higher ability to deliver New Capacity flexibly and on shorter timelines**
- Likely to result in **larger numbers of individual SFC extension applications** (consuming significant resources from the RAs, System Operators, and Participants as well as leading to less consistent outcomes)

→ **Regulation EU 2019/943. Article 6, 1 (a).** "*ensure effective non-discrimination between market participants taking account of the different technical needs of the electricity system and the <u>different technical capabilities</u> of generation sources, energy storage and demand response;*"

→ Building on the existing recognition of the key differences between AGUs/DSUs and other unit types is key to maximise competition in the market and remove undue / unsuitable barriers to participation for quickly deliverable, flexible capacity