CMC 03_24 Enduring Indexation Mechanism based on GB model

21/03/2024

sse Thermal

Justification

- Indexation should be accounted for on a reasonable and enduring basis:
  - to provide investors with protection from inflationary risk
  - to support delivery of capacity from 2026, to address significant capacity deficits detailed in the recent TSOs' Generation Capacity Statement.
  - Provides protection for existing generation –also supports their retention which is needed as per the GCS too.
- Aware of the current mod from Energia on Enduring Indexation and realise this is under consideration. Seeking to offer an alternative.
- This alternative is closer to the GB approach. This aligns with SEMC view of the style of enduring mechanism they may consider (SEM-23-045).
- This is not retrospective and doesn't seek to reopen settled transactions. This accords with the interpretation of Retrospectivity as defined by the SEMC in recent SEM-23-045 and SEM-24-015.

Benefits of the modification

- Methodology taken from GB, which is well known and consolidated. This aligns with SEMC view on the type of preferred enduring mechanism they may consider for indexation.
- We are notably using an indexation window across various months which avoids any “spot” indexation risk.
- Indexation base values will be known ahead of auction (at IAIP publication date), which allows existing participants to correctly assess in real terms their Opt-Out decisions or requirements for Unit Specific Price Cap, which are decisions made shortly after the IAIP publication.
- New capacity will also be able to build their business case with the correct assessment of project finance in real terms ahead of entering prequalification. There is potential for efficiency of bids since indexation will already be dealt with.
- Application of indexation can help to encourage bids that focus on efficient and known costs rather than trying to forecast unknowns like inflation where procurement is not yet finalised.
- Participants are protected from deflation (Lowest Capacity Payment Price possible is the Auction Cleared Price).
- No material changes to settlement systems as inflation adjustment value will be known months ahead of each capacity year and Market Operator can update auction payment price to inflation adjustments.

Application of the Mod

- Designed to align with ISEM Capacity market timelines. Would help to address different Auction Parameters Publication dates in ISEM.
- We suggest the standard CPI indices values as published in ROI and NI (Central Statistics Office and Office for National Statistics).
- Applies to new and existing projects and is not retrospective.

Legal Wording

F.9.1.2 From xxx [effective date of modification approval], awarded New Capacity that have yet to reach the end of the Substantial Financial Completion Period as defined in D.2.1.3A of the CMC, the Capacity Payment Price will be indexed at the start of each Capacity Year in accordance with the following formula as per Section O.
From xxx [effective date of modification approval], Existing Capacity that are competing for their next single year contract at auction will have their Capacity Payment Price indexed in accordance with the following formula in Section O.
For those units in development prior to the effective date of CMC_xxx [modification reference for this mod]; except to the extent provided for in the Trading and Settlement Code, the Capacity Payment Price shall not be subject to adjustment or indexation.

Section O

$$PCP_{\Omega n} \times \max\left(\frac{CPI_X}{CPI_{base}}, 1\right)$$

Where:
$PCP_{\Omega n}$ is the Capacity Payment Price
CPIx is the average monthly CPI figures for the winter before the Capacity Year, October to April inclusive, (April of the Capacity Year)
CPIbase is the average monthly CPI figures for the 7 months prior to the publication of the IAIP (Initial Auction Information Pack).

This value will be applied to the Capacity Payment Price and will apply to the Capacity Payments that become due in the Delivery Year of the project. This value will be recalculated, for each Delivery Year.

We expect to use the standard CPI indices values as published in ROI and NI (Central Statistics Office and Office for National Statistics).

Worked Example:
Capacity Year 2022/2023

ISEM T-4 22/23 Auction Timetable & Results	
IAIP date	28/09/2018
Submission Commencement	21/03/2019
Auction Run Start	28/03/2019
Auction approval date	25/04/2019
Auction results date	29/04/2019
Auction clearing Price	46,150 €/MW per year

- Since the IAIP was published in September 2018, the CPI base will be the average of CPI between February 2018 and August 2018, which is 101.26. The CPIx will be the average of CPI between October 2021 and April 2022, which is 107.69.

Month	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	CPI base average
ROI CPI values	100.60	100.90	100.70	101.30	101.40	101.80	102.1	101.26

Month	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	CPIx average
ROI CPI values	105.9	106.5	107	106.6	107.6	109.6	110.6	107.69

- The Capacity Payment Price adjusted for inflation would be: 46,150 x max(107.69/101.26, 1) = 49,080€/MW for the CY 2022/2023.

Implication of not implementing and Impacts

Implications:

- Lack of an inflation mechanism is a likely contributor to project terminations in the CRM
- Ireland is a small market with a challenging procurement climate. Procurement is only firmed up post auction when quotes are finalised and agreed. There is potential for price changes in that period which cannot currently be captured.
- This is why GB has applied an inflation mechanism averaging CPI indices at different points in the auction and delivery time. We are using a similar approach suitable for the ISEM CRM.
- Inflation adjustments implemented in 2024 would help to deliver capacity to help meet capacity shortfalls from 2026 onwards. This is critical for mitigating security of supply.

Impacts:

- We envisage SEMO would do a once-a-year update of the new award prices in systems, which should create only limited impact.
- Settlements of the contract would flow through as normal – this change should require no changes to settlement.