

# Industry Call: Mod 07 22 Indexation to Calculation of Capacity Payments for New Capacity

18 July 2022

**Attendees:** Andrew Burke, Brian Mongan, Cormac Daly, Cormac Fagan, Eoghan Cudmore, Guneet Kaur, Harry Molloy, Ian Mullins, Justin Maguire, Kat (Guest), Lauren Porter, Marc Curran, Martin McCarthy, Matt O’Kane, Paul Bell, Rainys Deividas, Robert McCarthy, Rochelle Broderick, Sandra Linnane, Sean McParland, Siobhan McHugh, Stacy Feldman, Tom Birney.

## Introduction

Cormac Daly (Tynagh) presented a brief overview of rationale for the mod and proposed structure for the industry call. The following topics were raised individually by Tynagh, followed by a window for participant discussion.

### Is the modification more appropriate in the TSC or the CMC?

Tynagh outlined the view that the Trading and Settlement Code is the most appropriate location for the modification, given Section F.9.1.2 and F.9.4.4 of the Capacity Market Code. Nonetheless, Tynagh recognised potential value in discussing the mod at the upcoming CMC workshop.

No participants commented on this issue.

### Is the modification retrospective?

Tynagh outlined the view that this modification is not retrospective, fundamentally because the TSC looks at the Calculation of Capacity Payments which happens in the present, and that Section F.9.1.2 of the Capacity Market Code fundamentally recognises the possibility of indexation in the TSC.

One participant expressed an understanding of Tynagh’s position but disagreed with the interpretation of Section F.9.1.2. They expressed their understanding that any indexation recognised within the CMC referred to any existing indexation included in the TSC, rather than facilitating the introduction of indexation in the TSC in the future.

Another participant queried whether the modification would interact with resettlement of previously settled data. Specifically, if you were re-settling T-1 payments which had originally been settled without indexation. The participant emphasised the need for clarity on a starting-date for the modification to take effect.

A participant expanded on this point seeking clarification on what point this modification would apply to Capacity. Tynagh explained that they envisioned the modification applying to all future payments going forward (i.e., applies to contracts previously awarded but paid out thereafter). This aligns with the objective of the modification to secure New Capacity in response to current spiralling costs.

One participant stated their support for the position outlined by Tynagh, stating that there is a focus on delivering temporary emergency generation for Security of Supply, but there needs to be attention giving to ensuring New Capacity is delivered. Historically, inflation rates have been so low that it is possible they would not have surpassed the threshold for the adjustment to take place.

### **Should the modification be bi-directional?**

Tynagh outlined their position, that initially the modification accounted for upward inflation only, but considering comments from Mods Committee Participants, the modification has been updated to account into deflation as well.

No participants commented on this position.

### **Inclusion of operational costs in adjustment**

Tynagh outlined a proposal from another participant to extend the modification beyond the construction period to account for year-on-year indexation movements within the lifetime of a contract.

One participant expressed confusion at this proposal, noting that the initial modification was designed to increase Capacity Payments to account for increased construction costs. The new position expands this adjustment into operational costs which is more significant.

Another participant stated that while this issue represents an expansion of the adjustment into operational costs, it is a conservative adjustment given the 2% discount on any indexation applied. This participant further noted that the construction period has already been partially accounted for through the 2% indexation applied to Auction Price Caps in SEM-21-110 and that it seems logical to apply indexation to the lifetime of the contract. Specifically, any indexation adjustment should be tied to the duration of any Reliability Option.

### **Variability of threshold and interaction with Auction Price Cap**

Tynagh outlined three approaches to setting the threshold for application of the modification. A fixed percentage, a variable based on Auction Price Cap increases, and a derived value based on the difference between Price Caps in the relevant year and the Capacity Auction year.

One participant expressed concern about the application of a fixed value threshold, based on interaction with SEMO's system. The participant stated that derived values would be more compatible with SEMO.

Another participant agreed with this point, expressing support for a derived, variable threshold, but stated that it would be necessary to ensure that any derivation functions for deflation as well as inflation.

One participant queried how the formula might respond if the Price Cap changes for reasons other than inflation.

### **Appropriate indices**

Tynagh presented a proposal on what indices should be applied to the amendment, specifically that a blend of Tender Price Index and Output Price Indices for New Infrastructure should be used to reflect the two jurisdictions. Tynagh also stated that if the modification was applied to operational costs, as well as construction, it would be more practical to use CPI.

One participant noted that if a blend of index rates were to be used, a 50/50 mix would be more sensible than a 75/25, which would not be accurate. The exact ratio could be based on capacity shares in each jurisdiction, but this could become messy if portfolios evolve over the year.

### **New vs. Existing Capacity**

Tynagh stated that while the preference for the modification and better alignment with its objectives would be New Capacity only, it is difficult to see how this could be implemented in practice. If there is a way to apply the modification to New Capacity only, it would be welcome but if not, it should apply to New and Existing.

One participant stated that they agreed with the principle of applying the modification to both New and Existing Capacity. They stated that an increase in costs across the board means that Capacity providers will be both building and operating at a loss. The participant stated that if applied to Existing, it would be more pragmatic to use CPI rather than a construction-based indices.

Other participants supported this position, stating that units already in operation are also facing a loss, and that other indices (such as CPI) may need to be considered where applied to Existing units.

Another participant agreed with the concept of application to both New and Existing Capacity, given that the TSC does not recognise differences between New and Existing Capacity in the calculation of Capacity Payments. The Participant also noted it would be necessary to ensure that if indexation threshold is based on Auction Price Cap, it will be necessary to define whether it is for the New or Existing Price Cap.

### **Technology specific**

Tynagh stated that they did not consider it appropriate to make any elements of the modification technology specific.

No participants commented on this position.

### **Time to solution**

Tynagh expressed the urgency with which a solution to this challenge is required. The risk to Security of Supply is real and significant and action is required as soon as possible. Tynagh believe that the mod should be implemented by 1 October 2023.

One participant questioned the timing of the mod and whether the application of an adjustment to Capacity which has already secured a contract would be retrospective. The participant stated that if the modification is applied, it should only be to auctions which are yet to take place.

Another participant disagreed with this statement, stating that the modification is intended to protect those who are participating in the market. They stated that the modification needs to be implemented urgently due to the Security of Supply risk. The participant stated that this mod is required as a result of wider economic inflation which all participants are exposed to, and as such would still represent an even playing-field if implemented after the Capacity Auction. This modification is intended to address increasing costs which were unforeseen.

One participant stated that realistically they did not expect the RAs to approve a modification which affects Capacity which has already been awarded a contract. Tynagh agreed with the idea, but expressed that the modification is not retrospective, as it is concerned with the future settlement of Capacity Payments.

Another participant stated that this issue is a core consideration for the mod as a whole. They could see the merits in both approaches (i.e., modification applied to future auctions, or applied to future payments), but expressed a need to make this very clear. They expressed a concern that if this was not very clearly defined, the RAs would be unlikely to approve in any case.

### **Next Steps**

Tynagh will be discussing the modification at July's Capacity Modifications Workshop, and separately at the next Mods Committee meeting.

Tynagh reiterated their position that they do not consider the modification to be retrospective, nor a change to the design of the CRM.