



Response to Integrated Single Electricity Market (I-SEM)

**Capacity Remuneration Mechanism
2020/21 T-1 Capacity Auction
and
2021/22 T-2 Capacity Auction Parameters
Consultation Paper
SEM-19-010**

**On behalf of
AES Kilroot Power Ltd and AES Ballylumford Ltd**

2nd April 2019

Capacity Remuneration Mechanism T-2 & T-1 Parameters Consultation Paper

Introduction

AES welcomes the publication of the I-SEM Capacity Remuneration Mechanism (CRM) 2020/21T-1 Capacity Auction and 2021/22 T-2 Capacity Auction Parameters Consultation Paper (SEM-19-010) and the opportunity to provide comments on the issues raised. AES would like to submit the following consultation response to the Regulatory Authorities.

AES is a global energy company with assets in the all island market consisting of CCGT plant, coal and gas fired conventional units, additional distillate fired peaking gas turbine plant and new technology Battery Energy Storage Array (BESA). AES is a non-vertically integrated independent generator which owns and operates Kilroot and Ballylumford power stations in Northern Ireland with a combination of merchant and contracted base load, mid merit and peaking plant. The responses to this consultation are therefore conditioned by the nature of our current position and portfolio of assets operating in the SEM.

CRM PARAMETERS – HIGH LEVEL MESSAGES

AES believes that there is a significant issue identified in the CRM Parameters consultation paper which has substantial consequences on the effective functioning of the Capacity Market and on the ability of Market Participants to effectively recover sufficient costs to enable ongoing operation in the I-SEM.

Section 5 (e) The SEM Committee welcome feedback on the potential for reducing the value of ECPC for the 2020/21 T-1 and 2021/22 T-2 capacity auctions. We have observed bidding behaviour in relation to ECPC from the first two transitional auctions, and by the time we come to make a decision on this parameter, we will also have data from the upcoming 2022/23 T-4 auction.

AES does not support the SEM Committee's proposal to reduce the Existing Capacity Price Cap ("ECPC") for the 2020/21 T-1 and 2021/22 T-2 capacity auctions.

In response to SEM-16-073, AES highlighted to the SEM Committee that the ECPC was not sufficiently high to allow the recovery of fixed and sunk cost – for example covering costs incurred for necessary upgrades. From experience of the previous auctions where AES has been required to submit USPC applications to enable a cost reflective missing money offer to be submitted, it is clear that the level of the ECPC at 0.5 x CONE is set too low.

AES has communicated to the RAs on several occasions and provided evidence through the USPC process, that the ECPC is set too low and that the USPC mechanism does not work for multi-unit stations where the fixed costs cannot be split evenly between units. The SEM Committee assumption that fixed costs can be split evenly on a unitised basis is not correct. Removing one unit of a two-unit station does not reduce the fixed costs by 50% due to levels of shared auxiliaries and common systems, all of which must be maintained whether one unit or two units are operating.

AES is concerned with a proposal to move away from the SEM Committee's principle to link price caps to market based parameters. The current method of linking auction price caps to CONE for new and existing plant was presented and accepted during the high level design with '0.5 x CONE = ECPC' an International Benchmark. The SEM Committee now appears to be ignoring its own principle by deciding on its own regulated price caps and moving away from a market based approach (the guiding philosophy contained in the relevant State Aid Approval). The resulting administrative and mechanistic price setting methodology creates more unwelcome uncertainty for market participants.

AES believes the consequence of regulatory manipulation with revenue fundamentally undermines confidence in the market with increased regulatory interventions skewing market outcomes, and potentially threatens the ongoing viability/solvency of certain participants

The rationale for the SEM Committee proposing a reduced ECPC based primarily on the fact that the RA's have gained experience in assessing USPC applications would evidence that the ECPC is currently set too low. Having been through the USPC application process for each of the auctions thus far, the time, cost and effort involved is considerable and in our view, outweighs the benefit gained by the auction process. Reducing the ECPC will only serve to increase this burden on ourselves and an increased number of market participants who find that their offer now exceeds the ECPC.

This proposal to reduce the ECPC views the administrative burden and associated cost exclusively from the viewpoint of the RAs and does not take into account the cost, time and effort incurred by a participant who finds that their auction bid exceeds a reduced ECPC and is now faced with that cost, time and tying up of considerable resources to prepare, validate and submit a USPC bid.

AES and other participants, also in response to previous consultations (E.g. SEM-16-073) pointed out the flawed assumption that non-fuel related costs are an adequate proxy for fixed costs. As mentioned above, for a multi-unit station there is not a simple per unit allocation of fixed costs which creates potential for under recovery due to the unitised bidding clearing risk. The choice of ECPC as a multiple of 0.5 x Net CONE was based on an RAs assumption that this would be sufficient to cover the Net Going Forward Costs (NGFC) for most capacity required to meet the capacity requirement. However, this estimate was based on analysis of Non-Fuel Operating Costs (NFOC) from historical generator financial reporting which also did not include capital costs associated with ongoing operations. Thus, according to this methodology ECPC set as a multiple of 0.5 x Net CONE would have been an underestimation

In addition, Variable Operation and Maintenance Costs (VOM) are recovered as part of the energy market bid however a provision for this cost is removed from the NFOC quantity in the USPC process even though it is not included as part of the NFOC submission. This effectively double counts the contribution value of VOM to overall revenue.

Unexpected market volatility has already had significant consequences for market participants with difference charges impacting on expected revenue, for example the events on January 24th Difference Payment 'event' which cost RO holders (through no fault of their own) €6.8 million over a couple of trading periods. Yet in the AES USPC process the risk of difference payments was completely discounted and the associated risk contribution to the USPC level was disallowed with the RA statement that there was no risk of scarcity.

Finally, AES would request that all future SEMC/RA consultations open for a minimum of 6 weeks and, for the reasons outlined above, that at the very least there is no reduction in the multiple of CONE used to determine the ECPC. On the contrary, AES would urge the SEM Committee to assess raising the ECPC, to reduce the USPC time cost and effort requirements placed on market participants.