Response to Consultation by the SEMC

Capacity Remuneration Mechanism 2020/21 T-1 Capacity Auction and 021/22 T-2 Capacity Auction Parameters - Consultation Paper SEM-19-010

Electricity Association of Ireland

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The Electricity Association of Ireland (EAI) is the representative body for the electricity industry and gas retail sector operating within the Single Electricity Market (SEM) on the Island of Ireland.

Our membership comprises utilities that represent 90% of generation and retail business activities and 100% of distribution within the market. Our members range in size from single plant operators and independent suppliers to international power utilities.

We believe that electricity has a fundamental role in providing energy services in a decarbonised, sustainable future, in particular through the progressive electrification of transport and heating. We believe that this can be achieved, in the overall interest of society, through competitive markets that foster investment and innovation.

We promote this vision through constructive engagement with key policy, regulatory, technology and academic stakeholders both at domestic and EU levels.

We represent the Irish electricity industry in EURELECTRIC, the representative body for the European electricity industry, and help shape the broader European response to developing policy and legislative initiatives.

A decarbonised future powered by electricity

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On behalf of the members of the Electricity Association of Ireland (EAI), the following consensus positions have been developed in response to the this SEMC consultation.

Consultation Period

It is unfortunate that it is necessary to again highlight the fact that this consultation paper was 'open' for a period of only 4 weeks (with request for extension refused). Cognisant of external time constraints, a 6 week consultation period was established as the norm during the design and implementation of SEM, with certain consultation periods restricted to 4 weeks only in exceptional circumstances. We note that there are currently two open SEM Committee consultations with durations of at least 6-weeks[1] respectively, durations which we welcome and support as the standard minimum consultation time period going forward. Absent external pressures as was in play during the design and implementation of SEM, the traditional minimum period of 6 weeks must be re-instated as the default period for consultations, with provisions for additional time in instances where the subject matter has significant impact, is more complex or if consulting over holiday periods.

Existing Capacity Price Cap

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 (or any future auctions) is NOT supported by the EAI and its membership for reasons explained below.

- The ECPC has already been set as a multiple of 0.5 x Net CONE for the first two T-1 transitional auctions for CY2018/19 and CY2019/20 respectively, and also for the T-4 auction for CY2022/23. The RAs suggest that they are considering the feasibility of reducing ECPC for CY2020/21 and CY2021/22, based on the fact that they have now had some experience with the process and the administration of other aligned processes, i.e. USPC. Such a rationale views the administrative burden and associated cost exclusively from the viewpoint of the RAs and ignores the costs incurred by a participant who finds that their expected going forward costs exceeds a reduced ECPC and is now faced with the costs, time and tying up of resources to prepare, validate and submit a USPC application and engage in that process. The RAs have not provided sufficient justification for reducing the ECPC. Rather, a reduction of the ECPC would significantly heighten the perception of regulatory risk in this market (raising the cost of capital), would needlessly interfere with proper market functioning (as explained further below) and would potentially put security of supply at risk, to the detriment of both investors and consumers alike.
- The rationale for the ECPC is to limit the market power of existing generators. This must be balanced with the need for generators to be given an opportunity to recover their total costs if there is demand for their product, consistent with a competitive market process, noting that a competitive market is at the core of the extant State Aid approvals (SA44464 & SA44465). The USPC process is not a

[1] SEM-19-011 (SEMO KPIs consultation) and SEM-19-013 (CRM DSU Compliance with State Aid consultation)

valid substitute for getting this balance wrong – i.e. setting the ECPC too low[2]. Apart from its other flaws, this is because the USPC process expressly rules out recovery of so-called sunk costs that would neither be denied from or discounted by rational actors in a competitive market. Thus, it is not simply a matter of balancing the administrative burden of going through the USPC process and mitigating market power, as suggested by the RAs. Consistent with regulatory duties, an appropriate balance must also be struck between mitigating market power and allowing the proper functioning of markets, and by providing a substitute for markets (through regulatory intervention, where justified) that is proportionate, consistent and provides for recovery of costs that a competitive market would allow.

- EAI believes it is important to point out that direct comparison with other markets can be misleading as a justification, for example, altering bid caps. In the Great Britain (GB) capacity mechanism, existing plant are not prevented under the scheme from earning a rate of return deemed necessary, since this may be included in their submitted justification for needing a higher level of payment. In contrast to the GB scheme, the inflexible bid cap (or any USPC approved based on the inflexible definition of NGFC) under the new SEM CRM does in fact prevent the recovery of total costs and earning any rate of return for many generators. In Great Britain, therefore, there is no presumption that price caps must be imposed on certain generators, unlike under the rules of the new SEM CRM.
- It should also be noted that the determination of ECPC as a multiple of 0.5 x Net CONE was based on an estimate by the RAs considered sufficient to cover the Net Going Forward Costs (NGFC) for the majority of 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 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 underestimated these costs.
- Market participants are exposed to the risk of significant difference payments which have been magnified during the bedding in phase of the new SEM. Tangible examples of this ‘uncertainty’ were the January 24th (and Oct ‘18) Difference Payment ‘events’ which cost RO holders (through no fault of their own) €6.8 million over a couple of trading periods. The risks/costs associated with ROs, including in the recent events where plants were not scheduled or dispatched during RO events, were not properly reflected in the ECPC / USPC, neither were these risks factored into the comparisons with the “International benchmark” and hence, in reality there is a strong, logical and justifiable case for the ECPC to be adjusted upwards rather than the suggested RA reduction.

[2] In response to SEM-16-073, the EAI made the point to the SEM Committee that the ECPC was not sufficiently high to allow the recovery of fixed and sunk cost – this assessment is arguably validated by the increased number of USPC applications that, from the Regulatory Authorities’ (RAs’) admission, appear to have been received over the course of the capacity auctions held to date for the new SEM.

EAI urges significant caution against taking regulatory decisions, in terms of reducing the ECPC, that for reasons elaborated on above are considered unnecessary and unjustified, and not in consumer's interests.

Conclusion

In summary, EAI respectfully requests 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 current multiple of '0.5 x CONE' used to determine the ECPC. On the contrary, it is arguable that there is an onus on the SEM Committee to assess raising the ECPC, for the reasons outlined above as well as considering that the current netting of DS3 revenues from the BNE calculation process removes the incentive to invest capital in the provision of services necessary to decarbonise the power system.

Yours sincerely,

Dr John MacNamara

Chair, EAI Markets Committee

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