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Re: Capacity Market Code Working Group 26 Consultation Paper (SEM-22-050)

EPUKI welcomes the opportunity to reply to this Consultation Paper.

We are disappointed with the minded to position presented by the SEM Committee in this paper. We consider the minded to position to be inconsistent with the objectives of the Capacity Market Code, the functions of both the Utility Regulator and Commission for Regulation of Utilities as regulators, and stated policy of the Irish government. Additionally, we believe that this minded to position is contrary to the very recent review of the Capacity Market carried out by Ernst & Young which was commissioned by the SEMC. Failure to implement this modification leaves New Capacity exposed to instances where a third-party(s) can cause a delay to project delivery in time for the relevant Capacity Year, outside the control of the developer which could lead to:

- i. contract erosion - loss of market income, risking a project's economic return; and
- ii. contract termination potentially resulting from projects missing Implementation Milestones (particularly Substantial Financial Completion) or Long-Stop Dates and hence having their Capacity contracts terminated.

This response is broken down into two sections. The first section provides a general overview of EPUKI's views on this modification proposal. The second section provides specific responses to each of the SEMC's points with respect to the modification.

Section 1 - Overview

This proposed modification is of significant benefit to the consumer.

This proposed modification will (if passed) significantly reduce the risk of termination of 1,870MW of flexible gas generation that was successful in the recent T-3 and T-4 auctions. Of this 1,870MW, 350MW is in Northern Ireland. This proposed modification will also increase competition and reduce the risk of insufficient new capacity in upcoming auctions. Rejection of this proposed modification will increase the risk of further shortfalls in capacity, leading to the potential for blackouts and the requirement for costly on-going emergency generation intervention undermining the integrity of ISEM.

The SEM has seen a high proportion of terminations of awarded capacity. Of the 1,365MW (eleven units) of gas capacity that were successful in the T-4 auctions for 22-23, 23-24 and 25-26, eight units (612MW) have been terminated. Of the three remaining units which are still on course for delivery two are owned by EPUKI and are in Northern Ireland. In Ireland eight out of nine gas units have been terminated. Many of these projects were terminated due to third party delays. These are startling figures and should be of deep concern to the Regulators who are tasked with ensuring Security of

Supply. Unfortunately, it has been left up to a participant to look to change the Capacity Market Code to ensure that successful projects deliver in Ireland at a time of a Security of Supply crisis.

Many projects have faced considerable delays due to non-delivery by statutory bodies and under the current rules of the Capacity Market Code the project developers are expected to absorb this loss. If, for example, due to planning appeals or delayed grid connection the project is delayed eighteen months then the investor would lose circa 22% of the value of the investment (using a 10% discount factor). This is very likely to lead to a negative Net Present Value for this investment. This raises an existential concern for any project, especially at times of high inflation.

If these projects were to be terminated as a result of delays caused by third parties then the RA's and Eirgrid will be forced to replace these units with expensive emergency generation and possibly look at another T-3 auction to bridge the gap. The capacity contract terminations for the 22/23 auction have shown that it is very difficult to replace capacity that has not been delivered. Emergency generation has proven difficult to procure, especially given reduced supplier stocks due to the significant portion of emergency units that are already being sought for Ireland. The CRU have stated that the cost of Security of Supply mitigation measures for 22/23 will be €478M for a period where the TSO is only procuring 200MW of emergency generation. If the TSO's have to replace a further 1,870 MW of capacity the cost will increase sharply. Non delivery of large scale flexible generation will also result in higher electricity cost whereby the proposed new capacity market units are efficient fast acting peakers that will be cheaper to run than the existing peakers and when these proposed units clear in the ex ante market they will result in lower prices than would otherwise have been the case.

If any of the new projects are terminated, then the existing tight system margins will continue over the next several years and the risks to security of supply will be significantly increased. The current risk of blackouts will continue until the replacement of that generation. Stable electricity supply is one of the fundamental requirements for any company considering investing in Ireland. Security of Supply is even more important in a smart economy like Ireland where a significant number of investors are technology companies. The IDA stated in August 2022 that *"From IDA's perspective, security of supply of energy is paramount. The situation with respect to the availability of energy, particularly electricity, is serious and is of particular concern to large energy users.. ...Accordingly it is imperative that all measures are taken by the relevant stakeholders to ensure that ample, competitively-priced energy is available at all times for the [foreign direct investment] base."*¹ This will affect existing businesses - both local and large scale multinational, but it will have an even greater effect on any potential new investor. The headline *'1,500MW of urgent generation cancelled in Ireland increasing risks of blackouts'* could scupper a number of potential investments.

It is our view that the RA's are significantly underestimating the amount of new build plant needed to fill the predicted capacity gap in Ireland over the coming years. There has been a recent decision to implement additional de-rating factors for ARHL plant and we note that on the 19th September 2022 the CRU clarified that grid connections for successful participants for the upcoming 26/27 T-4 will only be issued to plant with a de-rating factor of >0.5. Our view is, and always has been, that OCGT plant (which made up the bulk of new build capacity in recent auctions) is limited to 1,500 hours per year by EU law though we note that the EPA take a different view; however, we consider it probable that this decision will be legally challenged in due course.

¹ <https://www.irishtimes.com/ireland/2022/08/09/ida-clashes-with-electricity-market-supervisors-over-moves-to-impose-penalty-tariffs-on-big-business/>

The outcome of a successful challenge to the EPA (and an enforcement of the 1,500 hours ARHL) would be to significantly increase the amount of new build plant needed to fill the predicted capacity gap as it is likely that any new plant would be OCGT or reciprocating engine technology and thus subject to a further 0.43 de-rating factor. Indeed, this very issue was addressed in 'Interim Solution for Capacity Market Marginal De-rating Factors' (16.05.22) which stated in Appendix A:

'Without a change in the respective incentives and continued use of the same de-rating factors irrespective of run hour limitations, there are two possible scenarios:

- *either we risk capacity adequacy issues as some units are not permitted to operate due to emissions limits; or*
- *we procure large volumes of run hour restricted units, at significant cost to consumers, which is an inefficient way for delivering security of supply'*

Given that the most likely outcome of the current processes is that large volumes of run hour restricted units will be required then this modification will help ensure that these can be delivered to provide the security of supply required. In the event that this modification is rejected then the RA's will be relying wholly on the EPA decision to allow non-combined cycle plant to operate for more than 1,500 hours per year which, as stated previously, is a flawed interpretation of EU law. To our knowledge the RA's have not taken their own legal advice from a reputable firm on the EPA's interpretation of running hours, which any reasonable and prudent regulator should do.

This proposed modification is overwhelmingly beneficial to the consumer in that it significantly reduces the risk of blackouts and removes the requirement for expensive emergency measures required due to capacity shortages.

Oireachtas Committee on Environment and Climate Action

In August 2022, the CRU and the Irish Minister for Energy, Climate, and Communications spoke to the Oireachtas Committee on Environment and Climate Action about potential energy scarcities and high prices. At this meeting, EirGrid, the CRU and the Minister made statements supporting the objective which this modification seeks to deliver.

EirGrid stated that *"we must improve the performance of the existing mechanism to deliver new generation capacity"*. This modification seeks to secure the delivery of new capacity by addressing an issue outside the control of the developer which creates a significant risk of contract erosion and termination. In their minded to position, the SEMC outlined an expectation that this modification would require the TSO to apply greater scrutiny to applications for new capacity. We believe that this outcome would be a positive and represent an improvement in the effectiveness and efficiency of the CRM in delivering new capacity. Given that there have been a significant number of capacity contract terminations and a risk of further terminations we feel additional scrutiny of applications by the TSO is necessary in any event, and that this should go hand in hand with engagement with developers during qualification.

The Minister for Energy, Climate, and Communications, Eamonn Ryan, stated that *"laser focus"* was required in order to ensure the delivery of Capacity which has been secured through the CRM. He further stated that *"what we need to deliver now is the 2GW of gas capacity to keep the lights on. That is absolutely essential"*. The SEMC's minded to position; not to protect developers from contract erosion and potential termination because of third-party delays, is not consistent with the Minister's position.

The CRU also noted that there was “*significant work under way to support delivery*” of the newly procured capacity and noted that “*both generation and transmission network infrastructure remain particularly challenging to deliver in Ireland*”. Given this recognition, it is difficult to understand why the SEMC would oppose potential measures to support the delivery of new capacity particularly as this modification only seeks to protect new capacity where the delay is exclusively due to a third-party(s).

These statements and the wider sentiment delivered at the Oireachtas debate on Environment and Climate Action support the intention of the proposed modification CMC_10_22 and should be considered prior to any final decision in relation to this modification.

Ernst & Young Report

On 26 August 2022, the SEMC published a Call for Comments on an Ernst & Young (EY) report to review the performance of the CRM. This report examines a range of different aspects to the CRM and makes a number of recommendations on how the CRM could be improved. Having reviewed the EY Report, we believe that a number of these recommendations align with the intent of CMC_10_22.

These recommendations include:

- Increase lead time to at least four years from the announcement of the auction results to start of the relevant Capacity Year.
- A permissive approach to requests for extensions from new build projects.
- Greater focus on delivery of infrastructure to enable more competitive all-island market and to reduce pressure for new builds to be situated in particular locations.

While it is not possible to increase the lead time for auctions which have already taken place (or for the next upcoming T-4 auction), CMC_10_22 would, essentially, provide longer lead times for third parties to carry out required work to deliver capacity. We note that this modification is only intended to take effect where it can be proven that a delay has occurred as the result of a third party(s). This means that the modification would not reduce the pressure on developers to deliver projects but provide protection against the failure of third parties to meet their required delivery times. While the CMC currently allows for extensions to Substantial Financial Completion, it does not protect developers from contract erosion or long-stop date termination both of which can result in the non-delivery of capacity.

While the EY report recommends a more permissive approach to requests for extensions, we reiterate that the proposed modification does not seek extensions in cases of all delays, but only where it can be shown that a third-party is responsible for the delayed delivery of the project. In many cases, the developer has no ability to avoid or mitigate these delays. The SEMC’s minded to position to reject this modification appears to contradict this recommendation.

This modification, if approved, would emphasise the importance of third party infrastructure delivery to secure new capacity. While we recognise that the CRM should place a degree of risk on the developer to ensure timely delivery, if, for example, third party infrastructure is not in place for new capacity, there is little action that a participant may take to connect or commission on time. This means contract erosion and possibly termination. Equally if a Judicial Review is taken against a grant of Planning Permission, this is a challenge to a Decision of a Planning Authority and the developer is

an observer in the process and this cannot and should not be regarded as a step that should have been included for in contingency.

This modification would protect developers from instances where infrastructure delivery or planning grants have resulted in delays to new capacity being delivered. We further note that the TSOs have input into the qualification process for New Capacity applications, and as such have the ability to reject applications in locations where infrastructure delivery will not be possible within the required delivery window.

While we intend to submit a separate, more comprehensive response to the EY report, we believe its recommendations should not be ignored in the context of this modification decision. While CMC_10_22 aims to implement some of these recommendations, it still maintains the fundamental risk and responsibility for items within the control of the project developer.

Alignment with the Capacity Market Code

CMC_10_22 is aligned with the objectives of the Capacity Market Code, and we believe that the minded to position to reject this modification runs contrary to these objectives. The objectives of the CMC are set out in Section A. 1.2 of the CMC.

(a) To facilitate the efficient discharge by EirGrid and SONI of the obligations imposed by their respective Transmission System Operator Licences in relation to the Capacity Market

This modification protects developers from contract erosion or termination in instances where the third parties or third party processes (such as grid connection) have failed to deliver in a timely manner. By maintaining this burden of risk on participants, a degree of responsibility is removed from third parties. This does not promote the efficient discharge of these parties' obligations. Currently, if a project is delayed solely as the result of third-party delays the only downside is felt by the developer. While this modification would not necessarily penalise third parties for any potential delays, it places a burden of responsibility on these parties that does not currently exist.

(c) To facilitate the participation of undertakings including electricity undertakings engaged or seeking to be engaged in the provision of electricity capacity in the Capacity Market;

This modification specifically seeks to facilitate new capacity providers in the CRM. Failure to protect developers from third-party delays creates a significant risk of contract erosion and termination. If a third-party is unable to deliver required infrastructure in a timely manner, potential capacity providers will be unable to engage in the Capacity Market. Failure to mitigate third-party delays runs contrary to this Code objective.

(g) Through the development of the Capacity Market, to promote the short-term and long-term interests of consumers of electricity with respect to price, quality, reliability, and Security of Supply of electricity across the island of Ireland.

The minded to position to reject this modification would represent a negative outcome for consumer interest in the short-term and long-term. Failure to secure capacity through the CRM is highly likely to worsen existing adequacy concerns. This would result in a number of negative outcomes for consumers.

First and foremost, this outcome would result in immediate Security of Supply concerns for Ireland. In Ireland, there has already been significant indications of likely blackouts over the winter period.

This represents a worst-case outcome for consumers in the SEM and will remain a possibility until new capacity is delivered.

Additionally, the cost impact of the minded to position is also negative for consumers. New capacity is procured through the CRM at a competitive rate which represents the most economic outcome for consumers. If the CRM is unable to deliver New Capacity, the procurement of temporary emergency generation is required as an alternative to ensure Security of Supply. This is both a distortion of the Capacity Market and an inefficient outcome for consumers, coming at a higher cost than capacity procured through the CRM. Additionally, as such capacity is temporary, ongoing procurement of emergency generation will likely be required until new capacity is delivered.

The SEMC have an opportunity to mitigate the risk of this outcome as a result of third-party delays. It is unclear how the potential termination of new capacity, which has been delayed as a result of a third-party, is beneficial to consumers when weighed against the outcomes of such termination.

Duties of the Regulatory Authorities

Section 9 of the Electricity Regulation Act 1999 outlines the statutory duties of the Commission for Regulation of Utilities (CRU). One of these duties is to have regard to ensuring Security of Supply and ensuring that all reasonable demands for electricity are met. This modification is designed to protect the delivery of new capacity, particularly at a point in time when it is becoming increasingly difficult to ensure demands for electricity are satisfied. It is unclear how the rejection of this modification aligns with this duty. The decision to reject this modification would represent a position whereby new capacity could be terminated as a result of the failures of a third-party to exercise their functions in a timely manner.

Similarly, the objectives of the Utility Regulator of Northern Ireland (UREGNI) are set out in Article 36(a) to (h) of the Electricity Directive. In carrying out its function as a regulatory authority UREGNI must have regard to *“the need to secure that all reasonable demands in Northern Ireland or Ireland for electricity are met”*.

We believe that CMC_10_22 is aligned with both of these requirements, in that it secures the delivery of new capacity. Importantly however, it is only relevant where delays have occurred as a result of a third-party. This means that there is still risk and responsibility on the developer of new capacity but that they are protected from risks beyond their control.

Principle of Modification

We disagree with the SEMC’s minded to position on a basis of principle. We understand the need for a degree of risk exposure on developers of new capacity to ensure they carry out the delivery of projects in a timely and efficient manner. However, there are some aspects of project delivery that are simply beyond the control of developers. It is becoming increasingly frequent that these aspects, which cannot be remedied or mitigated by developers, are the bottlenecks which prevent new capacity from being delivered on time and may result in termination.

When a project qualifies for and competes in a capacity auction, the developers will have a comprehensive plan in place for the delivery of their project. For example, (with short notice auctions such as the T-3) under the current implementation of the CMC, it is possible that a participant may be awarded a capacity contract through the CRM and, immediately after receiving their contract, a TSO may provide them a connection date beyond the date at which the project is required to connect. This

is a fundamentally unfair outcome whereby a project may be delayed before any work on delivery has begun. This represents an outcome that the developer has no way of avoiding. It is reasonable to expect developers to build in some level of contingency in the delivery programmes and bid prices, to take account of risks to late delivery and contract erosion however, when the actual delays go well beyond what reasonably could have been counted for then there is a risk of termination that has a negative effect on not only the developer but on the market as a whole and ultimately the consumers.

The principle of flexibility of delivery was previously evident in the rules regarding Renewable Energy Feed-in Tariff (REFIT). Under Condition 9.6 and Condition 9.8 of REFIT 2 there was provision for an extension where issues arose outside of the control of the investor.

Feedback from other Stakeholders

EPUKI have reached out to a wide range of stakeholders for this modification, across the power industry, business groups and also large energy users. There has been near unanimous support for this modification. However, there have been some concerns raised in the workshop and the consultation, which we have responded to below.

With reference to paragraph 2.1.13 of the consultation, one participant was concerned that the modification could be deemed to be retrospective. We have received legal advice and are satisfied that the modification is robust and legally sound.

With reference to paragraph 2.1.8 of the consultation, Eirgrid stated that they shouldn't be considered a third party. We accept that with respect to the Capacity Market Code Eirgrid is not a third party however, in relation to the project, Eirgrid are very much a third party in their role as TSO. Eirgrid have no ownership or stake in the project and so are by definition a third party.

As noted in paragraph 2.1.12 of the consultation the RA's and the TSO's raised concerns about the potential of extended delays potentially three winters after the original contracted capacity year. This might occur if there was a Judicial Review of a licence or a planning permission. A Judicial Review is not the responsibility of the developer but could have the impact of delaying a project for a year or more. With this in mind EPUKI propose that where a project has been delayed (or will be delayed) for more than 12 months after the original long stop date, for reasons beyond the control of the developer, that the contract can be terminated at no loss to the developer.

The TSO have raised concerns that this modification may facilitate hoarding of capacity. There are a number of reasons why this is without foundation; i) The directed Connection Agreement cannot be reused for another auction (CRU19066), ii) a similar approach (where flexibility was granted to participants) was used for Renewable Energy Feed-in Tariff (REFIT) and which creates a precedence for the right to extend deadlines and iii) the RA's and TSO's are able to see the developer progress against the detailed implementation plan. However, we believe that the limit of an additional 12 months on top of the original Long Stop date should provide further comfort against this possibility.

The RA's raised a concern in the consultation about the additional responsibility that the RA's and TSO's would have to make judgements. What is required is to judge whether the timeline is correct for planning permission, gas connections or other similar third party activities. Planning Permission has a statutory timeline guideline and TSOs and RA's may wish to engage the services of expert consultants where they have any doubts.

An organisation not directly related to the power market mentioned the potential for a statutory delay in procuring an Environmental Licences, after researching this point we believe that this makes sense and that delays from all statutory bodies and relevant monopolies should be included in concept of the delay. In the appendix of this response, we have updated the proposed legal drafting to define both the prospective third parties and also what is an allowable delay.

A market participant suggested that all delays should be included. EPUKI believes that at this stage it is appropriate that only those delays caused by statutory bodies and relevant monopolies should be included.

Another participant highlighted that this is a question of fairness, investors should not be exposed due to delays that are completely outside of their control. At the time of qualification investors look to include appropriate contingency for events but should not be exposed to unreasonable third party delays.

Market participants are aware of the number of terminations of previously awarded capacity. It appears that statutory delays were a factor in a number of those terminations. There is the very real possibility that experienced developers will no longer see the SEM as a viable investment due to these delays.

Based on the above comments, in relation to this modification proposal all statutory bodies and relevant monopolies which affect the delivery of the project should be considered third parties, including the TSOs, the gas TSOs, the Environmental Agencies, planning authorities, statutory consultees and the regulators. Equally all third-party processes should be included. This includes any appeal or Judicial Review of a Planning Permission Grant or any other permission or licence.

We have updated the proposed Legal Drafting in the Appendix to reflect these changes.

Section 2 - Response to Issues Raised with Respect to SEMC Minded to Position

1. The SEMC identified a concern that the modification does not take account of any contingency built into the Implementation Plan.

As outlined above, there are instances whereby contingency (or lack thereof) has no bearing on whether or not a project is delivered on time. Currently the TSOs review the implementation plan and ensure that the plan is realistic. However, while a robust project should include adequate contingency for developers to deal with unexpected delays, there is no remedy for instances where a third party provides a completion date beyond the required delivery date. If a TSO provides a connection date which is significantly later than the required delivery date or Long-Stop Date, then no amount of contingency would be able to protect from a delay. In the particular case of the TSO there is further exposure as the TSO does not provide an estimate of the programme for the connection prior to a successful auction bid.

Implementation plans include an earliest and latest date against each milestone, however the problems occur when third parties fail to meet their statutory (or otherwise) timelines and other obligations. Whether through delays with statutory consultees in planning applications, delays to planning application processing timescales, legal challenges to a planning authorities process, failure of TSOs to provide connection offers in line with directions from an RA, etc. If, for instance, the statutory timeline for a planning authority to deal with a challenge or a regulatory directed timescale for delivering an electrical connection is exceeded it is unreasonable to expect any developer to include such contingency especially considering that these are risks all developers and projects face

and to include such contingencies would result in no new capacity successfully qualifying as none would be able to produce implementation plans that meet the capacity market deadlines.

2. The SEMC are concerned that removing penalties for capacity not being delivered in a timely fashion will result in overly optimistic Implementation Plans being submitted.

There are two issues with the above concern. Firstly, while we recognise the importance for penalties to incentivise timely delivery of capacity, it is unclear why developers should be penalised in instances where it can be demonstrated that the delay has arisen as a result of a third-party. There will remain sufficient incentive for project to deliver as timely as possible as developers will continue to be subject to the construction risk of any project where contractors are idle or stood down, as well as being subject to interest on loans and market inflation.

Secondly, it is not possible to have overly optimistic Implementation Plans approved. Currently, these plans are scrutinised by the TSO as part of the qualification process and in many instances Implementation Plans are rejected on the basis of being overly optimistic. Thus, introducing this modification would not result in an increase of optimistic Implementation Plans. Rather, it would protect developers in instances where a third-party has caused in a delay to project delivery.

3. The SEMC are concerned that the proposed modification has the potential to exacerbate situations where capacity which will not be delivered in time for the Capacity Year displaces capacity which could have been delivered on time.

The modification only seeks extension in instances where it can be demonstrated that a delay has occurred as a result of a third-party. The TSO has input into the qualification process and, for example, should be able to determine the likelihood of connection agreement in time for the relevant Capacity Year. The CRM Capacity Auction is a competitive process which should deliver the most efficient outcomes from the CRM.

If the TSO and Market Operator believe that a project cannot be delivered on time, then the TSO should engage with the developer and if not satisfied with the response reject the plan and the project will not qualify for the auction, therefore it will not be awarded a capacity contract over a more feasible project.

This modification will not affect instances whereby a project is delayed due to delays which the developer is responsible for.

4. The SEMC noted concern that this modification would require greater scrutiny of New Capacity applications at the time of Qualification by the System Operators.

We believe that this would be a positive outcome, particularly at a time when generation adequacy and Security of Supply concerns are highly prevalent. The System Operators have a significant weight of responsibility with respect to planning system adequacy and procurement of Capacity. If it is essential for the CRM to deliver New Capacity in the short-term to ensure Security of Supply on the island of Ireland, we believe it is imperative that the System Operators take time to assess and scrutinise applications to ensure the most effective and efficient outcomes.

Additionally, as stated before, an objective of the CMC is facilitating the efficient discharge of the System Operators' duties. The System Operator is best placed to assess capacity requirements in the SEM and as such, should be expected to scrutinise applications efficiently and effectively.

Finally, this modification is only intended to take effect in instances where a delay has occurred due to a third-party. In some instances this will be the result of a Judicial Review of Planning Permission

or other permission or licence. This is not a fault of the investor. The investor can only work off the statutory timeline for Planning with reasonable contingency possibly 20%. It is fair that the System Operator and the RA's use a similar mechanism.

5. The SEMC are concerned that the RAs would need to take a more robust view on the probability of timely delivery of Capacity.

As stated above, we believe that this trade off is warranted as a result of the current Security of Supply issues facing the SEM. Additionally, in many instances any third-party delays will have already been identified by the System Operators at the time of qualification and one would expect such projects to be filtered out at this time. As such, it is unclear to what extent the RAs would need to scrutinise such applications.

Conclusion

In summary, we oppose the SEM Committee's minded to position with respect to Mod CMC_10_22. We believe that this modification promotes more efficient outcomes for consumers and that the rejection of this modification would represent a contradiction to government policy, the duties of the Regulatory Authorities, the objectives of the CMC, and the ongoing review of the CRM.

Rejection of this modification is likely to lead to further terminations and extend the concerns regarding Security of Supply into the second half of this decade.

We would be happy to discuss this response with you at a bilateral meeting.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'K. Tubridy', with a stylized flourish at the end.

Kieran Tubridy

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EP UK Investments