



Kevin Lenaghan and Karen Shiels
Utility Regulator of Northern Ireland
Queens House
14 Queen Street
Belfast
BT1 6ED

127 Baggot Street Lower,
Dublin 2,
Ireland.

Kevin.Lenaghan@uregni.gov.uk
Karen.shiels@uregni.gov.uk

RE: EAI Response to SEM Consultation on the Capacity Remuneration Mechanism (CRM) T-4 Capacity Auction for 2022/23; Best New Entrant Net Cost of New Entrant (BNE NET CONE) (SEM-18-025)

Dear Kevin and Karen,

The members of the Association welcome the opportunity to respond to this important consultation, the outcome of which will have a significant influence on the security and reliability of the all island electricity system over the coming decades. The intent of the BNE NET CONE and the associated T-4 Capacity auctions is to ensure that the appropriate economic signal is given to generation in order to ensure a balance between the dual requirement of ensuring customers have a reliable electricity supply and that generators obtain a return on their investment that reflects the costs and risks they will face. In this context, we are concerned that the proposals outlined in this consultation are not realistic and are far removed from the realities and risks facing a rational investor in the evolving all island market. To assist in a robust and equitable decision and in line with the SEMC's request to provide quantifiable evidence, we have engaged Frontier Economics to conduct a thorough review of the principles and assumptions underlying the SEMC's proposals. The full report is enclosed alongside this cover letter.

We recognise that the RAs and market participants have a common purpose to ensure that Capacity auctions are conducted in a timely manner in order to facilitate an orderly entry and exit for generators, and provide the requisite lead time for new generation entering the market. Bearing this in mind, below we outline the key aspects of the consultation paper which EAI considers of critical importance to consider ahead of the decision paper. We request an urgent meeting with the RAs to discuss the more pertinent points below as a matter of urgency.

Choice of reference technology

Our members do not support the approach taken to the choice of reference technology. We are concerned that this approach will not deliver in a timely manner the investment required in the all island market. This is partly on the basis that our members cannot replicate the assumptions used to calculate cost inputs.

In addition, as the calculation of the BNE moves from a largely hypothetical exercise in SEM to being an intended actual reference plant in I-SEM, we are concerned that the intent of the SEMC to signal CCGT as the new entrant is divorced from the realities of the timeframes in which such plant can be delivered.

We therefore propose a revision to the approach, specifically, to reference Net CONE based on an average of candidate OCGT plants as a more realistic alternative to Poyry's proposal to take a subjective view on the winning provider of the technology in demand.

Calculation of Infra Marginal Rent(IMR) and DS3 Revenues

In addition to the aspects raised in relation to the calculation of the BNE inputs, the EAI has further concerns in relation to the assumptions on IMR and DS3 revenues. In particular, we note the expectation that IMR will rise in a linear manner over the time period. This fails to consider a range of variables, including the impact of new generators joining the system in the later years of the reference plant's life or the increasing penetration of renewables. In addition, EAI is concerned regarding the level of IMR from LOLE, which is subject to review as part of the CRM consultation paper. This could have a significant impact on the IMR for generators.

DS3 Revenues for CCGT plant have also been over-estimated because; for both reference technologies it is assumed that service provision is without additional cost, but it is unclear if the capital cost estimates include provision for the plant characteristics needed to supply enhanced DS3 products; DS3 estimates rely on average figures derived by Eirgrid for all existing CCGTs; and the proposals do not address interaction with energy market which may compete away revenues.

Weighted Average Cost of Capital(WACC)

The objective of the WACC calculation is to ensure that an investor receives sufficient remuneration for the financial risk associated with a given project. EAI notes that SEMC has proposed a WACC that is broadly reflective of risks associated with regulated entities. This approach is fundamentally flawed, as it fails to recognise the higher risk associated with investing in generation in I-SEM. This is exacerbated by flaws in assumptions associated with IMR and DS3 revenue which in turn heighten risk.

In addition, we are dismayed by the proposal from SEMC to set the WACC on the lower end of the range proposed by Poyry. This exacerbates the risk of underinvestment which in turn may jeopardise security of supply for consumers.

Conclusion

EAI is acutely aware of the desire of SEMC to conclude the decision on the CRM T-4 auction in a timely manner. It is equally essential that the calculation of the BNE is undertaken in a robust, replicable and market-tested manner which accurately reflects the true costs, risks and ability to deliver that generators face in the T-4 auctions.

We seek a meeting to discuss this response with a particular focus on the aspects raised in this letter at the earliest opportunity. We look forward to hearing from you.

Yours sincerely,



Stephen Douglas
Senior Advisor
Electricity Association of Ireland (EAI)