Integrated Single Electricity Market

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

Response from

Bord na Móna
Naturally Driven

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1 Context & Recommendations

Bord na Móna welcomes this opportunity to respond to this consultation.

We have highlighted in previous responses that for 'existing'[1], as well as 'new' providers of capacity, related capacity payments very much remain a key component of service remuneration, alongside energy and ancilliary service payments, as a key mechanism underpinning secure supply.

In this regard, we are particularly concerned about the consideration within the consultation to reduce the Existing Capacity Price Cap below its current value of 0.5 X CONE.

Our concern arises from the inappropriate proscribing of the provider to recover any financial recognition of their sunk costs should they be forced to make a USPC[2] exception application. It is taken as a given that a reduction in the ECPC will inevitably lead to an increase in the number of USPC applications.

The remuneration of sunk costs is a legitimately recognised and vital element of cost recovery in a competitive market. A change such as being considered is a radical change from an investor perspective in that it would represent a very significant and damaging retrospective change to the business investment model of existing plant.

We recognise how critically important it is for the RA's to ensure, at a most fundamental level, that there is a secure level of supply, and to ensure this supply, there needs to be a sufficient level of revenue certainty to financially support the supply base business model – be it for 'existing' or 'new' capacity providers. In this context, we would note the dynamic nature of increasing demand going forward driven by datacentres, electric vehicles, the electrification of heat, etc. As a commercial endeavour there needs to be an opportunity for the provider to make a normal financial return.

We also recognise that there is a system need for an increasingly efficient economic delivery to maximise social welfare, but we realise that that this needs to be achieved by following a path, ie., on an incremental basis so as to ensure 'security of supply' as priority on this transitional journey.

We fully understand and embrace that that new technologies, of which BnM will be a provider, will become more prevalent in the future, and our responses encompass this context.

A key point is that this journey will be a transition which prudence would suggest should involve a degree of caution and surety of foot on the part of the System Operators/Regulatory Authorities – which needs to reflect the equal relevance of both 'existing' as well as 'new' capacity providers.

Our most fundamental recommendation is to advocate a no regrets approach which allows a sustainable supply delivery model for both the System Operator and the Supplier/service Provider, while ensuring value to the consumer.

The proposal to reduce the ECPC to a value less than its current level of 0.5 x CONE totally contravenes this approach, and for more detailed reasons outlined within this submission we strongly recommend that it not be changed downwards. As we have highlighted, there is substantial rationale for it to be revised upwards, ie., for it to be increased.

[1] 'Existing' capacity taken to mean capacity which exists, which is required for energy and/or ancilliary services

[2] Unit Specific Price Cap

2 Response to Proposed Changes

Proposal 1: The SEM Committee propose to continue to set the Auction Price Cap at 1.5 times Net CONE.
No issue.

Proposal 2: 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.
BnM is totally opposed to consideration of any reduction in the ECPC from its current level of 0.5 x BNE in respect of any future auctions. In fact, we are fully aligned with the EAI[3] position which, in referring to its response to SEM-16-073, argues that the case for the value of ECPC being raised has been vindicated by events such as the unforeseen cost exposure to industry from a series of RO Difference Payment events to which Capacity Providers have been exposed, though no fault of their own.

There are other reasons which support its increase. 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 <u>not</u> 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 – <u>substantially supporting the case for the ECPC to be raised</u>.

At a more fundamental level the consideration to reduce the ECPC takes absolutely no account that those capacity providers which are forced to submit USPC[4] applications within the exception application route will thereby be precluded, within the USPC application rules, from recovering any financial recognition of their sunk costs, not to mention the rigorous cost and time based USPC process to which the applicant will be exposed, without compensation. As a commercial endeavour there needs to be an opportunity for the provider to make a normal financial return, as is the case when tariff setting under regulated arrangements. While we recognise that the purpose of 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. To do otherwise is totally inappropriate.

In a similar vein, we note that 'The rationale for originally setting the ECPC at 0.5 is that:'….. '*It is consistent with relevant international benchmarks*'. If this is the case, and if security of supply will inevitably be reduced, while also risking future investment decisions, then we objectively fail to see the balanced reason for any consideration of reduction.

The remuneration of sunk costs is a legitimately recognised and vital element of cost recovery. Such a change would be viewed negatively from an investor perspective in that it would represent a radical and damaging retrospective change to a 'standard' & respected business investment model.

The independent observer would have to ask 'why?' An independent observer might surmise that the reason for the Authorities considering the reduction reflects an improved capability to process the potential volume of USPC applications, rather than a market based approach, such as is supported under the relevant State Aid approval.

Apart from this, the paper itself highlights that the RAs have gained experience in handling USPC applications, which, of itself, clearly supports the position that <u>the ECPC is, in fact, too low</u>.

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[3] BnM, as a member of the EAI

[4] Unit Specific Price Cap

Furthermore, from the paper: '*It is important that the ECPC is not set at a level significantly above where the market is expected to clear in current market conditions*'. In this regard, we would highlight that the first T-1 auction cleared above the ECPC, the second one, just below. Whether the T-4 auction clears below the ECPC is largely immaterial – the principle of lack of sunk cost recovery is front and centre in taking priority with regard to i) security of supply, ii) normal commercial practices (and avoiding potentially totally unacceptable approaches with undetermined unintentional consequences from a loss in trust of the investment community).

We have outlined in section 1 above that a transitional journey is required, recognising the security of supply priority.

The proposal to reduce the ECPC to a value less than its current level of 0.5 x CONE totally contravenes this approach, and we strongly recommend that it not be changed.

Proposal 3: The SEM Committee propose to retain the NCIRT at €300/de-rated kW for the 2020/21 T-1 and 2021/22 T-2 auctions.
No issue.

Proposal 4: The SEM Committee propose to retain the Annual Stop-Loss Limit Factor at 1.5 for the 2020/21 T-1 and 2021/22 T-2 auctions.
No issue.

Proposal 5: The SEM Committee propose to retain the Billing Period Stop-Loss Limit Factor at 0.5 for the 2020/21 T-1 and 2021/22 T-2 auctions.
We see merit in further consideration of the implementation of daily or event-based stop-loss limits. SEM 16 022[5] Decision paper of May 2016 expressed that this decision will be kept under review. This could be another measure to contain 'event' exposure to providers against the type of events which occurred in October and January, in the main.

Proposal 6: The SEM Committee proposes to retain the following Increase and Decrease Tolerance levels for the 2020/21 T-1 and 2021/22 T-2 capacity auctions.

Technology Class	Increase Tolerance (%)	Decrease Tolerance (%)
All except DSUs	0	0
DSUs	0	100

We do not have an issue with the proposal, while recognising the provisions of note 2 within the paper, whereby under SEM-18-030, where satisfactory evidence is provided to the SOs, the decrease tolerance shall be 100% for a Candidate Unit that, due to relevant emissions legislation, has its running hours restricted to an extent that would reasonably be considered to prevent reliable delivery of their De-Rated Capacity at times of scarcity.

Proposal 7: The SEM Committee proposes to retain the Performance Securities from the 2022/23 T-4 Capacity Auction.
No issue.

Proposal 8: The SEM Committee proposes to retain the Termination Charges from the 2022/23 T-4 Capacity Auction.
No issue.

[5] SEM 16 022 ISEM CRM Detailed Design Decision Paper 2

Proposal 9: The SEM Committee proposes to retain the values for Full Administered Scarcity Price from the 2022/23 T-4 capacity auction for the 2020/21 T-1 and 2021/22 T-2 capacity auctions.
No issue.

Proposal 10: The SEM Committee proposes to retain these[6] values for the 2020/21 T-1 and 2021/22 T-2 capacity auctions.
No issue.

We hope that you find these comments of use and submit them for your consideration. We would be pleased of course to discuss any aspect of our responses should you so wish.

For and on behalf of Bord na Móna

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[6] Those illustrated on page 20 of the SEM-19-010 (the Consultation document)