Single Electricity Market
(SEM)

Call for evidence regarding the impact of inflation on delivery of new Capacity Market projects

SEM-22-071

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The proposed modification, Mod_07_22[1], to the Trading and Settlement Code was raised by Tynagh Energy on 2 June 2022, with a second version submitted on 25 August 2022 following an industry call. Mod_07_22 "Indexation to Calculation of Capacity Payments for New Capacity" seeks to include a term in the calculation of capacity payments to account for inflation. Mod_07_22 has not yet been voted on by the TSC modifications committee. However, the RAs have in parallel received correspondence directly from a number of market participants expressing their support for the modification proposal, and their view that exceptional rates of inflation over the last two years have created a risk to the delivery of new awarded capacity. The RAs have also received correspondence expressing concern in relation to this modification proposal insofar as it would apply to capacity contracts that have already been awarded.

The SEM Committee is very much aware that market participants are operating in a relatively high and volatile inflation environment, and that inflation is currently significantly higher than might have been envisaged by investors when they participated in the T-3 2024/25 and the T-4 2025/26 capacity auctions.

The SEM Committee also notes that the Government of Ireland has recently taken steps[2] to introduce construction inflation indexation provisions into certain Public Works procurement contracts, recognising the risk to delivery that certain infrastructure projects face.

Whilst the SEM Committee recognises the concerns of energy market participants with respect to the impact of inflation on projects successful in the T-3 2024/25 and T-4 2025/26 capacity auctions, the SEM Committee has not seen any reliable quantitative evidence to indicate how much of a developer's cost base is subject to inflation, how much inflation and for how long, how this maps against a developer's procurement timelines, and whether there is a materially different inflation exposure for different technologies.

For instance, for a unit developing a conventional OCGT or CCGT, the largest single component of construction-related cost during the build phase is likely to be the EPC contract. So:

- To what extent is the EPC contract price fixed at the time the contract is signed, and what determines how soon the contract can be signed? Once the contract is signed, what percentage of costs become fixed, and to what extent do construction-related costs continue to escalate until the build is complete, and why?
- To what extent do other capitalised costs per MW derated escalate in line with inflation during the build phase?
- To what extent, if any, do costs continue to escalate during the operational phase, and why?
- How, in detail, have unexpected rates of inflation impacted on the financial viability of projects to the extent that they pose a risk to delivery?

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[1] https://www.sem-o.com/documents/market-modifications/Mod_07_22/Mod_07_22-IndexationtoCalculationofCapacityPaymentsforNewCapacityv2.pdf

[2] Inflation/Supply Chain Co-operation Framework Agreement

Therefore, to inform decision making in this context, the SEM Committee is issuing this call for quantitative evidence on the level and impact of unexpected inflation on providers of new capacity, in particular in respect of the T-3 2024/25 and T-4 2025/26 capacity auctions.

Responses to this call for evidence should address the questions listed above and include any further supporting information available to demonstrate the risk to project delivery posed by rates of inflation since contract award.

Responses should be submitted to CRMSubmissions@uregni.gov.uk and CRMsubmissions@cru.ie by close of business on 26 October 2022.

All information received by the SEM Committee will be treated as confidential and commercially sensitive.