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Dear Kenny

Re: Possible Cancellation of Generating Unit Agreements in Northern Ireland.

Power NI welcomes the opportunity to respond to the recent consultation paper entitled 'Possible Cancellation of Generating Unit Agreements in Northern Ireland' published by the Utility Regulator (UR).

The assessment of the economic and policy features of the Generating Unit Agreements (GUAs) is a complex undertaking which requires significant detailed analysis and forecasting.

Economic Assessment

Power NI was somewhat surprised by the timing of the consultation undertaken by the UR.

The Regulatory Authorities are in the midst of managing a consultation process to implement the I-SEM requirements, which are likely to fundamentally change the operation and price outcomes of the wholesale market. The question of capacity remuneration is still to be answered in the future market design and a significant programme of work is underway in relation to ancillary services.

To account for these major future changes the UR appears to have made sweeping assumptions as to the economic outcomes. Such assumptions represent a significant risk to the assessment and undermine the findings. Given that within six months to a year, the UR will have a much clearer picture of the future characteristics of the market it appears that the UR is taking an unnecessary risk at this juncture.

In addition to the roll forward assumptions made in relation to the change from SEM to I-SEM and the outcomes of the capacity review and DS3 programme; the UR appears to have used a limited timeframe in assessing fuel, carbon and currency data. The UR has also made

assumptions in relation to the completion of the North/South Interconnector and the repair of the Moyle Interconnector; however no detail in relation to these assumptions is given in the paper.

Furthermore, the UR has not recognised the inherent credit cost benefits which PPB provides to Power NI. This element is an important consideration as via the regulated nature of Power NI the credit benefit provided by PPB facilitates an efficiency in the wholesale market which benefits the entire retail market in Northern Ireland i.e. the efficiency is realised in the end regulated tariff paid by circa 70% of domestic customers and referenced by all other suppliers.

The assumptions and their related risks coupled with the omissions, directly impact the UR's assessment of income which PPB can generate in the wholesale market. Power NI believes that given their nature, scope and materiality, no assurance can be taken from the economic assessment. Power NI also understands that there has been a lack of analysis of the nuances of the GUAs and that the cost benefit assessments of the contracts are also fundamentally flawed.

In consideration of all the issues in relation to the economic analysis therefore, Power NI does not believe that any conclusion can be reached.

Policy Considerations

In parallel to the economic assessment which relates to the UR's primary statutory obligation to protect consumers; the UR has considered a number of policy areas which relate to their financeability and efficiency obligations.

Power NI concurs with the UR's view in relation to security of supply, diversity and environmental sustainability.

In relation to the promotion of effective competition the UR has considered the implementation of the I-SEM, contract liquidity and market power.

The existence of the GUAs during the SEM design phase prompted the development of the 'intermediary' concept. This concept has been utilised widely by other mainly renewable participants as an effective, efficient route to market and will be considered an enduring design feature of the I-SEM. The GUAs have therefore not complicated market design but rather provided a means for flexibility and access to be provided to all participants.

Contract liquidity is the most important factor in setting regulated domestic and SME tariffs. In the current forwards market liquidity is extremely poor. This must be addressed in the I-SEM design. As the RAs have yet to conclude on a high level design of the I-SEM it is difficult to assess what impact the GUAs will have on liquidity. It is however important to recognise that via the GUAs the UR has an ability to direct liquidity to be provided to the market, this ability does not exist without the GUAs being in place.

The UR has correctly highlighted that the cancellation of the GUAs would give rise to market power concerns however Power NI believes that having the GUAs in place allows PPB to monitor and influence the activities of AES in line with the contractual obligations. This facilitates an enhanced form of market monitoring to be in place providing comfort to both the market and the UR.

Ensuring the financeability of licensees is also a statutory duty of the UR. Power NI is concerned that shortly after its price control was concluded the UR issued, without warning, a minded decision which undermines the basis of Power NI's price control determination. Collateral requirements were a fundamental element of the UR and its consultant's assessment

of Power NI. The collateral requirements used in the UR's calculation included the credit efficiency provided by PPB. The potential cancellation of the GUAs therefore impacts the financeability calculation and the results reached by the UR in Power NI's Price Control.

To consider such an action immediately after the conclusion of a price control is a clear illustration of the regulatory risk which Power NI argued exists in the market and the UR fails to recognise.

Conclusion

The assessment of the economic and policy features of the GUAs is a complex undertaking which requires significant detailed analysis and forecasting. The GUAs offer an effective risk mitigation option for customers i.e. if they are positive in monetary terms the benefit is recycled and if they are a cost to the consumer they can be cancelled. The cancellation can however only take place once and therefore careful, detailed consideration should be given and the UR must be as sure as reasonably possible that they will incur a cost before cancelling.

In its consideration the UR has assessed economic and policy issues. Power NI does not believe the policy issues support cancellation. In terms of economic analysis, given the high risk assumptions on the market side of the assessment and the flaws on the contract side; Power NI believes that the economic analysis is not sufficiently robust to enable a "minded to" decision to be reached.

Power NI urges the UR to revisit this area when more information about the future wholesale market is available and following a comprehensive review of the detail contained within the GUAs. This issue is of such importance to consumers it would be remiss not to complete all due diligence.

Timeliness of decision making is also important, particularly in respect of the forthcoming tariff setting and review process. Uncertainty deprives the market of critical CfD liquidity; therefore Power NI would urge UR to provide clarity regarding the most practical way forward, sooner rather than later, and ideally by mid June 2014.

Yours sincerely



William Steele
Power NI