

Priti Dave-Stack
The Commission for Energy Regulation,
The Exchange,
Belgard Square North,
Tallaght,
Dublin 24.

16th June 2009

Your reference: SEM-09-035

Dear Priti

Scope of CPM Medium Term Review

ESB is pleased to submit its response to this consultation and welcomes the medium term review of the CPM by the Regulatory Authorities. Below is a summary of the main points of our response followed by individual responses to the specific consultation points raised in the consultation paper.

Summary

The purpose of the CPM is to “provide the economic signals needed to ensure the maintenance of installed energy capacity, for the construction of new capacity as required, and for the participation of the demand side” as described in AIP-SEM-19-05. The review of the scheme should therefore ensure that these high level objectives are being, and will continue to be met. ESBPG consider that all aspects of the CPM, which may impact the ability of the scheme to meet its objectives, should be considered in the review. Central to this will be the distribution of payments, the treatment of wind generation and the overall size of the pot. We also consider that it is inappropriate that the reward for the provision of ancillary services be in any way linked with the CPM since the purpose of both revenue streams is to incentivise different requirements of the market. We would welcome the opportunity to discuss our response in greater detail with the RAs.

Response to Consultation Questions

Assessment of CPM in SEM:

Consultation Point 1: Comments and backup material in relation to any historical analysis they have carried out in relation to the CPM

ESBPG welcome the historical analysis that is being carried out by the RAs. It is important that the findings from such analysis are published on an on-going basis so as feedback from participants can be received. Ideally workshops should be held to disseminate the results.

Impact of SEM on Customers:

Consultation Point 2: Comments in relation to the impact of the CPM on consumers and the methodology for payments by suppliers

ESBPG welcome the fact that the impact of the CPM on consumers will be taken into account as part of the review.

Incentives for Generators:

Consultation Point 3: Comments in relation to incentives that could be introduced within the CPM or covered under the Ancillary Services mechanism

ESBPG agree with the RAs that with the increase in renewable generation on the island of Ireland, there has also been and will continue to be an increased requirement for more flexible plant on the system. However, we consider that the CPM is not the correct mechanism through which to address this. The examples given in the consultation document, e.g. fast start, high ramp rates etc., are all services which are required to ensure the safe operation of the system and should therefore be provided under the more appropriate heading of ancillary services. The objective of the CPM is about ensuring capacity adequacy. We are of the opinion that providing for these services out of the capacity pot would be diverting funds originally intended for a different purpose. An urgent review of the requirement and additional reward for provision of increased ancillary services in the SEM is needed however, to address this issue raised by the RAs.

Capacity Payments when Capacity is Needed:

Distribution of Capacity Payments:

Consultation Point 4: Comments in relation to the timing and distribution of capacity payments

ESBPG consider that it is important that both the timing and distribution of capacity payments be reviewed to ensure that the current rules meet the objectives of the CPM, as outlined in the CPM High Level Decision Paper (AIP-SEM-53-05), to “encourage short-term availability when required” and “encourage efficient maintenance scheduling”. We acknowledge that if the payments were more linked to pure capacity margins and LOLPs in each settlement period, that this would introduce some unpredictability into the market. However, the fact that 70% of the payment is being distributed without regard to the actual real time availability of generation is one issue which needs to be considered.

Capacity Requirement Calculation:

Consultation Point 5: Comments in relation to the capacity payments calculation and what parameters should be considered in the review

ESBPG welcome a review of this calculation and in particular welcome the introduction of more transparency with regard to its calculation. The calculation should be reproducible by market participants. Also, the calculation should ensure that generators make an adequate return in the SEM market.

WACC Methodology:

Consultation Point 6: Comments in relation to the calculation of WACC and the approaches that could be used in calculating the various WACC parameters

ESBPG consider that it is appropriate that the calculation of the WACC and associated parameters be reviewed, particularly in light of the current economic climate.

Inclusion of Infra Marginal Rent in CPM:

Consultation Point 7: Comments in relation to the impact of Infra Marginal Rent on the BNE Peaker

ESBPG consider that it is appropriate that the inclusion of infra marginal rent in the CPM be included in the review. The review should take into consideration the difficulties in predicting this figure to any kind of accuracy and the impact its inclusion has on the market uncertainty and risks to new entrants, taking into consideration that “efficient price signals for long term investments” and “reducing risk premium for investors” are core features of the CPM (AIP-SEM-53-05).

Impact of Exchange Rate in CPM:

Consultation Point 8: Comments in relation to impact of exchange rate fluctuations may have on the CPM

ESBPG welcome the inclusion of impact of exchange rate fluctuations have on the CPM in the review.

Treatment of Wind in SEM:

Consultation Point 9: Comments in relation to the Treatment of Wind within the CPM

ESBPG consider that it is appropriate that the treatment of wind in the CPM be reviewed at this time. The analysis carried out by the RAs in AIP-SEM-08-177 has given a lot of insight into this and further investigation is required. The capacity revenue received by all generators should reflect their contribution to generation adequacy in the long term and also their availability to meet demand at times of low capacity margin on the system.

Treatment of Interconnector in SEM:

Consultation Point 10: Comments in relation to the Interconnector treatment within the CPM

ESBPG consider that it is appropriate that the treatment of interconnectors in the CPM be reviewed at this time, especially taking into consideration the current body of work being carried out by the RAs on interconnector issues, and also in light of the fact that there is likely to be increased levels of interconnection with the UK over the coming years. The capacity revenue received by all generators, including interconnectors, should reflect their contribution to generation adequacy in the long term and also their availability to meet demand at times of low capacity margin on the system.

Relationship of CPM with Ancillary Services:

Consultation Point 11: Comments in relation to the relationship between the Ancillary Services and the CPM

The objectives of payments to generators for provision of ancillary services meet very different objectives to that of the CPM. Whereas the CPM is concerned with incentivising short term availability of plant and longer term efficient entry to the market, ancillary services deals with the provision of services necessary to operate the system. ESBPG therefore are of the opinion that the two issues are separate and should be treated as such. However, as mentioned earlier, a review of the arrangements and reward for ancillary services is also required as a matter of urgency given the changing mix of generation portfolio on the system and the increase in requirements for the provision of the services. This review would be in addition to the work stream looking purely at the harmonisation or rules between NI and ROI.

Impact of Diversity of Generation & Security of Supply:

ESBPG consider that the impact of diversity of generation on the security of supply should be taken into consideration in the review. Essential to the security of the system is the ability of generators to maintain their availability in the advent of an interruption to fuel supplies. Clearly generators with large reserves of stored fuels contribute more to the security of supply of the system when compared with generators with limited supplies of back-up fuels. This sentiment is evident in the ROI government's White Paper target of limiting generation from gas plant to 50% by 2020 and the recent decision by the RAs regarding secondary fuel obligations. Even though the core objective of the CPM is the security of the system, the role such generators play in the provision of this security is not factored in to any of the calculations or methodology.

ESBPG consider that the review should include the contribution generators with stored fuel capabilities and fuel diversity contribute to security of supply, with a view to including a mechanism for reward for such generators. The reward should reflect the contribution these generators make to system security and also the cost incurred by generators for the provision of this service.

Other Aspects of CPM:

Consultation Point 12: Comments in relation to any other aspects of the CPM that should be included in the scope of the Medium Term Review

- In the review of the CPM regard should be taken as to the ability of existing generators to make an adequate return in the market under existing rules. Analysis should be carried out by the RAs to establish if changed CPM would provide existing generators with sufficient incentives to stay in the market. One of the original purposes of the CPM was to “provide economic signals needed to ensure the maintenance of installed energy capacity” (AIP-SEM-19-05). However, the CPM methodology to date has been about ensuring the return of a BNE. With high levels of wind generation penetration in the market, existing conventional generators are experiencing much reduced running in the unconstrained schedule. Their energy revenue streams, including rent, are therefore being much reduced and a greater dependency on capacity income has resulted. Since these existing generators, as well as new capacity, are needed on the system in order to ensure generation adequacy, regard should be taken to their overall profitability in the SEM.
- ESBPG are aware of other work streams, e.g. Scheduling & Dispatch, which the RAs are also currently working on. We consider that a lot of the issues being dealt with in these reviews cannot be looked at in isolation and need to be considered together. We therefore request that a more holistic and integrated approach is taken by the RAs.

If you have any questions or would like to discuss any of the matters raised further please do not hesitate to contact me.

Yours sincerely,

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