



Electricity Supply Board

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CONSULTATION PAPER
SEM Scope of CPM Medium Term Review Consultation Paper SEM-09-035

Dear Kevin/Priti,

ESB Customer Supply (ESBCS) is pleased to be able to respond to this consultation on the Capacity Payments Mechanism (CPM). The Capacity Payments are important primarily to ensure that there is a financial signal to support adequate generation and security of supply. As a consequence, they form a significantly large part of the cost of electricity, making it particularly important that they reflect good value for customers.

ESBCS supports the concept of having a Capacity Payment so that the spot price of energy is less volatile on an hourly basis. However, volatility can also occur in average costs over a complete year, as well as in the hourly value. The volatility since Market Opening, in November 2007, has been at an unexpectedly high level. In the space of two years and two months it has increased by 42%. The reasons for this need to be examined and re-evaluated in the light of their impact on annual volatility and on the value for money for customers. ESBCS has already responded to the consultation on the annual volatility of the Capacity Payments and is seeking to reduce this volatility while preserving value for money for customers.

There are some notable positive features of the current system which incentivise generators to provide security of supply using economically efficient price signals. These include:

1. Having a Capacity mechanism in itself allows generators to have a reliable income for their fixed costs while recovering their variable costs in the energy pool. This has produced a very significant reduction in volatility.
2. Benchmarking the level of availability to that achieved by the better plants in the market ensures improved value for customers, and rewards improved performance by generators. Conversely, if the benchmark availability was set to actual availability, then there would be a perverse incentive for generators to under-perform and thereby increase their income.
3. Reflecting Pool income and Ancillary Services income in the total calculation avoids double-payments. It is also our view that current plans for Harmonised Ancillary Services are used when calculating any Ancillary Services income.
4. The monthly Capacity pots are set based on forecast demand. This allows generators to plan outages which will occur at the times of lowest demand. This enhances security of supply by taking advantage of the lower customer demand during summer months.

We support these key features being retained, even if they are modified in the details of their application.

Our response below is framed around the twelve consultation points raised in the paper.

Consultation Point 1: The RAs welcome comments and backup material from participants in relation to any historical analysis they have carried out in relation to the CPM.

ESBCS has no comment to make on this point.

Consultation Point 2: The RAs welcome comments from participants in relation to the impact of the CPM on consumers and the methodology for payments by suppliers

The profile for half-hourly weighting should match the payments to generators so that the cost to suppliers reflects the payments to generators. This will create a more cost reflective signal for demand users. Generators use a different profile to suppliers and include a more realistic mix of ex-ante and ex-post Capacity signals. Currently the profile used for supplier payments is based on a half-hourly profile set in advance in each year. This profile is then scaled up or down to match the supplier capacity payments total amount. Instead of using this ex-ante profile we recommend using the same final half-hourly profile used by generators and then scaling this profile to match the supplier capacity payment total amount.

Consultation Point 3: The RAs welcome comments from participants in relation to incentives that could be introduced within the Capacity Payment Mechanism or covered under the Ancillary Services Mechanism.

The additional complexity of evaluating any benefits from flexible capacity would need to be balanced against the benefits. Until this is provided we have no reason to change the current system. Any such changes would need to be co-ordinated with the proposed Harmonised Ancillary Services.

Consultation Point 4: The RAs welcome comments from participants in relation to the timing and distribution of Capacity Payments as described in Sections 6.4 and 6.5.

The current schedule of 12 monthly pots is satisfactory and should not change. Setting the monthly pots based on ex-ante forecast demand will incentivise generators to take outages when demand is at its lowest. There is a natural opportunity for generators to take outages during the summer months when demand is at its lowest. However the effect of this is that the amount of spare capacity is evened out throughout the year, between the high demand in winter and the generation outages in summer. If the capacity pots are determined based on historic capacity margin (or Loss of Load Probability) there could be a perverse signal sent to generators.

Consultation Point 5: The RAs welcome comments from participants in relation to the Capacity Requirement Calculation and what parameters should be considered in the review.

ESBCS has no comment to make on this point.

Consultation Point 6: The RAs welcome comments from participants in relation to the calculation of WACC and the approaches that could be used in calculating the various WACC parameters.

The RA's outlined in significant detail the determination of the WACC parameters in the 2009 BNE consultation and decision paper. They also state in the consultation that they will review the methodology again with a view to ensure the approach is transparent and that the assumptions made are clearly understood. ESBCS has nothing further to add at the moment.

Consultation Point 7: The RAs welcome comments from participants in relation to impact of Infra Marginal Rent on the BNE Peaker.

ESBCS has no comment to make on this point.

Consultation Point 8: The RAs welcome comments from participants in relation to impact of exchange rate fluctuations may have on the CPM

ESBCS has no exchange rate issues regarding the CPM.

Consultation Point 9: The RAs welcome comments from participants in relation to the Treatment of Wind within the CPM.

ESBCS has no comment to make on this point.

Consultation Point 10: The RAs welcome comments from participants in relation to the Interconnector treatment within the CPM.

ESBCS has no comment to make on this point.

Consultation Point 11: The RAs welcome comments from participants in relation to the relationship between the Ancillary Services and the CPM.

ESBCS agrees that close liaison with the Ancillary Services Harmonisation workstream is required.

Consultation Point 12: The RAs welcome comments from participants in relation to any other aspects of the CPM that should be included in the scope of the Medium Term Review

The primary purpose of the Capacity Payments is to ensure that security of supply is provided without undue volatility. This will theoretically be provided by the current “Best New Entrant” and capacity requirement. However the wider issue of revenue adequacy needs to be considered to ensure that the theoretical model behind the Capacity Payments is still valid and appropriate.

If you require any clarification on any of the points raised above please do not hesitate to contact me.

Yours sincerely,

Gerry McDonald,
ESB Customer Supply