

the voice of irish business and employers



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Re: Single Electricity Market Scope of CPM Medium Term Review, 8 April 2009 (SEM-09-035)

Dear Kevin and Priti,

The IBEC Energy Providers Working Group (EPWG) welcomes the opportunity to respond to the aforementioned consultation. The capacity payment mechanism is a fundamental feature of the SEM design and plays a key role in both providing revenues to cover capital and fixed costs not covered by payments for energy and in signalling the timely entry of new generation capacity onto the system as it is required. The EPWG has been consistently supportive of the need for a Capacity Payment Mechanism (CPM) since 2004. Please find attached comments that we hope prove constructive to the consultative process:

1. Price Stability and Simplicity

The consultation notes these objectives as criteria in the decision making process of the CPM. However, the medium term review does not explicitly address volatility, which has long been identified by market participants and this group as a concern in trying to finance investments. Our group has been engaged in constructive dialogue around the annual capacity payment methodology with the Regulatory Authorities (RAs) since 24 July 2007.

The Capacity Payment Mechanism (CPM) should be predictable enough to give certainty to the market on the costs (suppliers) and revenue streams (generators). This is not achieved under the current mechanism as the pot is calculated annually and has been subject to regular changes by the regulatory authorities. The EPWG suggest that the timeframe for calculating the pot (and therefore the BNE fixed costs) should be fixed in

the medium term (to match the typical tenor for financing arrangements). This would provide added surety to participants and potential new entrants.

2. Flexibility:

The objective of the CPM is to incentivise efficient investment and the availability of generation to provide security of supply. We note the recognition by the RAs of the importance of generator flexibility but suggest that the incentivising these services are best achieved through the ancillary services mechanisms. We suggest that ancillary service payments may be a more targeted and transparent mechanism to deliver improved generator flexibility and should be considered in the review. Ancillary service payments shouldn't vary with demand like CPM, giving added certainty to investment in flexible technology.

3. Fairness:

If the CPM discriminates between the different types of generation, it will be very difficult to fairly assess the differences between technologies and the potential for regulatory interference will significantly increase. On this basis we suggest that there should be no difference in the capacity payments to wind or conventional plant i.e. all generation should receive capacity payments to reflect their contribution to generation adequacy and security of supply in the long term and also their availability to meet demand at times of low capacity margin on the system.

4. Transparency:

The setting of the capacity requirement needs significantly improved transparency with a set of credible assumptions to be used in the calculation. For example, the assumption that generator availability is set based on unachievable levels rather than historical averages is not credible due to the age profile of the units in the current portfolio. This issue could be addressed through greater transparency in the calculation, greater communication with investors entering the market and a longer timeframe for the duration of the capacity pot calculation.

5. BNE:

The technology selected for BNE determination should be consistent with Ireland's 2020 targets for decreasing emissions and increasing energy efficiency. Irish legislation strongly encourages CER to issue authorisations to construct for dual-fuelled plant¹. However, the BNE selected for 2009 was not dual-fuelled. When selecting the BNE, the RAs should incentivise the right type of investment to support the Irish system. Only dual fuel units, or renewable energy sources, will support security of supply in the event of a national / international oil or gas interruption.

¹Electricity Regulation Act 1999 (Criteria for Determination of Authorisations) Order 1999 (S.I. 309 of 1999, Section 2 g)

Therefore, in addition, to the construction costs of a generator the costs of storage of the secondary fuel must be taken into account when considering the BNE calculation.

Infra-marginal rent and ancillary service payments should not be included in the BNE fixed costs. The BNE will be the marginal plant in times of sufficient capacity and will not receive infra-marginal rents. Infra-marginal rents will only be earned in times of scarce capacity – it would be a perverse signal to reduce capacity payments in times of scarcity when capacity and investment is most need on the system. Likewise, ancillary service agreements are entered into bi-laterally with the TSO and are not guaranteed revenues for a peaking plant, therefore ancillary payments should not be included in the calculation.

6. Demand Side Management:

To coincide with the National Energy Efficiency Action Plan 2009-2020 the CPM could be examined as a ‘demand-side-management’ tool for suppliers. However, this may be administratively complex and would require further analysis by the market operator before a decision regarding its appropriateness could be reasonably made.

7. Medium-term review in context of a long-term strategy

In order for the outcome of medium-term review to be meaningful, we need to have a long-term strategy for the SEM.

The SEM has a number of different elements that must fit together in order for the market to work. In limiting the medium-term review to the CPM, there is a risk that other elements might not fit together as they should. We suggest that the RAs should take a holistic look at the market. As such, the medium-term review should be of the entire market and the steps we need to take to reach the long-term goals.

This will require that a long-term strategy is developed. The RAs, in consultation with market participants, must develop a long-term strategy to facilitate the move to a regional market. Any medium-term review must be taken in the context of the long-term strategy.

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As always, the IBEC EPWG is committed to working alongside the Regulatory Authorities to deliver a stable and competitive electricity market in Ireland. We would welcome the opportunity to further explore the contents of this letter and invite you to contact Erik.ODonovan@ibec.ie tel. 01-605 1672 to organise a meeting.

Kind regards

A handwritten signature in blue ink, appearing to read 'G. Blaney'. The signature is fluid and cursive, with a long horizontal stroke at the end.

Garrett Blaney
Chairman
Energy Providers Working Group, IBEC