Bord Gáis Energy
think beyond

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The Commission for Energy Regulation
The Exchange
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Dear Clive, Jody

RE: CPM Medium Term Review Discussion Paper

The Regulatory Authorities (RAs) latest consultation on the Capacity Payment Mechanism (CPM) which takes a historical view of the mechanism and how it has been distributed is very helpful and sets a useful back-drop for the upcoming wider consultation on the CPM.

As this consultation was initially flagged to industry as a 'historical review information paper' Bord Gáis Energy (BG Energy) was surprised to see proposals and proposed decisions related to the calculation of infra-marginal rents (IMR), fuel options and exchange rates. Particularly, the RAs proposals around the IMR were, in BG Energy's view, premature and would more appropriately sit within the RAs upcoming consultation and wider medium-term review of the CPM.

In setting out the rationale for the IMR proposals the RAs assume a market in equilibrium where there is one marginal plant meeting the last MW of load and 8 hours of lost load per annum. However, investors do not make investment decisions in a 'theoretical world' and in reality these assumptions do not reflect the real market environment faced by investors. The CPM was established to provide investment signals and a degree of certainty to investors such that they would provide the right type and volume of capacity to the market. Therefore, in reality there are no instances of lost load in the Single Electricity Market (SEM) and an investor will not forecast rents from 8 hours at the market price cap during the year.

To this end, the "equilibrium state", which the RAs are using to model the market, does not reflect the market realities faced by investors. To account for this discrepancy and uncertainty as well as the reduction in the capacity pot, investors will set a higher risk premium when assessing investment decisions. This in turn will increase the cost of investing in the SEM and contradict the signal intended to be given through the CPM.

In terms of signalling investments, BG Energy is of the view that it will act to incentivise investment in the wrong type of plant for the market. As you are in no doubt aware, regulatory certainty is of vital importance to investors. Although BG Energy can appreciate that this proposal is premised on delivering certainty year-on-year to the market, the actual rationale is flawed and the outcome is contradictory. The real outcome of this proposal is to reduce the capacity pot by approximately 9%, which in turn has implications for investment costs and the type of plant incentivised into the SEM. As stated previously, this type of ad-hoc decision adds risks for investors, who will in future apply higher risk premiums to any investment cases related to the SEM.

Also, in reducing the pot, the signal to investors is to procure cheap, second rate plant. For the security of the system, especially considering the expected wind generation levels in future years, the CPM needs to ensure that the plant competing for availability payments are at the standard of a reasonable and prudent operator as per industry standards. Reducing the pot under the auspices of providing certainty will actually increase risks for investors and also potentially jeopardises the security of the system.

Also related to this point of certainty and security, the RAs propose to set an aggressive forced outage probability (FOP) of 4.23%. This firm target is premised on the basis that it will incentivise improvements in plant availability, yet the RAs are also considering a reduction in the revenues of those investors charged with meeting those targets. Effectively, the RAs are on one hand setting an aggressive standard to ensure load is met, yet on the other hand they are reducing the revenues earned by parties that must invest, operate and maintain plant to meet that standard and load. Again, this has implications for the security of the system as it may result in a capacity shortfall due to an understated capacity requirement which excludes reserve, transmission constraints and an unachievable FOP. It also highlights the contradictions in the RAs proposals and their ability to meet their designed objectives and the objectives of the CPM.

In summary, BG Energy does not believe that it is appropriate to model and assume a theoretical world without being cognisant of market realities and how investors in the SEM actually make investment and operational decisions. BG Energy and other market participants have observed significant uncertainty in the recent past related to decisions on a generator carbon levy and transmission loss adjustment factors (TLAFs). Any further changes to the market, which will reduce the revenues of investors, will create greater uncertainty risk and damage to the credibility of the market and the investment environment. On this basis, BG Energy advocates that the RAs do not change the current methodology of calculating the CPM and specifically the IMR at this time.

Yours sincerely,

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