ESB PG Response to SEM/11/019
CPM Medium Term Review Work Package 6 Onwards

ESB PG is pleased to submit its response to this consultation on the 4 remaining work packages for the CPM Medium Term Review.

General Comments:
There is significant uncertainty regarding the future market structure of SEM and the CPM arising from the required compliance with the Third Package and resulting Framework Guidelines and Network Codes. Given this uncertainty, ESB PG is of the opinion that significant change to the CPM is not warranted at this time and does not advocate wholesale changes to a mechanism which, notwithstanding volatility, works reasonably well.

In terms of the 5 proposed models, ESB PG has the following general comments to make prior to responding to the detailed questions contained within the paper.

The **Capacity Credit Scenario** and the **Rebalancing Scenario** are preferred as they both incorporate improvements, without radically changing a mechanism which, notwithstanding volatility, works reasonably well. Were it not for the uncertainty regarding the future viability of SEM and the CPM due to European legislation, ESB PG would marginally prefer the Capacity Credit Scenario. ESB PG is of the view that Capacity Credits are an appropriate and economically rational method of allocating the correct value to generators for their contribution to system adequacy. ESB PG does recognise however that move towards the Capacity Credits may represent too significant a change from the existing mechanism and prove particularly divisive in the industry. Unless there is clarity regarding the remaining life-span of the CPM, this may represent too significant a change for what is, potentially, too short a period.

As a result, ESB PG's preferred scenario is the **Rebalancing Scenario.** Changing of the existing technical parameters is a delicate balancing act of conflicting objectives of efficient price signals, price stability, capacity adequacy/reliability and behavioural incentivisation. It is ESB PG's position that changing the payment weighting to 50:50 ex-ante/ex-post would be an improvement in that it rewards plant which is available when required while also giving forward signals to encourage plant to be available in times of expected tight margin. ESB PG is conscious however that this change could have a negative impact on the financial viability of intermittent generation sources, and in particular, wind farms. ESB PG recognises that Government renewable energy policy, including for example, commitments under the NREAP necessarily requires to incentivise renewable generation (primarily wind) onto the transmission system. As such, any rebalancing of capacity payments should be accompanied by commensurate increases to the existing support mechanisms for wind to ensure that overall policy objectives are not undermined.

Any form of the **New Entrant Scenario** would not be supported by ESBPG on the grounds of that it is not appropriate to differentiate between new and existing plant as it would be against the fairness objective of the CPM as defined in SEM-53-05. ESBPG believes that the technical ability of the plant to deliver the contracted services should be the basis for any incentivisation and age should not be a factor in this decision. Therefore performance measures to ensure the CPM is delivering for the consumer on its stated objectives is warranted and that such an approach would be preferable to the New Entrant Scenario. Over incentivising additional new entry may lead to inefficient and expensive market entry if new entry is encouraged at a price over and above that which can be provided by existing plants. In contrast, an appropriate performance management regime would ensure that if some of the existing generators were not performing, the remaining, more reliable generators will receive greater income and the new investor would see this signal and respond only if there is a 'real' adequacy problem. In addition, continually non-performing plant, would effectively see an exit signal through reduced payments.

ESBPG agrees with the RAs that the payments for flexibility and capacity are separate issues and should be treated separately and for this reason do not support the **Payments for Flexibility Scenario**.
Under the current mechanism, any increase in the Ancillary Services payments triggers an automatic reduction in the CPM payment through the annual BNE process. ESB PG does not believe that this is appropriate and that the two mechanisms should be separate and have already responded on this matter in an earlier CPM work package consultation.
In addition, ESB PG is of the view that current payments for flexibility are wholly inadequate and are unlikely to sufficiently incentive generators to invest in technological changes to provide the services that the system will inevitably require with significant penetration of wind. ESB PG would welcome timely progress in this area from the TSOs and the RAs around the range of services required and the payment mechanisms for same so that the industry has sufficient time to make the necessary investments.

ESB PG is not in favour of the **SOCAP model** for a number of reasons, not least because it is complex, requires significant changes to T&S Code with associated risks and would be costly and time consuming to implement. Implementing this scenario would have significant negative impact on the smaller players in the market who may find the risk too great in relation to both the volatility in the timing and amounts of the payments. In addition, the fact that payments are likely to be very uncertain, given that it is 100% ex-post it will impose an additional financing cost on new investment, thus deterring entry.

Specific Comments:
ESB PG's comments to the specific questions raised by the RAs are provided below:

Work Package 6: Treatment of generator types in CPM

Should the RAs look more closely at a capacity credit scenario for the payment of generation types?
Is the capacity credit methodology appropriate for the CPM?

ESBPG is of the view that Capacity Credits for generator types is an appropriate and economically rational method of allocating the correct value to generators for their contribution to system adequacy. However, it is acknowledged that the method of allocating the capacity credits could be problematic, creating significant disruption in the industry in a manner similar to the TLAF debate unless it is robust and transparent and not subject to frequent change.

Does the current mechanism fairly reward wind or does it need to be revised?
Should there be a separate stream of capacity payments for wind?
The RAs welcome alternative suggestions for allocating capacity payments between generator types.

While wind energy makes a contribution to system capacity, due to its volatility it may not be there at times of greatest need and ESB PG would broadly agree with Poyry's assessment that in the current mechanism it is somewhat over-rewarded. It is ESB PG's view that the Rebalancing scenario also addresses this issue relatively well.

As a general principle, ESB PG does not favour the idea of separate streams of capacity payments and it would be a contentious exercise determining each capacity pot. If the capacity credit scenario/re-balancing scenario was used there would be no need for a separate stream of capacity payments for wind.

Should interconnector user's payments and charges be treated differently than under current methodology?
The RAs welcome alternative suggestions for allocating capacity payments between ICs/IC users

ESB PG believes the existing regime is an appropriate (albeit imperfect) means of attempting to ensure coupling of SEM and BETTA markets without creating additional seams issues between the two markets. Payments should be made to the users and not the IC owners as to do otherwise would create perverse incentives and lead to inefficient flows on the ICs.

Should energy limited plant and pumped storage units be treated differently to the current methodology in the CPM

Under the current market rules, Hydroelectric plant and Pumped Storage are treated in a manner which both allows the TSO optimum control for dispatch and at the same time rewards the plants themselves for the predictable energy they provide. The issue is that while these plants are energy limited, they are always predictable and controllable and thus have a greater contribution to system capacity than other variable plants and this is not rewarded under in the current capacity market. However, rather than change the existing T&S Code rules, ESB PG believes this can be addressed in a more global manner with a change in weighting to 50:50 ex-ante/ex post and/or adoption of capacity credits.

Work Package 8: Incentives for Generators

The CPM and AS revenue payment streams have two separate objectives and it is the RAs view that these should remain separate. Should the CPM offer payments for flexibility?

ESBPG agrees with the RAs that the payments for flexibility and capacity are separate issues and should be treated separately. Under the current mechanism, any increase in the Ancillary Services payments for BNE plant triggers an automatic reduction in the CPM pot. ESB PG does not believe that this is appropriate and that the two revenue streams each have separate independent objectives, and should be reimbursed separately and independently and have already responded on this to an earlier CPM work package.

Do the respondents agree with the SEM committee, that an appropriate mechanism for penalising generators for not providing capacity when they have declared they would, would increase the incentive to encourage the availability of generators when actually needed?
Do respondents believe that the CDP arrangement as described would fit the SEM CPM design?
What would an appeals process involve/include?
How should the proceeds from penalties be distributed?

While not in favour of introducing additional excessive penalties into the market, ESB PG acknowledges that it is reasonable that where payments are made for service provision, then for lack of provision of the service, payments should be recouped. It is appropriate that plants which are not normally dispatched are periodically tested. The fairest method would be explicitly penalising for each event where there was a failure. This could involve explicitly recouping some of the payments previously made or a change to the capacity credit of that plant.

Care needs to be taken in designing the system so that the size of the penalty would not unduly discriminate against either smaller generators or send incorrect signals to the market

in terms of investment decisions. For this reason a 3 month penalty as suggested in the consultation paper would seem excessive and create an inordinate level of risk. If the system is designed in a measured and transparent manner, there should be little need for appeals but any appeals should be decided on in the final instance by the RA's. The proceeds from any penalties should be distributed to the generators who provided capacity during the periods in question. This is because any payments which have been recouped from generators should by right not have been paid at all and were paid at the expense of other generators on the system.

Should new entrants be treated differently to the existing generators in the CPM?
The RAs welcome comments on the feasibility of introducing a new entrant guarantee

Any form of the **New Entrant Scenario** would not be supported by ESBPG on the grounds that it is not appropriate to differentiate between new and existing plant as it would be against the fairness objective of the CPM as defined in SEM-53-05. ESBPG believes that the technical ability of the plant to reliably and verifiably deliver the contracted services should be the basis for any incentivisation and age should not be a factor in this decision. Incentivising additional new entry may lead to inefficient and expensive market entry if new entry is encouraged at a price over and above that which can be provided by existing plants. ESB PG recognises however, that an appropriate performance management regime involving the existing plant does have a function in ensuring the existing CPM is delivering for the consumer on its stated objectives and that such an approach would be preferable. If some of the existing generators were not performing, the remaining, more reliable generators will receive greater income and the new investor would see this signal and respond.

Work Package 9: Timing and Distribution of capacity Payments

The RAs welcome comment on (a) Should the design of the distribution allocations be changed (b) the weighting of the three components (c) should the current values be maintained (d) new ideas on the distribution allocation

ESBPG believes that a move to a 50:50 ex-ante/ex-post weighting is a better allocation of the capacity taking into account the conflicting objectives.

Should an FPF be applied within the CPM?
Should the current value be maintained or changed?
If the mechanism moves to a heavier weighted ex-post payment will the FPF be as effective?

Again ESBPG believes that a move towards an FPF of 0.5 is a better compromise of the conflicting objectives as part of the Re-Balancing Scenario.

The RAs welcome comment on the feasibility of introducing a SOCAP model.
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- the concept that the SO's would "push money around" and signal the need for capacity within year
- the value to the system of more explicitly incentivising capacity providers to make sure they will be available when needed most,
- whether a floor, set high enough, is a sound tool for delivering revenue stability and lowering the cost of capital, and if not, why not?
- the implications for cash flow and credit for participants and operators.

The RA's welcome alternative suggestions for allocating an effective distribution and timing payments system.

ESB PG is not in favour of the **SOCAP model.** It is complex, requires significant changes to T&S Code with associated risks and would be costly and time consuming to implement. It is ESB PG's belief that insufficient description of the model has been provided to allow participants to fully analyse its impacts and were it to be considered further a more detailed description and further consultation on same would be required. It is also particularly unfavourable to the smaller players in the markets who may find the risk too great in relation to both the volatility in the timing and amounts of the payments and also the fact that it is 100% ex-post. This model has the potential to be deemed susceptible to gaming and thus leading to increased market monitoring costs. It does not deliver a demonstrably improved solution for CPM and thus does not warrant further investment or discussion.

Work Package 10: Impact of CPM on Suppliers

The RAs welcome comments from respondents/suppliers on options for shaping supplier capacity charges, in the context of the existing design and in the context of other capacity payment proposals in this document

In the current mechanism, the supplier changes broadly follow the same curve as the generator payments but are not equal. In an ideal world with real time metering data, both the charges and the payments would be equivalent and this would be used to improve efficiency and demand management. However, currently this is not possible with installed technology and thus ESB PG recommends leaving the existing algebra as is.