Capacity Payments Medium Term Review
Work Package 6 onwards
Discussion Paper
SEM/11/019

Overview:

NEAI welcomes the opportunity to respond to this discussion paper. Our membership[1] covers a broad cross-section of the generation and supply portfolio on the island of Ireland.

NEAI members support the concept of a capacity payments mechanism and believe it has assisted thus far to encourage new investment and reward the availability of existing investments. Our members believe the CPM medium term review may have been appropriate when it was initiated. However, the landscape has changed dramatically since the review began two years ago, which could not have been predicted by the Regulatory Authorities.

In addition to the changes in the investment environment, the legislative environment for energy is undergoing significant change. Ireland and Northern Ireland must comply with the Third Package and the emerging European Framework Guidelines and Network Codes. Given the significance of these changes and this uncertainty, the NEAI would not support any substantive changes to the CPM, pending decisions on the regional target model and the Network Codes, particularly as the existing mechanism is deemed to be working reasonably well and should continue to do so, given the revised medium-term projections of installed wind-capacity.

We note that the European Electricity Target Model has not yet been designed or properly defined. NEAI members therefore consider it would be more appropriate to devote resources to understanding the target model and the implications thereof before contemplating significant overhaul of the SEM, including in particular, the CPM.

Notwithstanding this position on the medium term market evolution, NEAI members see significant scope for improvement to the current mechanism, however these largely relate to the annual calculation of the pot and the input assumptions/conditions used in the calculation. NEAI members share the view that a stable and transparent regulatory framework is essential, particularly given the wider economic uncertainty faced by investors and customers. The CPM is a core element in providing this stability and therefore should be as transparent, stable and predictable as possible when delivering its primary objectives.

[1] [1] Members include; ESB, Viridian Power & Energy, Bord Gais Eireann, AES Corporation, Tynagh Energy, SSE Renewables, Endesa Ireland, Bord na Mona, Synergen Power, Coolkeeragh ESB, Hibernian Windpower, ESB Networks and NIE T&D

The CPM must also be verifiable and be cognisant of the environment in which it functions. For example, and as stated in the NEAI Response to the recent BNE 2012 consultation, the BNE should be reflective of the all-island market environment. Specifically, the risk free rate for an investment in NI should reflect (to a significant extent) the risk free rate of the island, which includes the ROI as a significant source of revenues. This must be reflected in the BNE for 2012. Unrealistic assumptions such as the risk-free rate, the debt premium, and equity risk premium will undermine the credibility of the capacity mechanism and so must be addressed in the BNE for 2012 decision. NEAI has responded separately on this issue but given its importance to the credibility of the CPM, it is worth reiterating at this juncture.

With regards the most recent consultation on the medium term review, our specific concerns relate to the following points:

No differentiation between wind and thermal generation

Capacity payments should be made to parties on the basis of their contribution towards key objectives, i.e. contribution towards system adequacy (in the longer term) and availability (in the shorter term). There is no prima facia rationale to pay some parties more than others for the same service. Differentiation in payments should only be determined on the basis of availability and remuneration for other services (e.g. flexibility) should be remunerated separately.

Ex-ante vs ex post capacity weightings

There is, as the consultation documentation suggests, a balance to be struck between stability/certainty of participant revenues, as provided by ex-ante weighting of payments, and appropriate incentivisation of participants to be available at times of tight margin. However, NEAI members do not believe that there should be significant changes to the weighting of the parameters.

It is the view of NEAI, that a fully ex-post mechanism, such as the proposal espoused in the SOCAP model is entirely inappropriate from a cash flow and retail perspective as it inhibits product development, e.g. the provision of cost-reflective pass-through products.

Performance Incentives

Our members appreciate that the CPM needs to incentivise appropriate behaviour. For the avoidance of doubt, flexibility incentives are the purview of the ancillary services mechanism and incentives to be available when declared (through the CPM), whilst important, need to be proportionate and reasonable. Generators are already subject to significant penalties when unavailable. An increase in these penalties is unlikely to result in greater availability. The specific proposals in relation to penalties are overly stringent and disproportionate. For example, footnote 15 on page 24 of the consultation paper refers to capacity penalties for failures to ramp up/ramp down. It is wholly inappropriate for capacity penalties to relate to ramping rates as this is a technical issue and falls under the Grid Code and generators obligations under the Grid Code. As proposed, such excessive penalties will only serve to create excessive risk in the mechanism and discourage appropriate and timely entry to SEM.