

Submission by Bord na Móna

on

CPM Medium Term Review - Draft Decision

SEM/11/088

Date 13th January 2012

CPM Medium Term Review – Draft Decision

Response to Consultation

1 Introduction

Bord na Móna (BnM) welcomes the opportunity to make a submission on the *Capacity Payment Mechanism (CPM) – Medium Term Review Draft Decision Paper*, and furthermore appreciates the deadline extension granted over the Christmas period.

Bord na Móna has commented, on each of the three papers which contained the 10 Work Packages making up the CPM medium term review. Bord na Móna agrees with the Regulatory Authorities expressed view that the CPM is a key component of the SEM design. It is the market mechanism which acts to provide efficient investment signals to deliver the optimal capacity and mix of generation required ensuring an efficient and secure electricity supply. It also acts to remove some of the significant volatility which has occurred in other energy only markets during periods of dramatic movements in primary energy prices, such as has been observed over the existence of the SEM.

The Draft Decision Paper (SEM-11-088) contains four proposed changes to specific aspects of the CPM calculation; BnM have commented on each of these proposals, below. It is import to stress that where the SEM Committee have elected to retain the status quo, Bord na Móna will not be making any further comment in this paper; however in such instances earlier submissions made by the organisation to the various Work Packages [WP] remain representative of BnM's position.

2 Forced Outage Probability [WP 2]

The Force Outage Probability (FOP) is both a material input assumption in the ultimate determination of the ACPS and is also a mechanism by which the RAs attempt to disincentivize poor plant performance. However, the quantum associated with the FOP must be realistic if this dual purpose is to be achieved. In the past number of years, market participants, chiefly during the annual BNE consultations, have argued that the FOP employed by the RAs was aspirational rather than realistic.

The RA's proposal in the Draft Decision paper modifying the FOP from 4.23% to 5.91% is to be welcomed as a move towards realigning the nominal value with that actually 'experienced' by the power system. Bord na Móna would be of the opinion, that this revised figure continues to underestimate the real value, which should embody the performance of the total generation fleet on the island.

It would therefore be desirable to have the methodology used in arriving at this revised figure of 5.91% published and open for consultation. We would be of the view that using the previous years forced outage rate or perhaps a rolling average of the

previous three years would represent a more realistic view of the FOP on the system in any given year.

3 Deduction of Infra Marginal Rent (IMR) [WP3]

BnM's comments contained in this paper are consistent with earlier submissions fundamentally opposing the deduction of IMR in the first instance. There is now in our view, something of a disconnect between the stated desire of the RAs and the impact the change as proposed by the RAs in the Draft Decision will have on market participants.

The CPM Draft Paper states *“the legislative environment for energy is undergoing significant change where Ireland and Northern Ireland must comply with the Third Package and the emerging European Framework Guidelines and Network Codes. There are significantly different contexts that should be taken into account, notably, the emerging European Target Model, the penetration of renewables and adverse economic conditions. Given the significance of these changes and this uncertainty, the majority of respondents would not support any substantive changes to the CPM. The SEM Committee agrees with this position but will make **minor changes** [emphasis added] to certain aspects of the CPM calculation”*¹

However, the SEM Committee have decided ‘to pursue its preferred option’; this option, as per the calculation in Table 7.3 of the Draft Decision paper, results in a net reduction of $\approx 9\%$ of the ACPS. Such a deduction, in what is a regulated income², can hardly be described as a “**minor change**.”

BnM in response to SEM-10-046 presented a cogent argument as to why, if the *transparent* objective is to minimise perceived volatility in the ACPS, deducting IMR, irrespective of the methodology (or Option) employed, is fundamentally flawed.

The current methodology used in the ACPS calculation has returned a zero IMR deduction for the past number of years. This present ‘status quo’ models the ‘market’ for the year ahead using the PLEXOS model and estimates the IMR that the notional BNE would earn.

Bord na Móna has first hand experience of operating a ‘new’ peaking plant in the SEM, and in the calendar year just past, provisional figures suggested that IMR represented less than 0.8% of revenues earned. It should be remembered that while this is a non-zero value, the peaking plant was operating in an environment where the actual system forced outage rate for the generation fleet (including Moyle & Turlough Hill) was substantially greater than the notional value used in the PLEXOS modelling runs; see the comments in relation to FOP above.

¹ SEM-11-088 at pp 4

² Fundamentally to recover Fixed Costs, in a market where only SRMCs can be bid

Ironically, the current ‘status quo’ whose retention is favoured by the National Electricity Association of Ireland (NEAI), mirrors the actual reality experienced by Peaking plants commissioned during the existence of the SEM.

Bord na Móna continues to re-iterate its argument that there is no fundamental market design reason behind deducting theoretical IMR from the ACPS ostensibly to minimise non-existent volatility, and would urge the RA’s not to implement Option 2. However, as the Draft Decision paper did not countenance the removal of the IMR deduction, Bord na Móna, as a member of the NEAI, therefore supports the retention of the status quo (Option 3) as it reflects the reality of the market (see above) and would request the RA’s not to implement Option 2 for the reason outlined below.

Fundamentally, the inherent flaw in Option 2 is that it is designed to only remunerate a level of capacity which will not serve all of the energy requirements of the market, (before accounting for provision of capacity for reserves), as such plant will have to rely on premium market payments to be adequately remunerated. Implementation of Option 2 will also have the effect of significantly damping market signals to attract new flexible generating plant required for the delivery of RES-E targets.

3 BNE Fixed Cost – Methodology [WP 7]

The proposal to fix elements of the BNE FC calculation for 3 years has merit in reducing the potential for volatility, within such a three year period. However, it is likely that there will be a step change at the beginning of the next three year block, an undesirable outcome. Furthermore, reduced volatility for just 3 years, when viewed over the investment lifetime of a typical plant, highlights just how little practical benefit this proposed modification will actually deliver.

A fully transparent calculation methodology, which takes due regard of the financial realities faced by investors, particularly in relation to the value imposed for the WACC, would be of substantially greater utility to market participants.

If the RA implement their preferred option, i.e. that the current methodology will be used to complete the BNE calculation for 2013, after which a level of ‘indexing will be applied to the BNE Peaker Cost (€/kW/yr)’, it will then become urgent and imperative that the outstanding issue regarding the value assigned to the WACC be based on risk premia reflective of funding generation assets operating in the All Island SEM as opposed to plants operating in a ‘Sterling only’ area.

4 Flattening Power Factor Analysis [WP 9]

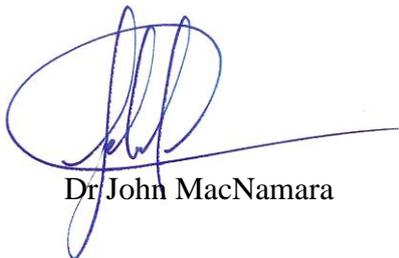
Bord na Móna notes that the RA’s are minded to increase the FPF to 0.5 for 2013 following a review by TSO this summer, BnM await the outcome of this paper and will respond accordingly.

5 Summary

Bord na Móra sees the Capacity Payment mechanism as a key component of the SEM design

- Bord na Móra welcomes the increase in the nominal value of the FOP. BnM believes that this revised FOP continues to underestimate the true value. It is proposed that the methodology, which should encompass every generation unit in the SEM, be published and open for comment
- Bord na Móra, on principle does not believe there is a valid market design reason for deducting IMR from the SEM's ACPS. The RA's preferred option of reducing the Peaker Cost by approximately 9% is a major change and at variance with the stated desire of the RAs for stability in a time of unprecedented economic and regulatory change
- The proposal to fix and index elements of the BNE FCs may provide a temporary damping of volatility; however, this may only be 'kicking the can down the road'. Fundamentally, this calculation process, and in particular the methodology employed for determining the WACC, must be transparent and more importantly be 'fit for purpose' in the All Island SEM
- Bord na Móra awaits the consultation paper on the FPF and will respond accordingly.

For and on behalf of
Bord na Móra,



Dr John MacNamara

13th January 2012