

I-SEM CRM Consultation Paper Workshop

Consultation 2

Dundalk, 29 September 2015



Agenda

Welcome and Introduction	10:30-10:35
Product Design – Detail	10:35-11:35
– Contract Length	
– Implementation Agreement	
– Indexation	
Cross Border Participation	11:35-12:20
Lunch	
Secondary Trading	13:00-13:45
Transitional Issues	13:45-14:30
Close	

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Welcome and Introduction

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Product Design - Detail

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Three areas considered in detailed contract design

- Contract length
- Implementation agreement
- Strike price indexation

Contract Length

- Decision 1: Availability of contract length
 - Same for all?
 - Longer contracts available to new and re-furbished plant
- Decision 2: How identify “new” or “upgraded” plant
 - Investment threshold (GB)
 - Tangible Criteria
 - Expert Judgement
- Decision 3: How long

International Experience

- PJM, NE and GB all allow new plant to elect to fix price for more than 1 year
 - Up to 3 years in PJM
 - Up to 7 years in New England
 - Up to 15 years for new plant in GB
 - Up to 3 years for upgraded plant in GB
- In each case, existing plant can only fix price for 1 year

Decision 1: Availability of contract length

- All plant get “short” contracts
 - Supports efficient exit for existing plant
 - Lack of certainty over capacity revenue may impact cost of capital
- All plant get “long” contracts
 - Barrier to exit for existing plant
 - Reduced financing costs for new entrants
- Long contracts only available if investment
 - Annual for existing → low barrier to exit (and entry)
 - Longer for new plant and upgrades → Lower cost of capital

Decision 2: Identifying New Plant

- Investment Thresholds:
 - Link to low-end estimates of cost for new entry and upgrade
- Tangible criteria
 - E.g. New connection or site
 - Difficult to form an exhaustive set and avoid “unintended consequences
- Expert Judgement
 - “Expert” reviews plans to opine on whether the capacity is existing, upgraded/refurbished, or new
 - Difficult to demonstrate that judgement is objective

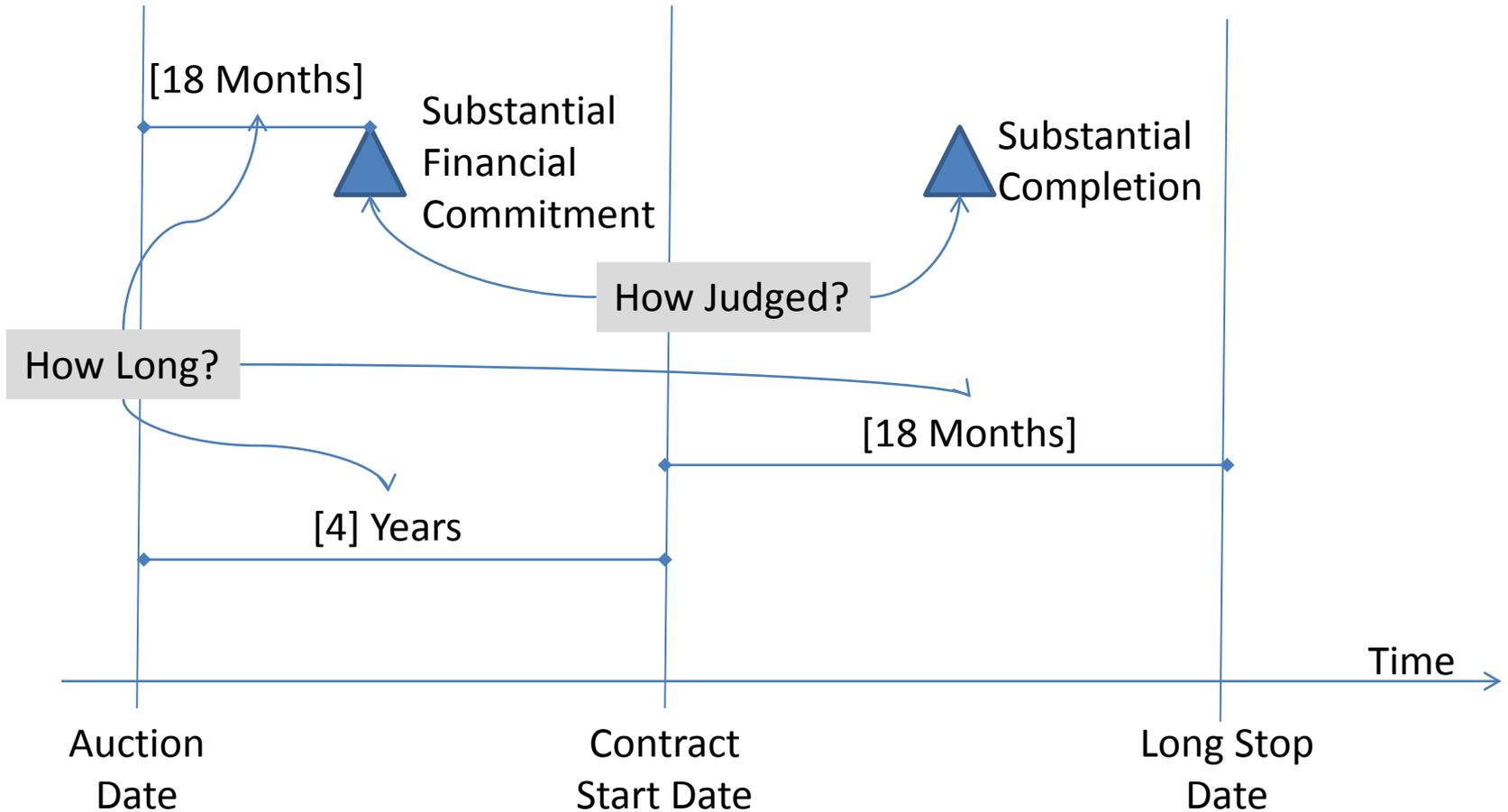
Decision 3: Maximum length for each contract type

- International experience is varied
 - Up to 3 years for new plant in PJM
 - Up to 7 years for new plant in New England
 - Up to 15 years for new plant in GB
 - Up to 3 years for upgraded plant in GB
- Aim is to minimise cost to the consumer, trading off:
 - Financing cost for investment (arguing for longer contracts)
 - Avoiding future stranded assets that increase costs (arguing for shorter contracts)
- We note that GB limits for new plant are consistent with “typical” economic life for CCGT
 - CCGT design still expected to lead to efficiency improvements
 - CCGT market being eroded by renewables etc.

Three areas considered in detailed contract design

- Contract length
- Implementation agreement
- Strike price indexation

Implementation Agreements



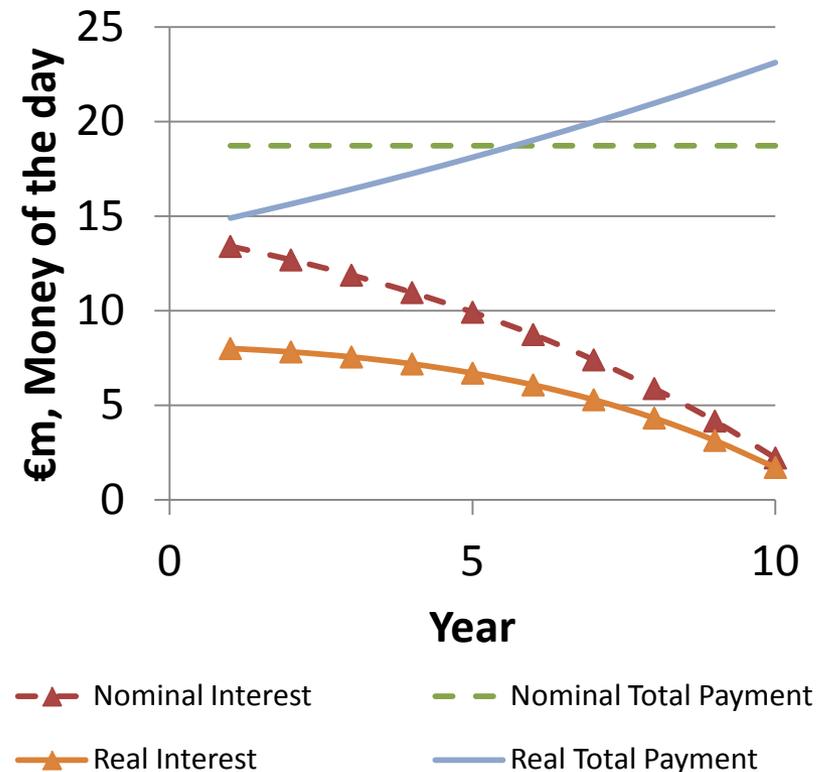
Three areas considered in detailed contract design

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Should option fee be indexed?

- Option fee arguably covers (or contributes to) fixed costs of plant
 - Initial construction costs (fixed at commissioning, but financing may be indexed)
 - Staff costs (subject to inflation)
- Availability of index linked debt would suggest enhanced efficiency from indexation

Index Linked (Real) 'v' Traditional (Nominal) Debt



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Cross Border Participation

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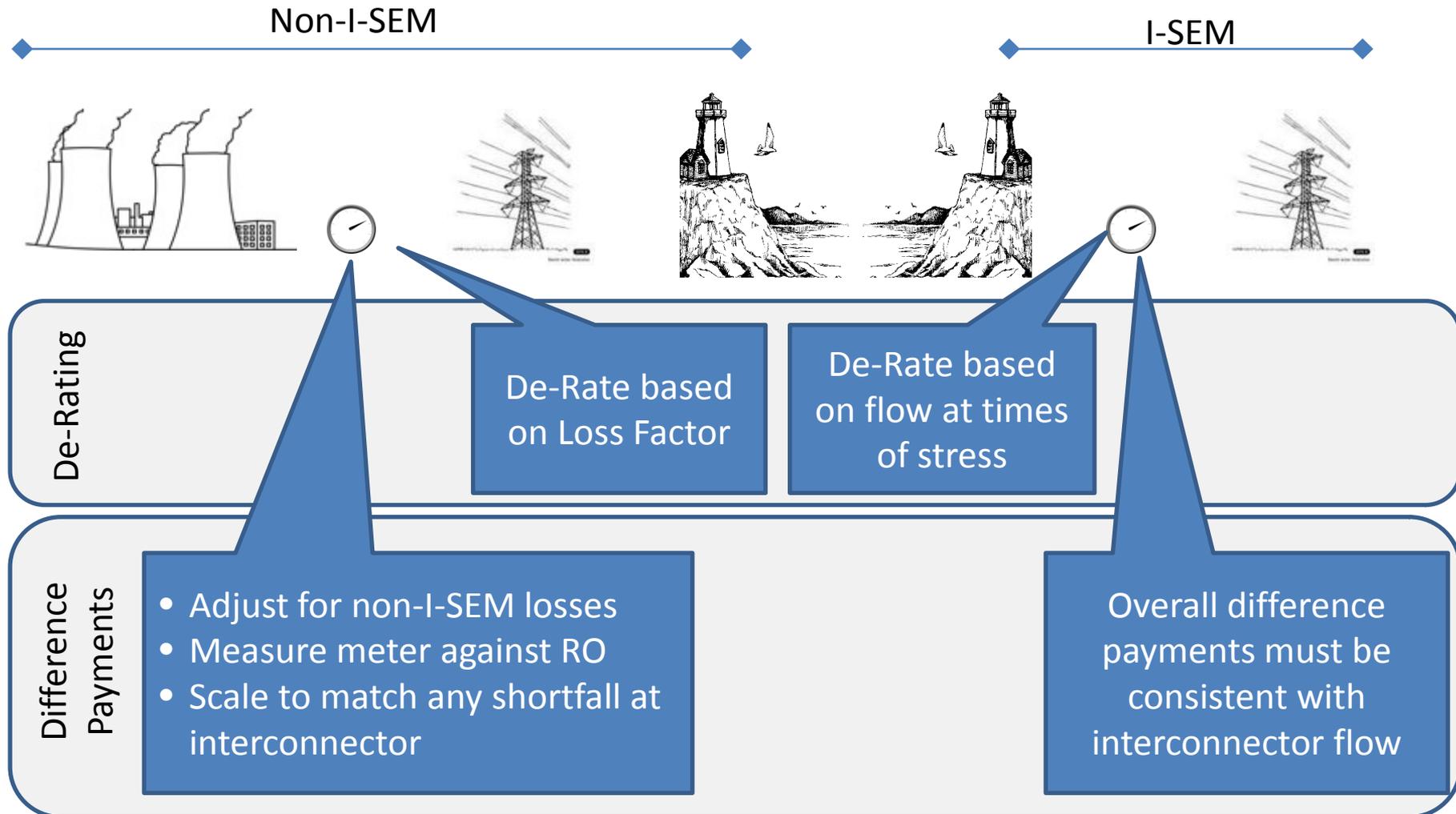
Cross Border Participation in the CRM

- There are a number of reasons to consider the extent that providers located outside the I-SEM zone can meet I-SEM capacity requirements:
 - It could lead to lower costs
 - EU State Aid Guidelines require us to consider it
- Two key options
 - Interconnector led
 - Provider (Generator) led
- Some basic principles
 - I-SEM Customers should only pay for capacity delivered to I-SEM
 - Treatment broadly equivalent to that for I-SEM providers

Interconnector Led Approach

- How it Works:
 - Each Interconnector is de-rated based on its expected contribution at times of system stress
 - Interconnector then bids for capacity – alongside other providers
 - Interconnector meter settled against RO commitment as for other Providers
 - Interconnector invests in non I-SEM “generation” if it enhances de-rating
- Options
 - Participant: owner of physical asset ‘v’ owner of FTRs
- Key Issues
 - Will this support up-stream investment outside the I-SEM?
 - Availability of FTRs at time of capacity auction
 - Impact on value of an FTR

Provider led approach



Provider led - Issues

- Access to non-I-SEM data
 - Provider meter
 - Losses from provider to I-SEM
- Treatment of non-I-SEM provider
 - Only in BM?
 - Evidence of position ahead of BM (e.g. Non-I-SEM DAM trade, FTR etc)
 - Non-I-SEM provider be penalised if it performs, but electricity does not flow into the I-SEM.

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Secondary Trading

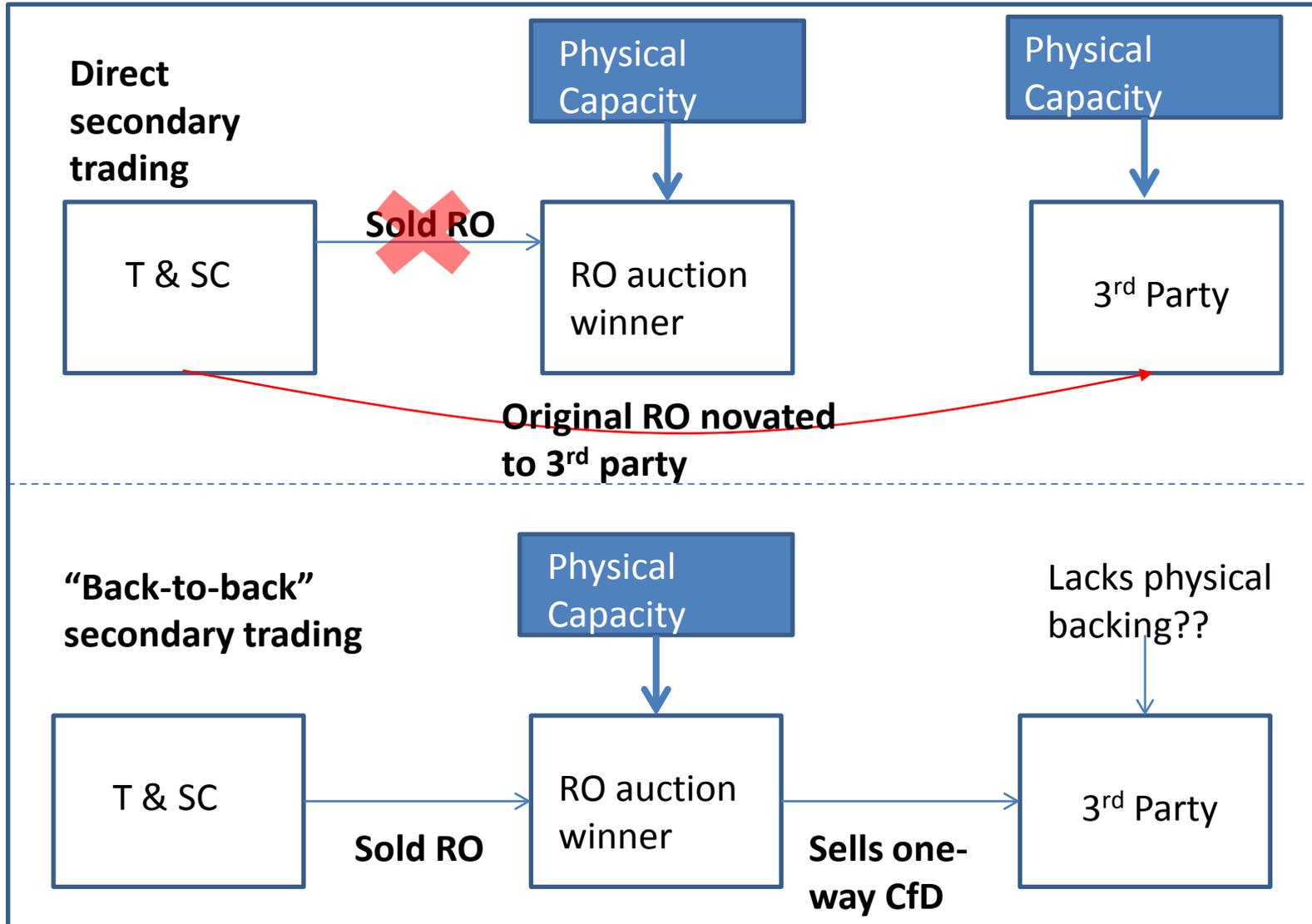
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Key issues

- **The case for secondary trading:** Should secondary trading be allowed)?
- **Secondary trading market place:**
 - Should the RAs require that the Capacity Market Delivery Body put in place a secondary trading platform
 - Should the RAs require that any secondary trading must take place on the secondary platform?
- **Substitution of plant backing:** Should a holder of an RO be able to change the physical plant backing for an RO without engaging in secondary trading?
- **Pre-qualification:** What are the pre-qualification criteria for a secondary acquirer of an RO?
- **Central registry:** Is a central registry required to support secondary trading, and if yes, what are the requirements of the central registry?

Direct secondary trading vs “back-to-back”



Case for secondary trading

Advantages

- Allows management of planned outage exposure (particularly for non-portfolio capacity providers)
- Facilitates efficient market exit
- Others?

Disadvantages

- Costs of administration
- Others?

Advantages of direct secondary trading for RO holder

- **Credit risk.** With “back-to-back” trading, the original RO holder is exposed to the risk that the third party defaults on its obligations to make difference payments
- **Market exit.** In the “back-to-back” model, the original RO holder retains the obligation to have operating entity;
- **Split market approach:** under MRP Option 4b- third party RO settlement dependent on where primary RO holder sells (DAM, IDM or BM);

Requirement for a centralised secondary market place

Options

- **Option 1:** Leave secondary trading entirely to the market.
- **Option 2:** Regulate to create a centralised market place for secondary trading of ROs, but also allow bi-lateral trading of ROs
- **Option 3:** Regulate to create a centralised market place for secondary trading of ROs, only allow ROs to be traded there

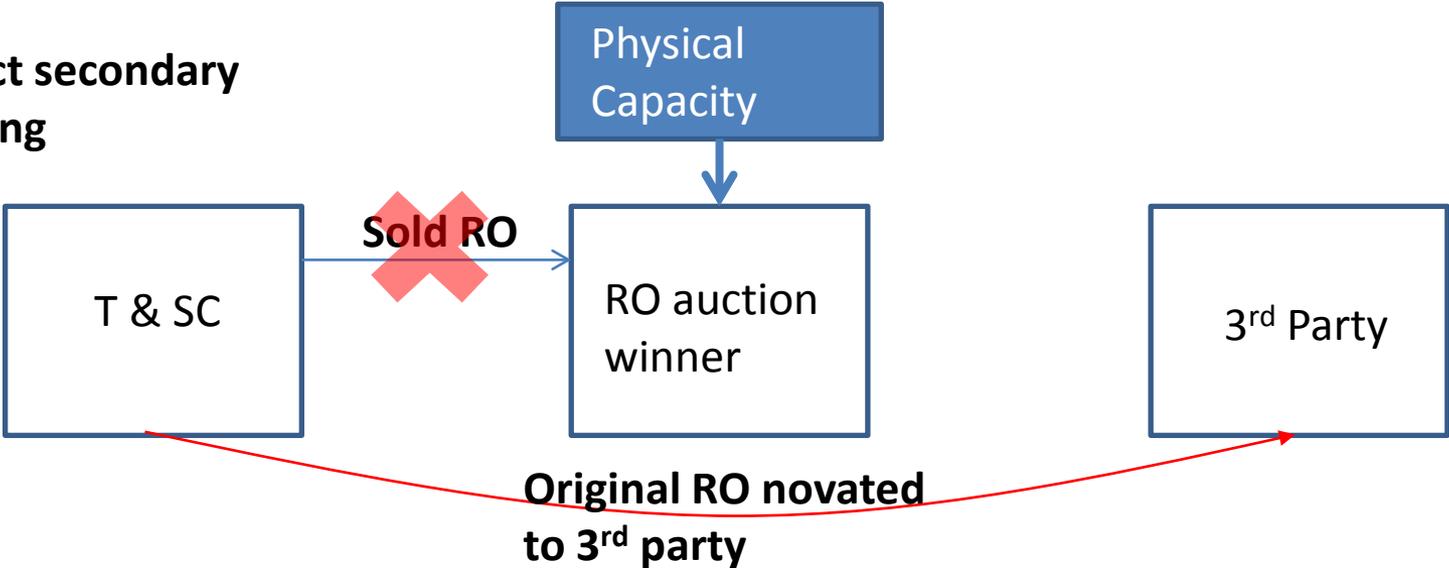
Benefits of single centrally organised market place

- Improved price transparency?
- A level playing field for competition and reduced market power?

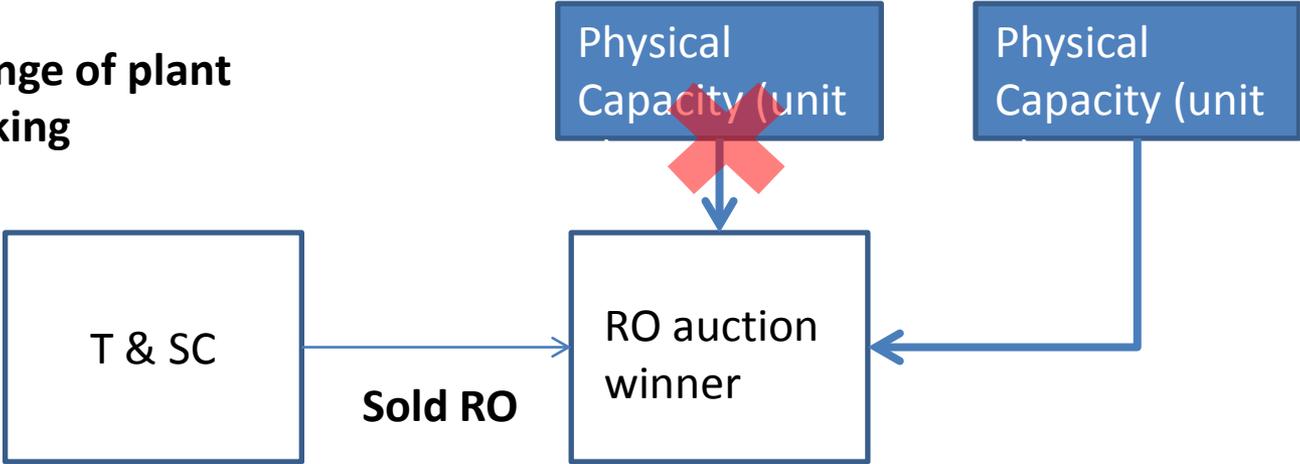
Do benefits justify cost?

Change of plant backing- also to be allowed?

Direct secondary trading



Change of plant backing



Other issues

- **Pre-qualification requirements** for secondary acquirer: same as for original RO holder?
- **Capacity registry:** Capacity Body will need to maintain a register of capacity to:
 - Track the physical backing of each unit of RO,
 - Ensure that a single MW of de-rated capacity does not “back” more than one MW of RO

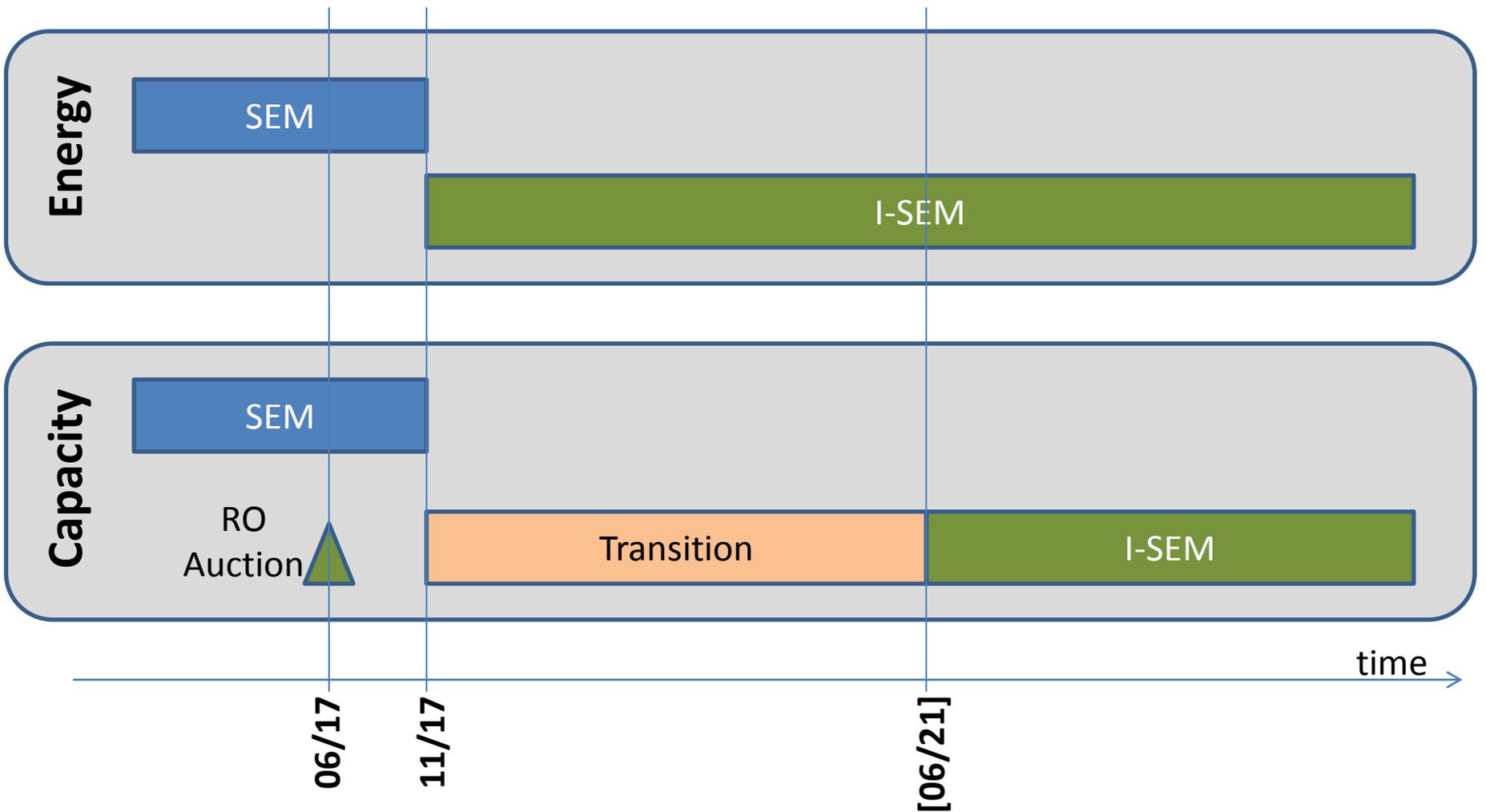
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Transitional Issues

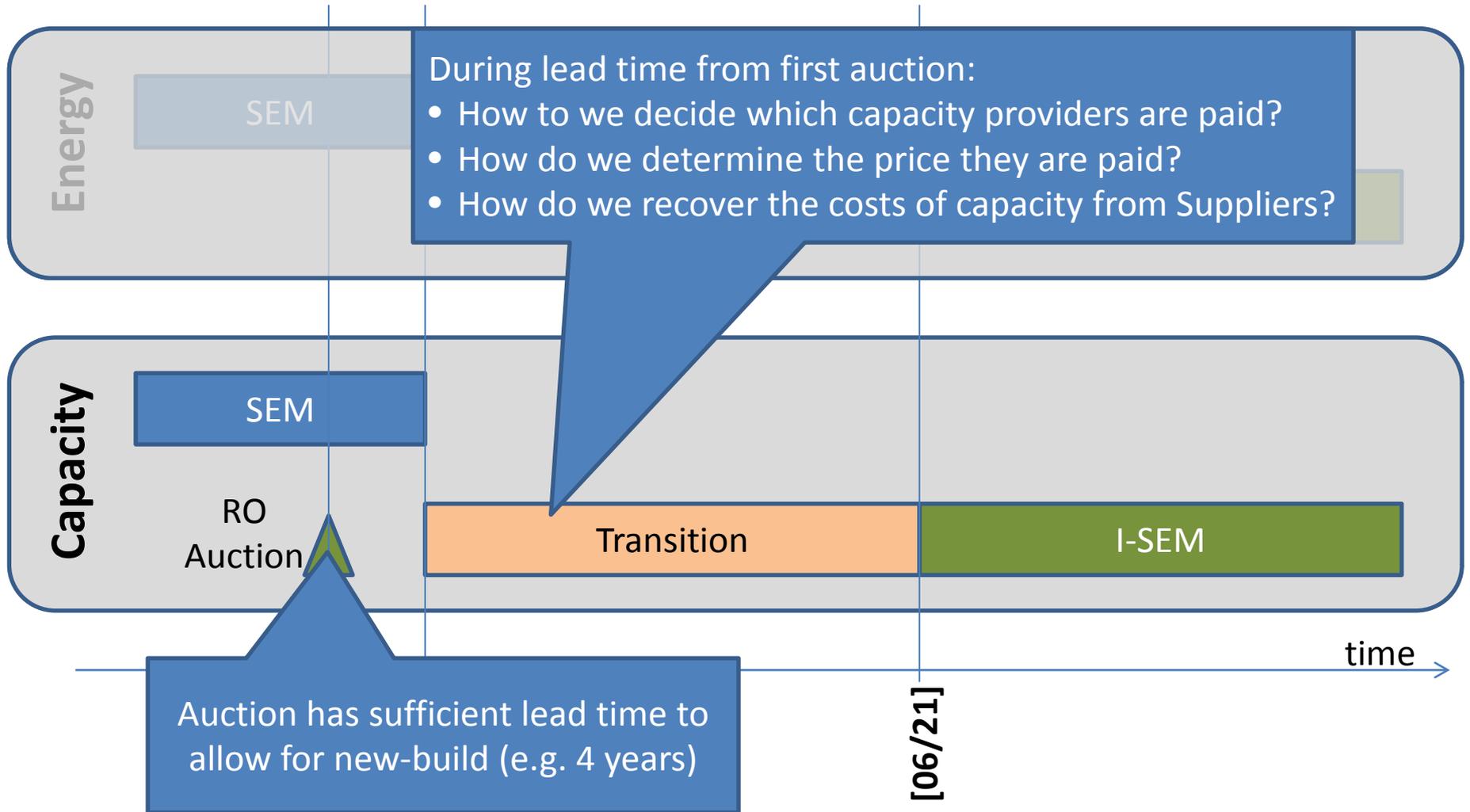
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“Transitional” issues cover the movement from the SEM to the I-SEM



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Transition – Payments to Providers

Options

- Auctions for each year of the transition:
 - Held on annual basis?
 - Held in Summer /Autumn 2017?
 - Need for a floor price?
- Price “Glide Path”
 - All capacity gets the same price (as in SEM)
 - Glide path shows how the total “pot” moves from that under the I-SEM to that arising from the I-SEM Auction

Issues

- EU State Aid Guidelines
 - Support efficient exit
 - Allow entry – including by Demand Side Measures
- Overall Efficiency
 - Avoiding over-payment
 - Ensure we don’t close capacity that is needed later in the transition period

Transition – Payment from Suppliers

- Two options:
 - Move to the I-SEM Model
 - Keep the SEM Model
- Issues
 - Practical impact on central systems
 - Potential improved efficiency of I-SEM model