

**Thomas Quinn
Commission for Energy Regulation
The Exchange
Belgard Square North
Dublin 24**

**Brian Mulherne
Utility Regulator
Queens House
14 Queen Street
Belfast
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17th August 2015

Re: Capacity Remuneration Mechanism Detailed Design

Dear Thomas and Brian,

PrePayPower, as Ireland's largest prepay electricity provider, welcomes the opportunity to contribute to the SEM Committee "Capacity Remuneration Mechanism Detailed Design" Consultation Paper (SEM-15-044).

PrePayPower consistently throughout the I-SEM process has focussed on the importance of a vibrant, deep and liquid forwards market. The lack of such a market is one of the current shortcomings of the Single Electricity Market, and it is the reason why PrePayPower has consistently looked for SEM Committee engagement in the forwards contracting market as we transition to the I-SEM.

In previous responses and bilaterals following the High Level Design proposed decision, we have accepted the design of the Reliability Options (ROs), noting with some caution the potential complications for the forwards contracting market that may arise. We do welcome the peak-price hedging that could result from ROs, particularly against the day-ahead market price where we intent to trade the majority of our power.

The complexity of the RO and its impacts on hedging arrangements with merchant generation, however, appears to be growing. Options are presented in the paper whereby the reference market for generation could be a mix of day-ahead and balancing market prices. The split market reference pricing for the RO (or the hedge against balancing market prices) means that the benefits of this hedge are eroded. The payments from generators under the RO across the various markets will not match the exposure of individual suppliers to high prices in the markets in which they trade. Generators might have negligible exposure to the balancing market price (providing little in RO payments), put an individual supplier could be considerably short in terms of its ex ante trading, having to cash-out considerable sums at an unhedged balancing market price.



These types of interactions mean it is difficult to establish a common understanding of the exposure of market participants to the costs and benefits of the one-way RO CfD. It undermines the potential liquidity of the forwards market by giving every participant subtly different interactions with the RO, and therefore adds unnecessary complexity to what will be a small forwards market by international norms.

Furthermore, the potential introduction of scarcity pricing, i.e. a regulated penal price in the balancing market should certain security of supply margins not be available to meet demand, has been introduced. This appears to be an introduction to the balancing market design arising from the consideration that the RO might not offer sufficient incentives for generation to be available by itself.

PrePayPower is fervently opposed to the introduction of scarcity pricing in the ISEM balancing market. We are opposed to it for the following reasons:

1. It is a price that will be delivered ex post to suppliers (and may only become apparent at short notice), and so suppliers have no opportunity to respond to its signal by reducing demand;
2. Suppliers would be exposed to a regulated scarcity price on their ex ante trade forecast inaccuracy, rather than their physical contribution to the security of supply event. It is genuinely questionable whether the application of a regulated balancing price is a penalty on large consumption at times of system stress (which is the consultation paper's assumption), or a penalty on poor demand forecasting at times of system stress (which is our assertion).

We find the arguments around the introduction of scarcity pricing circular. The ROs do not provide sufficient signals for generators to be available, so introduce scarcity pricing in the balancing market and reference the ROs against the balancing market price. Suppliers at this point should be grateful of the RO, as it protects them (although not in all circumstances – see above) against scarcity pricing.

Fundamentally, PrePayPower strongly urges the regulator to keep the Reliability Options simple and use the day-ahead market as reference price. We suggest that it is far too early to include scarcity pricing as part of the I-SEM balancing market design. If the SEM Committee wishes to incentivise short-term availability from generation, they should introduce a set of regulated penalties outside of the RO one-way CfD hedging structure focussed on short-term margin.

We have responded in further detail on the questions raised in the capacity payment mechanism consultation, and are available to discuss any aspect of our response further.

Yours sincerely,

Cathal Fay

Chief Executive Officer



A) Feedback on our minded to position to retain the all-island security standard of 8 hours LoLE.

PrePayPower sees no evidence that a 3 hour LoLE in the CRM will pragmatically mean any difference in security of supply outcomes for end customers. Therefore, the 8 hour LoLE can be maintained, reducing costs for customers.

B) Comments from respondents as to their preferred method of accounting for unreliability of capacity in determining the capacity requirement, along with reasons behind their preference.

De-rated capacity appears to be the correct approach for the reasons given in paragraph 2.3.8 of the SEM Committee consultation.

C) Feedback on the options presented in relation to accounting for demand forecast uncertainty, along with rationale behind any position.

The options presented are: the average scenario, the worst case scenario, the “optimal scenario” based on least regret, or stochastic modelling. Prepaypower supports the average scenario, as it appears to be the most straightforward, and it represents a reasonable estimation of the likely output of the stochastic modelling with much less complexity. While the optimal scenario is intellectually appealing, it is highly influenced on the choice of VoLL and BNE costs; regulation of VoLL and BNE will effectively regulate the outcome. The worst case scenario will over-insure by over procuring capacity.

D) Feedback on our minded to position to base the capacity requirement for the CRM on a single capacity zone

PrePayPower supports the continued all-island nature of the Single Electricity Market in both energy and capacity as a point of principle.

E) Detail of any other considerations respondents felt that we should take account of when determining the capacity requirement for the CRM.

No further comments.



A) The approach to setting the Reliability Option Strike Price:

a. Should we adopt the “floating” Strike Price approach, which is indexed to the spot oil or gas price?

While it adds complexity to the forwards contracting arrangements, a floating CRM price appears to allow the most amount of generation throughout the market participate in the RO auctions with some understanding of the relationship of their costs with the RO Strike Price.

b. How do we choose the reference unit? Should it be based on actual plant on the system or a hypothetical best new entrant (BNE) peaking unit as currently used for setting the Annual Capacity Payment Sum?

It should be based on a real plant on the system. If the BNE price is higher than any plant on the system, the RO hedge will not provide any benefit to suppliers. If the BNE price is lower than many plant on the system, it will reduce the number of interested participants in the auction.

c. Should we grandfather this reference unit where a multi-year RO is sold by new capacity?

While it adds complexity to the RO, it is difficult to see how a long-term RO would be useful for a generator were the strike price methodology was not grandfathered.

B) The implementation of scarcity pricing in the I-SEM Balancing Market?

Please see the body of our main letter for our high-level fundamental disagreements to the introduction of scarcity pricing.

C) The choice of market reference price options from amongst the options presented and consistency with key objectives.

We believe the day-ahead price should be the sole reference market. Consistent with previous submissions, we believe this can be used as a mechanism for renewable generation in particular to be incentivised to trade day-ahead. If there is a concern that the resulting signals to generation are too weak, they can be supplemented with regulated penalties for non-performing generation based on incentives derived from real-time system conditions.



D) Whether the RO volume and/or the additional performance incentives should be load-following.

We believe that the RO incentives should be load following. Suppliers do not want to over-procure unnecessary RO hedges against peak price volumes that they do not use. We believe the market should have a similar overall aim.

E) The requirement for, and design of additional performance incentives, including:

- a. The form of additional incentives;**
- b. Scarcity based triggers for performance incentives**
- c. Caps and floors on incentives;**
- d. Performance incentives for renewables and DSUs;**
- e. Performance incentives during the pre-commissioning phase;**
- f. Detail of any other considerations respondents feel that we should take account of when determining policy in relation to product design**

As a non-vertically integrated supplier, PrePayPower has no comment on this section other than to say this is the tool that should be used to increase the incentives on generation to be available, instead of scarcity pricing and balancing market reference pricing for the RO.



- A) The options presented in relation to the eligibility of plant supported through other mechanisms;**
- B) The options for eligibility of demand side and storage providers**
- C) Do you have a view on the technology vs plant specific approaches to de-rating?**
- D) Do you have a view on the historic, projection or hybrid approaches to de-rating?**
- E) Do you have a view on grandfathering of de-rating factors?**
- F) Do you have a view on options presented with respect to the non-firm generation?**
- G) What evidence should an aggregator be required to show physical backing?**
- H) Should there be a maximum size of unit that can bid into the RO auction via an aggregator, and if so what is that threshold?**
- I) Should there be a minimum size below which a capacity provider may not bid directly into the RO auction, and must bid via an aggregator? If so what is that threshold?**
- J) What pre-qualification criteria should be applied?**
- K) Detail of any other considerations respondents feel that we should take account of when determining policy in relation to eligibility.**

Renewables should receive a capacity payment only if they actively trade (i.e. trading forecasts changing daily) in the day-ahead market. Consistent with that requirement, we believe there should be special rules for wind generation to make that reward for good trading meaningful. We believe that wind generation (and other Priority Dispatch generation more generally) should receive a nominal RO payment based on their capacity credit and the cleared auction price, i.e. wind is a price taker in the capacity auction. Wind generation's energy revenues would be capped at the RO strike price, but there would be no penalty for non-delivery; that penalty is implicit in the calculated capacity credit. This will lower the capacity price, and provide revenue to offset the Irish PSO levy for REFIT generation.

Any technology which can contribute to security of supply should be able to participate in the auction. Any rule to exclude a potential provider (and potentially raise the clearing price in the auction as a result) should be avoided unless it can be demonstrated that the participation results in an administration cost greater than the potential reduction in clearing prices in the auction. We see no evidence presented that is the case, and therefore any exclusion (or requirement to participate through a third party) seems arbitrary.



A) Whether the recovery of CRM option fees from Suppliers should be on a flat, profiled, or focused basis.

PrePayPower has advocated a flat charging regime for RO fees. This is based on the assumption that the RO responds through energy pricing to indicate a security of supply of event. Under such circumstances, the energy price is already providing the appropriately shaped scarcity signal. Profiling of RO fees is further complexity with no justification, unless market failure in energy pricing can be demonstrated. It is inappropriate in PrePayPower's view to start the market design with the assumption of market failure built-in.

B) Whether the Supplier credit cover arrangements for the I-SEM CRM should be broadly similar to those under the SEM, and whether / what credit cover arrangement should be introduced for capacity providers.

PrePayPower notes that there has been no market default of any participant since the introduction of the SEM. The full collateralisation model therefore appears to be over-insuring generators, with the ultimate cost of same being placed on consumers through increased supplier collateralisation costs.

We note that there is an interaction between high market prices in energy and payments under the Reliability Option back to suppliers. Suppliers should be able to offset their potential RO fees future energy revenues within the reference market, and reduce the collateral requirements in the energy market accordingly.

C) Whether the costs of exchange rate variations (arising from differences in the €/£ exchange rate at the time capacity is procured and its subsequent delivery) should be borne by capacity providers or mutualised across the market.

We see no added efficiency in moving away from the mutualisation option.

While it has not been asked as a specific question, PrePayPower would like to comment on how the called RO CfD payments from generators are recycled back to suppliers. Much of the emphasis in the paper is around management of the basis risk of the individual generator taking on a RO CfD if the market reference price is the balancing market or a blend of balancing market pricing with other market prices. The paper does not give the same emphasis to suppliers' individual exposures to "above strike price" market pricing and how they should be recycled back to suppliers. The consultation paper suggests that they should be passed back to the supplier in relation to its demand. Furthermore "net payments from capacity providers during a period of scarcity or near scarcity could exceed those required to hedge 100% of demand".



If the “RO as hedge against peak prices for suppliers” is to be meaningful, there are also times when a further fund of money beyond that recovered from generators will be required, i.e. the net payments from capacity providers would not be enough to hedge 100% of demand. This fund of money should be recovered through increased RO fees as a form of cross-market insurance between all suppliers, as a hedge against exposure to high prices in whatever market the supplier demand is traded.

A simple pro-rata to demand recycling of generator RO CfD payments does not come close to “a hedge against energy prices in the reference market” where there are split markets. There are some risks associated with a single market reference price as well, but they are less than the issue that arise with split markets (or a market reference price emphasising a balancing market where a supplier will not seek to trade).



A) Are the above outlined governance arrangements suitable for implementation of the I-SEM capacity mechanism?

PrePayPower believes that both options will work for a governance arrangement.

B) Which options for contractual arrangements are the most appropriate as assessed against the listed criteria?

PrePayPower prefers interaction with a single trading and settlement code (where changes can be more readily made and collateral can be managed across energy and capacity) rather than interacting with a further central counterparty. This is consistent with a single point of contact and contract for all the markets (forwards, day-ahead, intraday, balancing), even if the different markets are operated by different organisations in the background

C) Are implementation agreements required for new entrants participating in the capacity auctions?

No comment given.

