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Ibec views on the Capacity Remuneration Mechanism Detailed Design Second Consultation Paper

Dear Natalie, Dear Thomas,

Ibec, the group that represents Irish business, welcomes the opportunity to respond to the second paper of the Capacity Remuneration Mechanism Detailed Design.

As noted in our views on SEM-15-044, Ibec supports the decision to retain a Capacity Remuneration Mechanism (CRM) given the need to provide a stable regime for a small, relatively isolated island system with certain inbuilt safeguards both for providers, end-users and investors. As noted in the consultation paper, a successful CRM should provide security of supply and a reliable power system at least-cost over the long-term, and it is against this backdrop that we have assessed the proposals.

1. Interconnector and cross-border capacity

In terms of **de-rating the interconnector**, and the different approaches that can be adopted to assess its contribution to the capacity requirement, we would propose a staged introduction between I-SEM and non-I-SEM participants. Consultation paper SEM-15-144 points out the fundamental difference between SEM and I-SEM and how the impact of these changes will only become clearer over time. Therefore, as historical flows will no longer apply, a staggered de-rating methodology would seem to provide the most prudent approach.

Cross-border participation options

In choosing an approach to assess the treatment of cross-border capacity, consumers will look for Reliability Options (ROs) that incentivise security of supply through efficient investment, underpinned by a market design that allocates the costs and benefits in a proportionate manner. The various options have unique pros and cons. We therefore offer some of our insights or request for further information/clarification.

- a) **Net Off Demand:** This option appears to offer the most attractive route for consumers, as it does not provide any capacity payments to reflect the support (if any) provided by cross-border capacity. It would also appear to perform well in terms of cost of implementation. However, as pointed out in the consultation paper, if the interconnector is judged to increase the need for I-SEM capacity, the total cost of capacity will increase while not accounting for cross-border capacity in the I-SEM. Therefore, the I-SEM consumer will pick up the tab for an increased capacity event even if the need for increased capacity is driven from consumers outside of I-SEM. In striking the balance in accounting for and incentivising capacity, as the approach does not award ROs in respect of non-I-SEM providers, and therefore does not provide incentives for delivery (over and above signals in the energy market) some members are concerned about security of supply implications stemming from this approach.
- b) **FTR Led:** As this approach only applies at the day-ahead stage and is financial, our consumers have voiced concern over guarantees that physical capacity will be delivered when required.
- c) **Interconnector Led:** While there could be cost implementation benefits in the short-term, there is concern should the interconnector(s) fail when required and the cost implications stemming from a lack of capacity. Furthermore, as noted in the consultation paper, the performance based option places a high risk on the interconnector who are unable to access energy revenues to cover different payments. Therefore we would welcome some further information as to how these costs would be recovered.

As all of the options detailed in the paper will require the de-rating of the interconnector(s), it is suggested that the methodology and approach which is developed and implemented be prepared by an independent third party with oversight from the Regulatory Authorities.

- d) **Provider Led:** The consultation paper acknowledged the complexities inherent in this approach and makes reference to issues such as double counting, delivery assurance and dependence upon third-party data for verification purposes. In an interconnector outage scenario, the potential increase in the “hole in the hedge” could result in price surges even in the absence of energy being provided.

While the performance based approach provides an incentive to non-I-SEM providers (with in-built safeguards to compensate I-SEM consumers in the event of lack of delivery), the availability based approach is in danger of leaving I-SEM consumers with the bill (and the consequences of spiky prices) in the event of non-delivery. The impact on the energy market could thus be disproportionate and it must be asked if delivery is guaranteed at time of system stress and if I-SEM consumers will pay for something they shouldn't be.

- e) **Hybrid option:** On the face of it this appears attractive to consumers, if capacity costs are reduced in the long run with efficient provision of non-I-SEM capacity **and** the benefit of cheaper prices if there is a surplus of non-I-SEM capacity. Clarification would be welcome as to whether, under this methodology, consumers would be the main beneficiary in the event of surplus non-I-SEM capacity.

However there are concerns with this approach, such as cost recovery options if the interconnector is penalised due to technical issues. Furthermore, questions remain over settlement during the various timeframes.

2. Secondary trading

There is merit in having secondary trading to enable the efficient delivery of capacity and to offer a practical solution to temporary planned/forced outage, and to allow efficient exit without adversely impacting security of supply. While there are no substantive comments to make on its actual design, we would offer a couple of observations.

The lack of physical backing in the “back-to-back” scenario would make the direct secondary trading option the more robust from a security of supply perspective (especially when one considers that the direct trading subjects participants to the same pre-qualification as original auction participants). As noted in the consultation paper, the new RO holder has not gone through a pre-qualification process and may not be backed by physical plant.

The benefit of a mandatory centralised trading platform is well made. If this option is chosen, we would ask that the costs of creating and maintaining a centralised platform are proportionate. We would welcome further analysis on restrictions on de-rated capacity in backing secondary trades. As noted in the paper, it recognises that plant availability will increase approaching delivery, but any decisions on limits must be informed by the type of trading platform in place.

3. Detailed Reliability Option Design

We have no substantive comments to make with regards to RO **contract length**. The RO design will have to balance the incentives in place for new entrants without disproportionately transferring risk to the consumer.

Our members recognise the benefits in having a cap on losses in order to make the market investable and competitive (especially when there are lessons to learn from other capacity auctions).

The proposal to align implementation agreements with the suggested GB list seems to be a sensible approach. Early indicators and **Performance Bonds** (in place to

compensate consumers for failure to deliver new capacity) build in important safeguards. Ibec supports the SEM Committee proposal to estimate the Performance Bond in the first instance, and then to revise the appropriate level once the first round Auction results become available.

4. Level of Administered Scarcity Pricing

Ibec supports the principle of introducing a lower level of **FASP/ASP** during some introductory period, though would suggest it be introduced for a four year period. If it is decided that it should increase progressively towards FASP, it is important to subject the trajectory to a review process so as to examine the regularity of such occurrences. It should also be noted that in general suppliers and consumers' exposure to the FASP/ASP can be limited by a liquid forward market which allows consumers/suppliers to hedge their residual exposure up to the ASP.

5. Transition Options

The transitional phase must consider the consumer prerogatives of security of supply and provide a hedge against high energy prices. The third option i.e. "do nothing" does not provide the required incentive.

In conclusion, we would like to thank the willingness of the Regulatory Authorities, especially the Commission for Energy Regulation, to keep Ibec's members engaged in this market reform process. The high degree of technical complexity in the recent consultation documents has presented a challenge for many members and we welcome continued engagement.

Yours sincerely,

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