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Dear Natalie and Thomas

PrePayPower, as Ireland's largest prepay electricity provider, welcomes the opportunity to contribute to the SEM Committee "I-SEM Capacity Remuneration Mechanism Detailed Design" Consultation Paper (SEM-15-014).

We have responded to the specific questions raised in the discussion paper in detail below, though our greatest concern comes over the section on Administered Scarcity Pricing, where we believe an inappropriate handling of this particularly topic could badly undermine the I-SEM in its early days. There are clear lessons to learn from the go-live of the, very similarly styled, GB market on March 27<sup>th</sup> 2001.

Specifically, we believe that setting the Full ASP value too high, both initially and indeed at all, could seriously endanger smaller players on both sides of the market but especially on the supply side. We acknowledge that the Reliability Option strike price is intended to protect suppliers from the ASP value, but are concerned that the wider the spread between the RO Strike price and ASP, the greater the overall cost to the market. In particular we are concerned that this could be used by vertically integrated utilities to subsidise their supply business, and for larger retail players with more flexible customers it could be a way of generating super-normal profits.

The consequence of this could be to eliminate smaller players from the market, reducing competition, transparency and innovation. This could lead in turn to higher prices for particularly the residential end consumer, and a lack of competitiveness for Irish business relative to European counterparts.

Our response is not confidential and may be published in full. If you wish to have further communication in relation to our submission, please don't hesitate to contact me.

Yours faithfully,

Cathal Fay



## Section 2 – Interconnector and Cross Border Capacity

*Which of the approaches to the treatment of cross border capacity do you prefer and why? (For the Provider Led and Interconnector Led approach, please specify whether you prefer the “Performance based” or “Availability Based” variant).*

*B) Should the de-rating of interconnectors be based on historic performance, or include forward modelling to project how its performance could change in the future?*

*C) If there is a preference for the “Interconnector led performance based” approach there will be a need to allocate total interconnector flows between specific interconnectors. Which of the specific approaches set out in 2.4.6 do you prefer? These approaches were:*

- Balance interconnector utilisation;*
- Pro-rata to interconnector metered flow; and*
- Complex power flow modelling*

*D) If there is a preference for the “FTR led” approach, which of the specific approaches set out in 2.4.15 (net or gross) do you prefer for the allocation of non-day-ahead flows?*

*E) If there is a preference for the “Performance based Provider Led” approach, which of the specific approaches set out in 2.4.25 do you prefer for the allocation of intra-day and balancing market trades?*

- As traded*
- Pro rata to Reliability Option (in which case – do you prefer “gross” or “net”)*
- Ignore – all in Balancing Market*

*F) If there is a preference for the “Hybrid” approach:*

- Should this be paired with the “Delivery Based” or “Availability Based” provider led approach?*
- Should Interconnector participation be mandated or voluntary?*

PrePayPower believe that the most suitable approach of those presented in the paper is the Hybrid option, which encourages greater competition amongst providers and is least susceptible to issues of market dominance. Furthermore, the transparency of this option should ensure a competitive level playing field, which will deliver the cheapest and fairest prices for the end consumer under the I-SEM power market.

On de-rating, PrePayPower believe that historic performance should be used as this uses de facto evidence, whilst forward modelling will be based on assumptions that may, or may not, prove to be correct. Additionally, forward modelling introduces uncertainty and complexity into price formation, which is unnecessary. In an already complex market, this risks making things needlessly complex.

Given our support for the Hybrid option, we believe that the delivery based approach should be used, as an availability based approach risks promoting a signal whereby the intent to provide capacity, rather than the actual provision of capacity is enough. PrePayPower is concerned that the availability based option risks reducing Security of Supply and failing to provide proper investment signals for the future of the I-SEM market.

Additionally, and for reasons described above, we believe interconnector participation should be mandatory, to encourage competition, to promote security of supply and to reduce market dominance – and its associated risks - in the capacity market.



### Section 3 – Secondary Trading

- A) Do respondents agree that direct secondary trading of Reliability Options should be permitted?*
- B) Should secondary trading of Reliability Options be via an organised secondary platform? If so, which one of the options is preferred?*
- C) Do respondents believe that “back-to-back” trading to lay-off exposure to difference payments should be permitted?*
- D) With respect to the creation of a centralised Reliability Option secondary market platform:*
- I. Is there likely to be sufficient demand for secondary trading to justify the cost of the development of a centrally organised platform;*
- II. Do respondents think that capacity providers should be allowed to acquire Reliability Option volume in excess of their de-rated capacity (plus the tolerance margin), and if yes, how the limit on Reliability Option volume for the net primary and secondary volume should be structured?*
- III. What limits should be placed on secondary trading timeframes, including: the timing of secondary trade execution - how soon after the auction should they be allowed, and how late in relation to real time delivery should they be allowed; and the length of the Reliability Option contract which can be traded?*
- IV. Should the Capacity Market Delivery Body maintain the processes and capability to undertake pre-qualification throughout the year, and what service standards are required for processing new applications?*
- V. Should a secondary acquirer of a Reliability Option start from a zero position against each “stop-loss” limit, or should the loss transfer?*

PrePayPower believe that secondary trading should only be through a mandatory centralised platform, in order to promote transparency and competition, with the ultimate aim of enabling this competition to drive prices to a level at which they provide the correct market entry and exit signals at a clear and fair price. We believe that direct secondary trading is not clear enough on this front and will not provide the relevant transparency and competition, which could be seen on an open platform.

We believe sufficient demand will be available for such a platform, in particular if the cross border route, described in the section above is followed, as it will allow participants into and out of the market as they so choose. Similarly the ability to move outages dates to allow for the optimal timing for generators will also promote the use of such as platform, as will forced outages – though this will tend to be in the shorter term.

We believe that the total volume of reliability options required is best decided upon by the TSOs, who are based placed to understand how much supply is needed to provide an appropriate level of security. Thereafter it is for market participants to compete for this volume, understanding their commitments to actually deliver it. As such, participants could be allowed to bid above their de-rated capacities if they so choose, but they should bear in mind the consequence of not delivering when so doing.

The timescales for auctions should be driven by the need to provide competition whilst ensuring transparency. Following from this we believe that secondary trading should begin immediately following the primary auction and conclude at the day ahead stage. Similarly we believe that pre-qualification is important in ensuring that, where necessary, Reliability Options are passed on to



participants capable of supplying it, and that the TSOs are best placed to decide on the required security standards to meet this aim.

We do not believe a stop loss should be re-zeroed when it is resold, as the security of supply could be compromised by such an approach. Instead options where there has been a high degree of previous failures, should be worth less and should retail at a lower price in the secondary market. This reduces the chance of non-delivery of a reliability option, both with its initial provider and overall.

Finally, PrePayPower would like to express concerns that secondary trading could be used as a method of gaining market dominance after the initial auctions by dominant players hoovering up volume in the secondary market. We request that appropriate measures are put in place to mitigate against this.

#### **Section 4 – Detailed reliability option design**

##### **Reliability option contract length questions**

###### **A) Principle of Longer Term Reliability Options:**

*I. Do respondents agree that plant requiring significant investment should be able to avail of longer term Reliability Options?*

*II. Do respondents agree that existing plant should be restricted to reliability options with a term of 1 year?*

*III. Do respondents believe that longer term Reliability Options should only be available to new-build plant, or should also be available to existing plant where significant investment is being made to enhance or maintain its capability to provide capacity?*

###### **B) Classification of plant as new, upgrade or existing**

*I. Do respondents have a view on which approach should be used to classify capacity providers as “new”, “upgrade” or “existing”?*

*II. Do respondents prefer the approach of classifying providers as “new”, “upgrade” or “existing”, please indicate your view of the criteria, evidence and thresholds that should be used to inform this classification.*

###### **C) Maximum available Reliability Option lengths**

*I. Do respondents have a view on the appropriate maximum Reliability Option lengths that should be available to new-build and upgraded plant?*

*II. How do respondents view the Reliability Option lengths in relation to the five generic frameworks set out in this section.*

##### **Stop-loss limits questions**

*D) Do respondents favour the I-SEM Capacity Year running from October to September, with annual stop loss limits applying over that I-SEM Capacity Year?*

*E) Do respondents believe that “per event/day” and “per month” limits are required in addition to the annual stop loss limit?*

*F) Which approach do respondents favour for the definition of the Per Day/event limit?*

*G) Please provide views on the appropriate levels for the each of the proposed stop loss limits.*

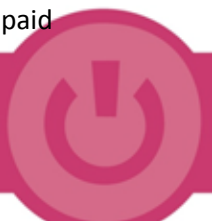
##### **Commissioning Window and Implementation Agreements questions**



- H) *Is a period of four years from the Auction Date to the start of the first Delivery Year appropriate?*
- I) *Does setting the Long Stop Date at 18 months after the start of the first Delivery Year strike the correct balance between the costs incurred by the market and the ability for delayed or longer-running capacity projects to be completed?*
- J) *Are the proposed milestones reasonable?*
- K) *Are there any other milestones, especially prior to Substantial Financial Commitment, which could be used to add security to the delivery of new capacity?*
- L) *What proportion of the contracted capacity is appropriate to use to identify Substantial Completion?*
- M) *Is six-monthly reporting appropriate?*
- N) *Do any (or all) of the reports need to be independently verified?*
- O) *Does 18 months provide sufficient time after the Auction Date to achieve Substantial Financial Commitment?*
- P) *Is it appropriate to terminate a Reliability Option for failure to achieve Substantial Financial Commitment?*
- Q) *Should failure to achieve any other milestones (within a suitable window) trigger termination of the Reliability Option?*
- R) *Is it appropriate to partially terminate a Reliability Option if it can achieve 'Minimum Completion? What level should be set for Minimum Completion?*
- S) *If a Reliability Option is terminated under the terms of the Implementation Agreement, should this project be 'sterilised' for a period of time following the termination and be unable to participate in capacity auctions?*
- T) *Should the I-SEM consider terminating Reliability Options if the information submitted as part of the qualification process is discovered to be false or mis-leading?*
- U) *Do respondents agree that the level of the performance bond should be based on a pre-estimate of the cost to the market of non-delivery of contracted capacity?*
- V) *Do respondents agree with the principle that the level of performance bond should rise over time, reflecting increased costs to the market? If not, what alternative principle should be used and why?*
- W) *At what level in €/MW does the performance bond create a serious barrier to entry? Does this differ for small vs large plant or for different technologies?*
- X) *Do respondents agree with the principle that use of a fixed €/MW level for all participants, regardless of size, to set the size of the performance bond does not fully capture the costs and risks to the I-SEM and that a more complex approach is needed? Do participants have an alternative preferred method for handling the greater risks to the I-SEM created by larger new capacity projects?*
- Y) *How should the level of the performance bond change over time? Should this have any link to the milestones?*
- Z) *Do you consider that the Time To First Delivery (/Time to LSD) proposed here for the CRM should also apply equally to the delivery of System Services under the DS3 arrangements? If you consider that the time (s) should be different, on what basis / what rationale should they differ?*

PrePayPower acknowledge that plant requiring significant investment is likely to need longer term reliability options, whilst these are not necessary for existing plant. Noting the age of existing plant in the current SEM, PrePayPower believe that annual one year contracts should be used for existing plant, whilst for new plant reliability options up to the economic life – 15 years – of a typical new generating unit could be granted.

We do not believe that this should apply to upgrading existing plant, as we believe that all major work required for existing plant – be it the installation of Flue Gas Desulphurisation (FGD), Selective Catalytic Reduction (SCR), rotor, stator or turbine upgrades etc. are not of the same scale as building an entirely new unit. Given that the costs for almost all existing thermal units should have already been paid



down, this would be a waste of money, which would be better dedicated to the provision of a new unit.

PrePayPower do not hold strong views on the timing of the I-SEM capacity year, and related calculation of stop losses, and believe that the TSOs are best placed to decide what this should be. We believe that a per month limit should be required so as to prevent per year events racking up and risking compromising security of supply. We believe that a stop loss per event definition would be too complicated to monitor correctly and its complexity may end up having a deleterious effect on both pricing and security of supply.

PrePayPower strongly believe that the replacement of older, less efficient, more expensive plant by new, more efficient and cheaper plant is key to the I-SEM, or indeed to any power market, in order to drive down price for the end consumer. However, it is also key that the right plant is built and that the new market does not become one littered with partially completed projects.

We strongly believe that only plant delivering actual capacity should be paid and that no revenue from the Capacity Remuneration Mechanism (CRM) should be made available until a plant is delivering capacity. Consequently, we do not believe a performance bond would be necessary, as no payments would be made to a project until it completes its target milestones and commissions.

The Commissioning window and implementation agreements section of the paper must be beholden to this. That is, that there are no payments to a project until it completes its targets and milestones and that there is no requirement for a performance bond. Beyond this overarching principle, PrePayPower are relatively flexible as to how the specifics are implemented.

Though we would not take a strong view, a 4 year period from auction date to the first delivery year and a long stop date of 18 months seems appropriate given the current technology and experience in other markets. Project milestones, and achievements against these, should be monitored at least bi-annually and more usefully quarterly, with reporting on similar timescales. We also believe that independent verification should be aspired to given the potentially complicated technological detail, especially were new technology is employed.

Whilst we believe that the failure of a project to adhere to these goals should lead to the withdrawal of a reliability option for it, had one been granted, we do not believe that such a project should be "sterilised" if new owners were to take over a previously failed project. Indeed, it is possible that given some progress in its initial phase such a project may be easier to realise than one starting from a blank slate.

We also believe that were a project to fail to deliver its initial targets its reliability option should be terminated, though it would be free to reapply under its new criteria, however, were false or misleading information to be submitted this should lead to immediate cancelation of such an option.

PrePayPower has some concerns over the balance of volume made available for long term and short term options, but believe the TSOs are best placed to decide on what this balance should be, given their future view of supply and demand in I-SEM. We would suggest greater volume be made available on short term options if there is little or no requirement for new plant in the medium-term and vice versa.



## Section 5 – Level of Administered Scarcity Price

*A) Which of the options do respondents prefer (and why) for the enduring level of the Full Administered Scarcity Price (FASP)?*

*I. VoLL;*

*II. EU Consistent (e.g. with GB);*

*III. Euphemia Cap; or*

*IV. Existing SEM PCAP*

*B) Do respondents agree with the definition of full load shedding (when Full ASP applies) as set out . If not please explain why, and your proposed alternative definition.*

*C) Do respondents agree that virtual bidding removes any incentives on capacity providers to withhold power from the DAM or the IDM to sell in the BM? Do you agree that this applies regardless of what market power controls are placed on DAM, IDM and BM bids? Do you agree that this applies regardless of the level of the Full ASP? If you do not agree, please explain why.*

*D) If stakeholders consider that it is appropriate to set the Full ASP at a lower level for an introductory period they should also set out, how long that introductory period should be and why, or alternatively the principles that the SEM Committee should employ in deciding when to move from the introductory full ASP to the higher rate full ASP.*

*E) If you favour a different level of Full ASP, either for an introductory period, or after any introductory period, please indicate the level and justify your response.*

*F) Do respondents agree with the proposed approach of using a static approach to setting the piece-wise linear ASP function at the inception of the I-SEM, and if not why not? If yes, do you agree with the proposed approach of setting the piece wise linear equation as a function of the remaining MW of available operating reserve?*

*G) What should the value of X in Figure 12 be?*

*H) How far in advance of the start of the Capacity Delivery Year should the piece-wise linear function be set. Does this need to be before the T-1 auctions?*

*I) Do respondents think that any changes need to be made to the governance of the target operating reserve policy. If yes, what are these changes?*

This is a section over which PrePayPower have a number of significant concerns and where great care needs to be taken, especially in the early years of I-SEM. During its time the SEM market has delivered security of supply under very testing conditions, be it significant growth, recession or wind penetration, to this extent the existing SEM PCAP value has proven its worth over this time, likewise the reviewing of it.

PrePayPower are concerned that substantial move away from market-set pricing early on could significantly undermine the new I-SEM market, especially noting the very high imbalance prices seen in the early days of the GB NETA market and in the “Damhead Creek incident” of May 19<sup>th</sup> 2004. These led to imbalance prices that were so severe as to threaten the existence of small players in the GB market. Therefore we believe that the existing PCAP value be maintained at I-SEM go-live for the full ASP, and monitored on an annual basis as is currently the case.



Whilst we note that the RO strike price is intended to protect suppliers from ASP, the difference between the RO Strike price and ASP will need to be recovered by generators, and the greater this difference, the greater the additional cost in the RO fee chargeable to suppliers. Furthermore, it would be possible for vertically integrated utilities to use increased RO fees to subsidise their retail arms, which would in turn threaten to drive smaller players – who would not be able to access these RO fee payments – from the market, decreasing competition.

It is also possible that larger retailers with stronger balance sheets maybe able to over purchase in ex ante timeframes in order to access such imbalance administered prices. Suppliers with interval metering also have this opportunity, whereas suppliers with non-interval metering (where demand reduction relative to a profile is not reflected on a given day's estimated profile) do not. This presents a risk that there is a, potentially profitable, section of the market that is open to only a limited number of players, and this could be used to enhance their market share in other market segments, driving smaller players from the market and reducing competition.

The greater the delta between the RO Strike price and the Full ASP, the greater this risk is, consequently we believe that, given the nature of the RO strike price, a lower value of ASP is desirable.

The point at which the Full ASP value applies should be the point at which fundamental load shedding begins, i.e. actual black outs for part, of whole, of the system, rather than the point at which frequency or voltage rules are relaxed.

Clearly there are concerns about volume being withheld from the Day Ahead and Intra Day markets at times of system stress and in anticipation of higher prices in the balancing mechanism. This essentially is anti-competitive behaviour, which PrePayPower believes must not be tolerated. We believe that such incidents must be investigated ex-post by the Market Monitoring Unit, and that repeated examples of such behaviour should lead to a units' license being withdrawn.

We believe that the value "X" in Figure 12 should be the RO strike price, as this would provide a clear transition in pricing from normal levels of operating reserve to sub normal levels of operating reserve, but we do not believe any changes should be made to the Target Operating Reserve level. This is for the simple reason that no generating units bigger than the current largest on the system are due to commission in the near future.

## **Section 6 – Transitional issues**

- A) Which of the suggested options (annual auction, block auction, do nothing) do you prefer?*
- B) If you prefer the do-nothing auction, do you believe this should be accompanied by relatively low levels of Administered Scarcity Price?*
- C) Are there any other transitional issues respondents feel that we should take account of when implementing the CRM?*

Though PrePayPower do not hold strong views on the topic, our view is that Option B is the best option, for the reason of avoiding contingency issues and achieving the best overall price. We are strongly against any floor price being introduced, through mandating minimum bids from certain







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providers, as this would appear to be counter to EU law and would mitigate the effect of competition, falsely increasing prices.

