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Ireland.

DATE: 27th of April 2016

To: Karen Shiels (Karen.shiels@uregni.gov.uk) and Thomas Quinn (tquinn@cer.ie)

RE: EAI Response to CRM3 Consultation

Dear Karen and Thomas,

EAI welcomes this opportunity to respond to the third consultation in the CRM workstream.

EAI would like to re-emphasise its considered views put forward in response to CRM Consultation 1 (SEM-15-044) that step-wise changes be implemented in the transition from the SEM to the I-SEM. While EAI has no argument against the CRM introducing an exit signal, the medium-term history of capacity provision in both jurisdictions of Ireland and Northern Ireland is characterised by a 'bust-boom' cycle. And it has tended to be the case that most capacity interventions have been designed to counteract the primary trend prevailing at each time. Given the relative small size of both systems and the resulting 'blockiness', relatively small tilts in either direction tend to become magnified over relatively short periods.

EAI strongly urges that the design adopted should aim to avoid this 'boom-bust' cycle associated with capacity adequacy, as well as minimise to the greatest extent inefficient exit of plant. It is our considered opinion that a long-term view should be adopted, reflected in a mechanism that smooths out transitions (exit & entry) on the system, without creating requirements for periodic interventions.

With the above in mind, careful consideration should be given to the lumpiness problem identified in the consultation paper and the creation of the sloping demand curve.

In the event that exit signals are appropriately received by plant, it is imperative that the obligations placed on that plant (for instance through its generation licence or the Grid Code) allow exit in the same timeframe as the signal given by the market.

We also propose to use this opportunity to raise a concern in relation to the RAs' emerging thinking on Secondary Trading and the treatment of interconnectors. Specifically:

1. we are concerned that the proposal to limit the timeframe when secondary trading can occur to 6 weeks of the year will not give adequate cover to participants; and
2. we believe that Interconnectors should be subject to the same rules as any other potential capacity providers.

The remainder of our response outlines the consensus position of the industry on other issues raised in CRM 3 such as Auction Timing, Net CONE Calculation, the Lumpiness Problem, Demand Curve, Strike Price, difference payment shortfall and Governance.

Auction Timings

The dates of the respective auctions need to be concrete to give confidence to participants and to enable effective planning and resourcing as well as timely engagement on the changes to any input parameters.

Net CONE calculation

- The existing BNE calculation methodology will need to be reviewed, adapted and consulted upon if it is to be used to calculate NET CONE for ISEM Reliability Options(RO). For example, the BNE calculation assumes a 20 year time horizon whereas the ISEM RO contract will have, at maximum, a 10-year time horizon. Furthermore, the calculation of Net CONE would have to be adjusted to allow for the expected cost of RO difference payments.
- The RO scheme cannot function effectively if a price cap is set on the basis of 1x Net CONE. To allow for errors in the calculation of Net CONE, missing money and for fluctuations in the market price across years (which will sometimes be below Net CONE and sometimes above it) it will be necessary to set any price cap as a multiple of (rather than equal to) Net CONE, consistent with international practice

The lumpiness problem

The EAI is concerned that accepting out-of-merit bids will distort capacity prices and market signals and is not an acceptable solution. Only in-merit bids should be acceptable, but the definition of “in-merit” must be extended to accommodate the problem of lumpiness and we suggest this is achieved by deriving a sloped demand curve based on a security standard of 3 hours.

As outlined in our response to CRM 1, we believe that aligning the ISEM security standard with the GB standard is necessary to safeguard security of supply in ISEM and facilitate efficient trading between the two markets as well as to ensure inward investment and economic competitiveness.

Strike Price

The strike price must, in all circumstances, exceed the cost per MWh of every generator running at times of system stress. Therefore, the formula to determine variable costs needs to be comprehensive, realistic and explicitly capture all costs. Whatever formula is chosen, it must cover the total cost of running all generators during a short-lived period of system stress.

- A thermal efficiency of 15% is inappropriately high

Difference Payment Shortfall

- The risks associated with the ‘hole in the hedge’ need to lie with the TSO in its role as BMO and Capacity Market Settlement, and not with suppliers directly who will not have any hedge available to them to protect against cashflow uncertainty when the strike price is breached as a result of the RO design.

- Due to the wider development and design of the CRM and the proposed treatment of Interconnectors, the application of a scarcity price and one-way CfD will not provide the desired supplier hedge in all instances.
- A central fund, administered by either TSO or SEMO, is needed to cover the shortfall. A K-factor adjustment should be used to reconcile any difference over subsequent years.

Governance

There will be a number of input parameters to each capacity auction which will directly influence the nature and outcome of the market. These include, but are not limited to:

- Net CONE;
- The cap multiplier;
- The slope of the demand curve;
- The financial thresholds for new build/refurbs;
- Target capacity;
- Market power thresholds;
- Bid bonds;
- Collateral requirements;
- Decrement sizes, and
- Data sources for strike prices

It is imperative that the governance of these parameters is transparent, both in terms of the timelines for review and the review process itself. The EAI would welcome an opportunity to discuss the governance process and timelines with respect to each specific parameter at a later date.

EAI looks forward to further engagement on the issues raised in this consultation.

Yours sincerely,



Stephen Douglas
Senior Advisor
Electricity Association of Ireland (EAI)