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Utility Regulator
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Thomas Quinn
Commission for Energy Regulation
The Exchange
Belgard Square North
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27th April 2016

Dear Thomas and Karen,

PrePayPower, as Ireland's largest prepay electricity provider, welcomes the opportunity to contribute to the SEM Committee Capacity Remuneration Mechanism (CRM) Detailed Design Third Consultation Paper (SEM-16-010), "the consultation paper".

As non-dispatchable demand will not explicitly participate in the CRM, PrePayPower focusses its comments on:

- Market power and Investment Cycle;
- The Base Charging Structure of the CRM; and
- The Difference Payments and Socialisation Arrangements for the Hole in the Hedge.

We have made parallel comments to the I-SEM Market Rules Working Group in relation to the latter two items which will be reflected in the CRM settlement rules.

Market Power and Investment Cycle

There are few opportunities, short of market generation entry which remains limited by uncertain jurisdictional connection policy, to hedge the outcomes of the capacity auctions and the resulting charges. Sudden shocks in capacity pricing cannot be absorbed by a non-vertically integrated supplier. **Therefore, PrePayPower prefers gradually changing capacity charges at a fair price, reflective of where the system is in relation to the generation investment cycle.** Year-to-year volatility neither serves our customers, nor provides for appropriate entry/exit signals for the generation fleet.

The I-SEM will be a small capacity market. It has "lumpiness" issues in terms of clearing capacity, and may have cyclical sharp pricing events around the points of new generator entry. We support design features in the auction to smooth those signals, without damping the necessary entry/exit signals. This would suggest:



- Mandatory bidding (subject to exclusions) – already decided
- Physically withheld capacity netted off auction volumes – already decided
- Plant that has signalled market exit should not be allowed to re-enter auctions without being subject to rigorous checks and balances
 - As noted by the consultation paper, such behaviour increases the year-on-year volatility of pricing signals between T+4 and T-1 auctions
 - The checks and balances should be principles-based, rather than being set out in explicit rules which could be gamed
- Auction caps
 - To prevent the clearing price reflecting the spiked cost of new entrant capacity, should it urgently be needed, particularly during T-1 auctions
- Bid limits (caps and floors) to ensure certain predictability in the outcome prices which should be applied to all existing generation, not just those which fail a dominance test
 - It should be based on a common best new entrant pricing methodology for all generation, to remove complexity from the market design
- A sloping demand curve, particularly past the point where sufficient capacity has been procured
- If the bid limit for existing generation and the auction cap prohibit necessary new entry, then those generators should be pay-as-bid and recovered through the capacity charge
 - The alternative is to run a separate competition, resulting in the same outcomes for customers through a different regulated charging mechanism, e.g. PSO Levy
- If the implementation complexity can be resolved, and the SEM Committee are satisfied that market power issues can be managed, then PrePayPower supports a multiple round descending clock auction due to the greater transparency and stable prices that would emerge
- We support the concept of out-of-merit clearing of bids, subject to maximising social welfare, as described in the paper

The Base Charging Structure of the CRM

We note that this area is not being consulted on within this detailed design paper, and we believe there remain policy-level decisions to be made here. We are bringing these comments to the SEM Committee's attention as the Rules Liaison Group are making certain design decisions which have comparable impact to the difference payments socialisation arrangement discussed under Section 8.3 in the consultation paper.

When setting tariffs for customers, PrePayPower wants the capacity charges to be reasonably predictable. Today in the CRM, the price per MWh chargeable to suppliers varies with differences in demand forecasts, and can vary from month to month. Within the context of a retail domestic supplier, however, these variations – while not hedgeable – comprise a small proportion of the end tariff to customer and therefore can be managed. The NEMO has raised a concern that there will be greater variations in the chargeable amount at the end of each month due to the timing of entry/exit.



PrePayPower wants the NEMO to manage this risk with its own working capital facility, to maintain a predictable CRM charging base for our customers.

Furthermore, PrePayPower would strongly recommend that resettlement of capacity charges relates solely to variations in a supplier's demand as currently. Pricing changes in M+4 and M+13 resettlement, or indeed any year-end reconciliation are to be avoided, which is currently proposed in the NEMO design. Such pricing changes for customers of suppliers – particularly those suppliers with growing or shrinking market share – means difficult to explain and volatile pass-through of charges to those customers. Also note that when the “true” capacity cost is known to a supplier for serving a customer, that customer might no longer be with that supplier.

A supplier should therefore be only exposed to variations in its own metered demand in capacity resettlement, and not what is fundamentally a repricing of the capacity charge.

There are a number of mechanisms to potentially manage this process. The first option, and our preferred option, is to create a working capital facility at the NEMO level, allowing differences between what is to be paid to capacity providers and what is charged to suppliers at the end of each month. Shortfalls or over-recovery in capacity payments would be managed by the NEMO, and corrected through capacity charge corrections in the following year. The first is – on the assumption that variations in capacity payments are limited to current levels of volatility – simply charge what is to be paid to capacity providers from suppliers at the end of the month.

The Difference Payments and Socialisation Arrangements for the Hole in the Hedge

PrePayPower notes its desired design features for the base charging arrangements. If there is any unpredictability in the charging rate, it should be limited to that observed currently or managed by the NEMO, and capacity charges once settled should not be materially revisited in terms of price. We note and welcome that “avoiding price shocks” in the socialisation fund is a principle set out by the SEM Committee for the socialisation fund to meet the hole in the hedge.

To that end, PrePayPower support predictable charging for the hole-in-the-hedge. These charges should not be collateralised. Those who do not pay do not receive benefit from the fund.

The socialisation fund should be set at reasonable and not unduly onerous level. It should not be set at an “all-risks” level. TSO/NEMO short-term funding should manage the vast majority of potential hole-in-the-hedge scenarios.

Thirdly, PrePayPower note that a prudently traded supplier should have confidence that the socialisation fund will be fit for purpose to provide for complete difference payments. These difference payments form part of a supplier's hedging strategy, and the reliability of the CRM provided hedge should be equivalent to any other standard hedging product.

That said, there are limits to covering all possible scenarios for all suppliers, even with reliance on the EirGrid/NEMO short-term funding, and this in particular relates to suppliers with large imbalance positions



being exposed to the imbalance market price arrangements. The balancing market prices are likely to be more volatile than day-ahead pricing. It is PrePayPower's contention that subject to the socialisation fund being appropriately sized, it is unreasonable for the socialisation fund to reallocate from well traded suppliers to poorly traded supplier through an immediate further charge. This shares the cash-flow risk of the hole-in-the-hedge equally amongst participants, irrespective of the nature of their trading.

PrePayPower supports the Suspend and Accrue model, as it is a more predictable form of charging and does not cross-subsidise what are likely to be poor trading decisions from suppliers. We also go further and suggest that the socialisation fund should be utilised for ex ante trades in advance of its utilisation for imbalance volumes.

We have responded briefly to the specific questions raised in the discussion paper below.

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

