ISEM Capacity Remuneration Mechanism

Parameters Consultation Paper

SEM Committee Consultation

SEM-16-073

Power NI Response

21 December 2016

1. Introduction

Power NI welcomes the opportunity to respond to the Regulatory Authorities (RAs) Capacity Remuneration Mechanism (CRM) Parameters Consultation Paper

As the RAs are aware, Power NI is the largest electricity retailer in Northern Ireland. Power NI is part of the Viridian Group which has within in its portfolio, a retail position in Northern Ireland and the Republic of Ireland, as well as a significant thermal and renewable generation presence.

Power NI is however a separate business. Power NI's legal, managerial and operational separation is mandated via licence condition and it is within the context of being a supplier without vertical integration; that Power NI has approached the CRM workshops, fed into ETA rules workshops, assessed the issues presented and now responds to the CRM Parameters Consultation Paper.

2. General Comments

As the SEM Committee is aware Power NI has responded to the CRM Design Consultations issued to date. Unfortunately Power NI remains concerned about a number of aspects of the design from a supplier's perspective.

In respect of the capacity settlement and what has been developed and presented to date, Power NI is of the view the algebra is overly complex. This is something that has previously been communicated back through the ETA comments process by Power NI

Due to the wider development and design of the CRM it is clear that the mechanism, application of a scarcity price and one-way CfD rules will not provide the desired supplier hedge in all instances. This "hole in the hedge" is clearly undesirable, represents a significant risk and requires addressing. The socialisation fund is in essence an insurance policy for suppliers complete with premiums to be paid and returns at times of duress. It is therefore vital that this fund is robustly designed and operates effectively.

Supplier's contributions to the fund

Power NI welcomed and supported both the two objectives (adequate funding and avoiding shocks) and set of principles outlined in Sections 8.3.7 and 8.3.8 of the CRM3 Consultation Paper. The RA's have outlined a funding arrangement which is predictable and therefore manageable by suppliers i.e. "*recovered from Suppliers by increasing the amount they are charged for capacity*".

For the avoidance of doubt, Power NI believes the practical implementation of this proposal would require SEMO (backed by Eirgrid and SONI) acting as

Balancing Market Operator (BMO) and CRM settlement entity to forecast and publish a socialisation fund tariff ahead of the year.

Shortfalls in the fund

The RA's have however highlighted that the BMO may not be able to cover all shortfalls through borrowing. Power NI has interpreted this to mean that should an under recovery become too large, the RAs do not expect the BMO to cover the shortfall and recover through the following years correction. Power NI does not agree with this approach and believes the BMO should manage all shortfalls through a corrective K-Factor.

Power NI remains concerned with the lack of clarity in respect of the socialisation financing facility and in particular the size of this facility. Power NI would ask the RAs to provide further clarity on this matter.

While Power NI expects a shortfall to be an exceptional circumstance, we do recognise the working capital obligations the above arrangements place on the BMO, especially until the fund is fully established. To mitigate against such a concern, Power NI previously called for the transitionary inclusion of a small socialisation levy pre I-SEM go-live.

Power NI would again welcome and support the RA's approving the transitionary inclusion of a small socialisation fund charge being added to the capacity requirement for the pre I-SEM go-live part of the tariff year 2017/18 i.e. a small levy on a per MWh basis added to the CPDP (Capacity Period Demand Price) for October 2017 to May 2018 to create the fund for the start of the ISEM. Power NI would expect this to be subject to all relevant due diligence, regulatory audit and contractual trust arrangements. This has the advantage of establishing the fund ready for Day 1 of the I-SEM while smoothing the required contributions necessary to meet the proposed confidence metrics over a longer duration. Such an approach would reduce the BMO's working capital concerns and facilitate the management of shortfalls within year in a non volatile manner.

ASP

In our response to both CRM 2 and CRM 3 consultations Power NI eluded to the fact that the ASP mechanism in general places a risk on suppliers that may not be avoidable without appropriate mitigation measures. These measures were outlined in our response to CRM 2, and include:

- A fully liquid and effective Forward Market with appropriate market power mitigation measures.
- A fully functioning and liquid Day Ahead Market and Intra Day Market (IDM) to allow suppliers to trade and refine their position.
- Appropriate and timely measures to return revenues paid by generators under the one way CfD.

No comfort can be drawn that there will be adequate measures in place to mitigate the risks associated with points 1 and 2 above. In fact, risks associated with the Forward Market point have been heightened following another delay of Forward Market decision to at least the end of March 2018.

In relation to point 2, and in particular the IDM, concerns still prevail in relation to availability of a fully functioning “commercially ready” IDM market. External dependencies continue to pose a threat, for example, the status of EUPHEMIA, state aid approvals, cross-border interactions with GB in terms of regulatory and participant participation and also the enduring IDM solution and associated timeframes.

In relation to point 3, there are still uncertainties regarding this area, primarily regarding the CRM socialisation financing facility and the size of this facility as alluded to in the introduction.

As a general point, the CRM should be fair, cost effective and backed by physical generation able to provide energy at times of system stress, thereby maintaining the agreed security standards. The correct balance needs to be struck that adequately rewards providers of capacity in terms of facilitating total cost recovery and sends appropriate investment signals whilst at the same time does not burden consumers with excessive costs.

3. Specific Questions

As a supplier Power NI has focussed on the limited number of directly relevant questions posed within the Consultation Paper.

Q2.3.1 - The SEM Committee welcomes views on all aspects of this section, including whether you prefer Option 1 (as set out in Section 2.2 above), Option 2 or some intermediate option for the shape and slope of the ASP function, and why?

ANS: In relation to the specific options proposed in respect of the shape and slope of the ASP function Power NI prefers Option 1, certainly in the interim.

Option 1 is a simple and transparent interpolation between €500/MWh and FASP at €3000/MWh versus Option 2 which is less transparent, relies on estimations of both VoLL and LoLP and ultimately will result in higher prices having to be borne by consumers. It is not apparent from the consultation paper whether these additional costs will have an offsetting benefit of maintaining and/or creating incentives for efficient investment and in doing so contributing towards ensuring the efficient level of security of supply. Also, the process of updating the function used in Option 2 is not transparent or objective and unspecified in the Consultation Paper.

Q3.4.1 A – Which of the Option 1 to 3, as set out in Section 3.2, do you think is most appropriate, and why? Alternatively, what other definition of the Supplier Charging Base would you chose and why?

ANS: Power NI strongly supports Option 3. This option is most akin to the current treatment of capacity costs within the SEM, minimises the adverse impact on domestic customers and importantly, given the revised go-live date, facilitates the build up of funds into the Socialisation Fund from the beginning of the ISEM.

The build up of funds, as referred to above is an important issue for suppliers. The Socialisation Fund represents a protection measure and hedge for suppliers. Any delay in availing of this protection places a potentially significant financial burden on suppliers who are typically asset light.

Q3.4.1 B – Which LIBOR (or other such reference rate) should be used as the BIR, and what the values of the SPR and DPR should be?

ANS: Power NI is of the opinion 1 month or 3 month LIBOR is probably the most reasonable, appropriate and easiest to administer.

4. Conclusion

Power NI has focussed primarily on a limited number of directly relevant supplier questions posed within the Consultation Paper, primarily the supplier charging basis and the ASP. The other areas for consideration within the paper focus on participation within the CRM auctions which is not something a supplier has to do.

Power NI supports the RAs minded to position of Option 3 in relation to the supplier charging base in the interests of consistency, fairness and the early funding of the socialisation fund. In respect of the shape and slope of the ASP function Power NI supports Option 1 in the interests of transparency, simplicity and to avoid regulatory risk associated with Option 2.

Power NI would urge the RAs to be mindful of the fundamental objective of the CRM which is the provision of physical capacity, capable of providing such capacity when required i.e. at times of system stress. The appropriate parameterisation of the mechanism must be transparent, objective and stable to ensure a predictable and efficient investment signal as required to underpin the prevalent security standard.

Power NI is happy to engage further with the RAs in respect of the points raised in this response.