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## **SEM Consultation Response SEM – 16-073**

### **CRM Parameters Consultation**

Vayu welcomes the opportunity to comment on the SEM Committee’s (“SEMC”) consultation paper – SEM16-073 on CRM Parameters. Although Vayu are mainly involved in the CRM as a supplier, responsible for paying CRM fees on behalf of customers, we believe there are a number of important areas in this consultation that we should respond to. In particular, on the Supplier Charging Base, Vayu believes that the options presented are inadequate and we would like to propose an alternative.

The CRM should provide a price signal to the demand side of the market to manage load at, or to shift load away from, peak times, i.e. the periods where the system is most likely to come under stress. Option 3, which proposes to set a charging base flat across the year singularly fails to provide this and the option of charging at peak periods throughout the year (Option 2) offers little improvement. However, we recognise that a supplier charging base that is too narrow, focussing only on winter peaks (Option 1), creates an opportunity for some market participants to avoid paying anything towards capacity, particularly in situations of system stress and the need to call on capacity may fall at other times of the year. Focussing charging at winter peaks also places charges somewhat disproportionately on domestic customers, who, at least in the short term, will not be in a position to manage load or respond to price signals in the same way as commercial consumers.

In order to reconcile these conflicting objectives and demands, Vayu proposes that a hybrid option, combining elements of Options 1 and 3 be used. This would effectively split the Supplier Charging Base into two parts; one focussed at winter peaks and one recovering costs throughout the year when capacity may still be required to cope with unexpected system stress. Such a supplier charging base would be similar to the time of use tariffs used to recover Distribution Use of System charges (DUOS) by DNOs in the GB market. Vayu believes that this would offer a more equitable basis for charging between customer classes whilst retaining a price incentive to reduce peak demand and, ultimately, reduce CRM costs in the long-run.

As always, we would be pleased to discuss this response and the issues in the consultation paper directly with you, either in a meeting or by telephone. Please do not hesitate to contact us if you require any further information or explanation of anything raised in this response.

## Response to Consultation Questions

### **2.3.1 The SEM Committee welcomes views on all aspects of this section [Administered Scarcity Price Parameters], 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?**

Vayu would prefer Option 1 (as set out in Section 2.2) for the shape of the Administered Scarcity Price curve, as it is preferable to avoid the discontinuities in prices (jumping from €500/MWh to €2000/MWh with little change in capacity margin) embodied by the curve proposed in Option 2. Vayu believes that this would support more rational pricing outcomes and support measured intra-day trading to respond to changes in plant margin.

### **3.4.1 The SEM Committee welcomes views on all aspects of this section [Cost Recovery and Charging], including:**

#### **A. Which of Options 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?**

Vayu does not believe that any of the three Options set out in the paper are appropriate as a definition of the Supplier Charging Base. In addition to rewarding generators for maintaining capacity and providing an incentive on them to make this available at times of system stress, the CRM should provide a price signal to the demand side of the market to manage its load at times of system peak, thereby reducing the requirement and cost for capacity in the medium term. Option 3, and to a slightly lesser extent Option 2, singularly fail to provide this.

While Option 1 does provide a sharper incentive to manage load away from system peak periods, the consultation does recognise that charging in this way would fall relatively heavily on domestic consumers and does not charge for the possibility of system stress occurring at other times of the year.

Vayu favours a combination of Options 1 and 3 as a definition of the Supplier Charging Base, with part of the CRM cost recovered across all day time periods and part of the cost targeted towards system peak periods. This compromise would result in all consumers making some contribution towards the CRM, recognising that the need for capacity may occur at nearly any point in the year. However, it would also target more of the cost towards consumption at peak periods and provide an incentive to manage demand away from this timeframe. Ultimately this should result in reduced peak demands and a consequent reduced requirement to purchase capacity resulting in lower costs overall.

We would urge the RAs to consider the balance between each option and other costs and to conduct detailed analysis on the appropriate level of split, particularly with reference to the ability of the domestic sector to shift demand.

#### **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?**

In order to minimize costs to consumers, Vayu believe that the TSOs should at all times seek to pay the highest interest rate possible on balances in the Socialisation Fund, consistent with the requirements and operation of that fund.

### **4.6.1 The SEM Committee welcomes views on all aspects of this section [Reliability Option Parameters], including:**

#### **A) Do you agree with the SEM Committee's proposed approach to set the DSU floor price at €500/MWh?**

The SEM Committee's proposed approach to set the DSU floor price at €500/MWh seems reasonable, provided that this parameter and the methodology are regularly reviewed in light of market developments as proposed.

#### **B) On the assumption that the gas index will be a reference price related to gas obtained from the GB system, do you agree with the carbon intensity factor? Do you have any other comments on the approach to setting the gas or oil carbon intensity factors?**

Vayu agrees with the carbon intensity factor and has no additional comments on this approach.

**C) Do you agree with the approach to setting transport adders set out in section 4.4?**

Vayu agrees with the approach to setting transport adders set out in section 4.4.

**D) Do you think that the Billing Period Stop-Loss Limit should be set to 0.5 times the Annual Stop-Loss Limit (i.e. 0.75 times the Annual Option fee)?**

Vayu agrees with setting the Billing Period Stop-Loss limit at this level to balance the risk on capacity providers against the incentive to continue to provide capacity following a scarcity event.

**5.4.1 The SEM Committee welcomes respondents' views on the issues raised in this section [New Build, Termination Fees and Performance Bonds]. In particular, the SEM Committee welcomes respondents' views on whether:**

**A) You agree with the approach of setting the New Capacity Investment Rate Threshold at around 50% of the gross investment cost of the BNE plant, currently estimated at €310/kW? If not, what is an appropriate maximum size of termination fee for new capacity which achieves an appropriate balance between protecting consumers by the failure of new capacity to deliver, and not providing a barrier to entry for new capacity?**

Vayu agree that setting the New Capacity Investment Rate Threshold at around 50% of the gross investment cost of the BNE plant is appropriate and in line with the international norms quoted.

**B) You think that the SEM Committee's indicative schedule of termination fees set out in paragraph 5.3 is appropriate? Please provide evidence for your answer.**

Vayu believes that the timing of the termination fees is appropriate but would prefer them to be set around £10/kW (c. €12/kW) higher, to recover a higher proportion of the cost of non-delivery to consumers and to ensure that developers are less likely to receive surplus funds from liquidated damages in the event that a project fails to deliver.

**C) It is appropriate to place termination fees on capacity that does meet the definition of New Build, and if so, at what level, including:**

- a. Minor refurbishment or other upgrades to capacity which does not meet the financial threshold to qualify as New Build;**
- b. Unproven DSUs;**
- c. Any other capacity provider which has not already demonstrated its ability to physically deliver; or even**
- d. All existing capacity**

The consultation recognizes that there is a potential need for capacity providers in the CRM to have some stake in delivering their capacity beyond a simple loss of revenue and to avoid them perceiving a capacity award as a 'free option'. In line with this, Vayu agree that it is appropriate that capacity that does not meet the definition of New Build should pay some sort of termination fee. For the different categories Vayu suggest:

- a. Minor refurbishment or capacity upgrades do entail a slightly higher risk of non-delivery compared to existing capacity but not as much as New Build. A termination fee proportionate to this position would be appropriate.
- b. In order to align with the objective to promote environmental objectives and stimulate the provision of innovative DSU proposals, there should be no termination fee on unproven DSU's. This recognizes the smaller scale of individual DSU sites and that, in some cases, non-delivery of DSU capacity (demand reduction) will be accompanied by non-delivery of the necessary demand to create the demand reduction opportunity.
- c. Without any indication of what these 'other' capacity providers are likely to be it is difficult to provide an appropriate indication of the appropriate level of termination fee. It may be appropriate to treat these on a case by case basis where they do not fit into the existing/refurbished/new paradigm.
- d. For the reasons recognized in the consultation paper, existing capacity should receive an obligation to pay termination fees for non-delivery. Vayu would suggest that this be set at 50% of the capacity payment they expect to receive in the delivery year. This is in line with the stop-loss level for that

capacity in the event that it fails to deliver capacity at times of system stress through the year of delivery.

**D) Performance Bonds should be required for 100% of termination fees, and should this vary by type of capacity?**

Vayu believes that Performance Bonds should be required for 100% of termination fees for New Build Capacity. If this is not the case, there exists the possibility that a capacity project developer could receive liquidated damages from a contractor, pay off the termination fee and retain surplus cash as a profit. This introduces a perverse incentive to not press contractors to complete ailing projects to the fullest extent possible.

For other types of capacity, a different approach may be preferable, taking account of their shorter contract lengths, likely smaller scale and the potential for capacity from terminated projects to be more easily replaced.

**6.6 SUMMARY OF QUESTIONS**

**Net CONE**

**6.6.1 Do you agree with the proposed adjustments to the BNE calculation approach set out in section 6.2.8 to 6.2.10. If not, explain why.**

Vayu agrees with the proposed adjustments to the BNE calculation approach set out in section 6.2.8 to 6.2.10.

**Auction Price Cap**

**6.6.2 Do you agree with the choice of multiple of 1.5 x Net CONE in setting the Auction Price Cap?**

The multiple of 1.5 x Net CONE proposed for setting the Auction Price Cap is in line with international norms and can be adjusted in the future so Vayu has no objection to its use as a starting point.

**Existing Capacity Price Cap**

**6.6.3 Do you agree with the proposed methodology of estimating a generator's Net Going Forward Costs (NGFC) at:**

**Max[(Fixed operating costs – gross infra-marginal rent from the energy and ancillary service markets),0] + Expected Reliability Option difference payments**

Vayu agrees with this methodology of estimating a generator's Net Going Forward Costs.

**6.6.4 Do you agree with the proposed process and data inputs to calculate NGFCs as set out in 6.3?**

Vayu agrees with the proposed process and data inputs to calculate NGFCs as set out in 6.3.

**6.6.5 Do you agree with the proposed approach of setting the Existing Capacity Price Cap at 0.5 x Net CONE? If not explain why, your preferred alternative approach and your rationale for the alternative.**

The multiple of 0.5 x Net CONE proposed for setting the Existing Capacity Price Cap is in line with international norms and can be adjusted in the future so Vayu has no objection to its use as a starting point.

**6.6.6 Do you think that the NFOC costs reported by generators to the RAs as part of the SEM Generator Financial Reporting are a good proxy for the Fixed Operating and Maintenance costs that a capacity provider may need to recover via the I-SEM CRM, or do you think that the NFOC contain material variable cost which can be recovered via the energy / ancillary services market? If the latter, how big an adjustment should the SEM committee make to exclude any variable elements of the NFOC from NGFCs included in the Existing Capacity Price Cap?**

Vayu do not own or operate any generation and lack any detailed information on the breakdown of these costs. However, the figures would appear to be very high, particularly when compared to international

benchmarks, and every effort should be made to exclude variable elements from NGFCs to protect customers from paying excessive costs to generators.

**6.6.7 Why are reported SEM generator NFOC/FOM costs substantially higher than international benchmarks? Do you think that existing SEM generators have material scope to cut fixed operating and maintenance costs, and if yes, do you think that this should be reflected in the Existing Capacity Price Cap? Explain why.**

Vayu do not own or operate any generation and lack any detailed information on the breakdown of these costs. It may be possible, as highlighted in the consultation, that this is a factor of a significant proportion of aging plant in the SEM. However, not all plant in the SEM is aging, particularly CCGT plant which is directly comparable in age to similar plant in GB, and we would question why this appears to have substantially higher NFOC/FOM costs. The most likely explanation appears to be a lack of competition, driving an incentive to minimize these costs and Vayu believes that this should be corrected by introducing a lower Existing Capacity Price Cap. The Regulatory Authorities would appear to be best placed to gather the information from existing plant to reach a reasoned decision on the level of this cap.

**Demand curve parameters**

**6.6.8 Which of options A, B or C with respect to the demand curve set out in Section 6.4 do you think is appropriate for the first transitional auction, and why?**

Vayu agrees with the reasoning set out in the consultation and that Option C is appropriate for the first transitional auction.

**6.6.9 Do you have any other comments on the shape and/or positioning of the demand curve for the first transitional auction?**

Vayu would re-iterate previous comments made to the Supplier Charging Consultation that it is not appropriate to position the demand curve to take account of the capacity contribution of de minimis generators when there is no mechanism in the market to direct any rewards to de minimis generators for this capacity contribution.

**Locational parameters**

**6.6.10 If the SEM Committee proceeds to incorporate locational requirements within the I-SEM CRM, do you agree that the costs/risk of implementing local demand curves (as opposed to a minimum requirement) outweighs the benefits?**

Vayu tends to agree that, in a market the size of Ireland that the cost/risk of implementing local demand curves outweighs the benefits.

**Load Following for Secondary Trading**

**7.2.1 Do you have any comments on the approach to setting the load following parameter set out in the section? Specifically do you agree with the granularity of the parameters, the proposed historically based methodology, and proposed governance approach? If not, why not and what other arrangements would you propose?**

Vayu believes that the whole exercise of setting these parameters, including granularity, historical methodology and governance is over-complicated and unnecessary. Capacity providers should be allowed to make their own assessment of additional capacity that they can use to back secondary market sales of ROs and to be responsible for any risks they take on in the event that the incorrectly estimate what their load-following headroom should be.

**7.2.2 Do you think that capacity providers should be able to trade against load following margin in calendar year +2 and any subsequent years, and should the parameters for subsequent years be scaled to 75% of the calendar year Y+1 values or some other percentage?**

In line with our answer to 7.2.1 above, Vayu believes that capacity providers should be able to make their own assessment of their ability to provide capacity in the secondary market and to take responsibility for any risks. Applying scaling factors to subsequent years is, therefore, not necessary.