Response to:

Capacity Payment Mechanism Medium Term Review: Work Package 6 onwards (SEM/11/019)

4th July 2011

Introduction

ESB Wind Development (ESBWD) welcomes the opportunity to respond to the consultation on the Capacity Payment Mechanism (CPM) Medium Term Review. ESBWD is a leading developer of wind projects across the island of Ireland and future certainty in Capacity Payments is of significant importance to our business.

High level general comments to the consultation are given in Section One below. Answers to specific questions raised in the consultation are given in Section Two.

Section 1: General Comments

Case for Change to the CPM

The Regulatory Authorities (RA) consultation states that the "overall performance of the current CPM design appears satisfactory when considered in the context of its competing objectives". A key objective of the CPM as per the SEM High Level Design (HLD) is the security and capacity adequacy of the system and it is clear from the joint Eirgrid & SONI publication "All-Island Generation Capacity Statement 2011-2020", which forecasts a positive all-island generation adequacy situation for all study years under all scenarios studied, that this objective is being met under the current mechanism. Given that the CPM is meeting its objectives, any changes to the mechanism do not appear to be necessary.

It is likely that substantial and significant changes to the SEM design will need to be considered in the near future to ensure compliance with the European Target Model (ETM). Given this it seems pointless to make tweaks to the current design which will result in an even greater level of regulatory uncertainty and risk for market participants then exists already because of the ETM. Furthermore any changes to the CPM will result in potentially significant costs which ultimately will be borne by customers. It is not clear that such costs are justifiable.

It is therefore the strong view of ESBWD that there be no change to the CPM at this time.

Implications for Wind Generators

All of the proposals put forward in the consultation for changes to the CPM design could, if implemented, result in diminution of revenue streams for wind generators in the SEM. These changes could therefore have a negative impact on the economic viability of wind projects and ultimately could lead to wind projects not being developed and Government renewable targets not being met.

The implications of any changes to the CPM design on the economic viability for wind generators and achievement of Government renewable targets needs to be considered before any changes are made to the CPM.

Section 2: Consultation Questions

Capacity Credit & Wind Generators

- Should the RAs look more closely at a Capacity Credit scenario for the payment of different generation types?
- Is a Capacity Credit methodology appropriate for the CPM?
- Does the current mechanism fairly reward wind or does it need to be revised?
- Should there be a separate stream of capacity payments for wind?
- The RAs welcome alternative suggestions for allocating capacity payments between generator types

ESBWD firmly believe that a capacity credit based capacity mechanism should not be introduced. Such a scheme would be extremely complicated and potentially costly to implement and would most likely require further rounds of consultation. It would also result in significantly lower capacity incomes to some generator types which is completely at odds with the CPM objective of fairness. The reduction in revenues to renewable generators may put Government renewable targets at risk of being achieved. Also, it is not at all clear that the mechanism as proposed would help in anyway with incentivising the ideal capacity mix on the system.

Flexibility Payments / Ancillary Services

- The CPM and AS revenue payment streams have two separate objectives and it is the RAs view that these should remain separate. Should the CPM offer payments for Flexibility?

ESBWD agree with RAs view that the CPM and AS schemes and their objectives remain separate. It is important however that flexible generation is incentivised on the system. This should be done through the AS scheme, without dilution of the capacity payments.

Changes to the current AS current scheme also need to be made in order to allow renewable generators participate. Currently the liability amounts in the standard AS contracts are linked to the level of AS revenues a conventional generator could expect to earn. This liability level is prohibitive however for renewables.

New Entrants

- Should new entrants be treated differently to incumbents in the CPM?
- The RAs welcome comments on the feasibility of introducing a new entrant guarantee

ESBWD believe that all generators should be treated the same under the CPM. The AS mechanism should be used to incentivise the flexible generation mix that is required on the system.

Current Distribution & Flattening Power Factor

- Should the design of the distribution allocations be changed?
- The weighting of the 3 components
- Should the current values be maintained?
- New ideas on the distribution allocation
- Should a FPF be applied within the CPM
- Should the current value be maintained or changed?
- If the mechanism moves to a heavier weighted ex-post payment with the FPF be as effective?

ESBWD believe that the distribution allocation of capacity payments should be left unchanged. The main argument for such change seems to be that increased ex-post based payments result in a more efficient short-term price signal thereby ensuring better availability of generation at times of tightest capacity margin. It is not clear however how this would result. For this to happen would require generators to be able to predict what the LOLP on system will be and then to be able to react and reschedule maintenance around this. There are no short term forecasts of LOLP available to be able to do this. It is therefore not clear that such changes to the CPM are justified.

Furthermore changes to the distribution allocation will reduce the stability of the capacity revenues to generators which is contrary to the HLD of the CPM which seeks to provide "financial certainty to generators".

SOCAP Model (System Operator Capacity Allocation Programme)

- The RAs welcome comments on the feasibility of introducing a SOCAP model
- The concept that the SO's would "push money around" and signal need for capacity within year
- The value to the system of more explicitly incentivising capacity providers to make sure they will be available when the system will genuinely need them most
- Whether a floor; set high enough; is a sound told for delivering revenue stability and lowering the cost of capital, and if not why not.
- The implications for Cash Flow and Credit for participants and operators

ESBWD believe that the SOCAP Model should be discounted as it would require major changes to the Trading & Settlement Code and a large amount of resources to implement. Inevitably such change would be a lengthy and costly process and is not justifiable. Furthermore, the SOCAP method would significantly increase the volatility of payments to generators, moving the market design away from the fundamental existing structure toward an energy only market.

If you have any questions or would like to discuss any of the matters raised further please contact:

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