



Response to
Fixed Cost of a Best New Entrant Peaking Plant
Calculation Methodology
SEM-09-023

27 March 2009

Introduction

Airtricity supported the introduction of the Capacity Payment Mechanism (CPM) in the SEM. As we stated in our response to the CPM Options consultation paper in 2005 ‘a well designed capacity payment is the appropriate solution to provide capacity entry incentives for the SEM in Ireland.’ We continue to support the CPM and hence welcome the SEM Committee’s (SEMC) decision to review aspects of this market feature. While, as the SEMC notes, the SEM is yet at an early stage and it may be inappropriate to engage in wholesale overhaul of any aspect of the market, least of all the CPM, still some review is required to ensure that operation of the mechanism delivers on the objectives outlined in its design.

Need for Comprehensive Review of CPM

The current consultation identifies volatility in the capacity payments pot as ‘a key concern raised by industry participants’ and embarks on a review of the CPM to reduce this. While this is indeed of concern to the industry, it is not clear why this particular issue deserves priority over various other issues arising within the CPM. For example there is the issue that the capacity payments pot is inadequate to recover all generator capital and fixed costs not covered by energy payments, such as transportation charges for delivering gas into Ireland.

Airtricity would have preferred a comprehensive review process that attempted to address the CPM in a holistic manner rather than addressing it piecemeal. An intricate relationship exists between the functions of the CPM to ‘provide revenues to cover the capital and fixed costs’ not covered by energy payments (‘Capacity Investment’) and to ‘provide incentives for generators to be available at times’ of tight system capacity (‘Capacity Availability’). This two-pronged multi-year v intra-day role of the CPM requires any attempt to modify it to be a fine balancing act.

We believe that the two-phase approach adopted to address the CPM is likely to result in consideration of aspects of the mechanism in isolation, potentially losing sight of the multifaceted interactions between them.

Current Consultation Has a Narrow Focus

The current consultation proposes to ‘address a key concern...regarding the stability of the capacity payment pot due to the annual determination of the Best New Entrant Fixed Cost (BNEFC) and the Annual Capacity Payment Sum (ACPS)’. It then proceeds to focus exclusively on ‘options to reduce the perceived volatility of BNEFC’. This represents a further narrowed focus.

The BNEFC is only one component in determining the ACPS. The annual Capacity Requirement is the other variable in that determination. The expectation then would have been that this first phase of the CPM review ‘focusing on the possibility of

reducing volatility in the capacity payments pot' would have at least also considered the annual Capacity Requirement.

Addressing 'Capacity Investment' – Option 6

In terms of the narrow remit of this consultation, considerations for reducing the volatility of the BNEFC concentrate on the 'Capacity Investment' side of the CPM functions – incentivising a rational investor to 'procure and construct a peaking plant in the SEM'; making capacity available to alleviate diurnal and seasonal system tightness responds less so to this volatility. Of the options presented, Option 6 most obviously responds to this requirement.

As the consultation notes, if this option is selected for further consideration, the details of its implementation and operation will need to be worked out at a later stage.

Addressing 'Capacity Availability' – Combination of Options 2 & 5

However to address the limited impact of this volatility on the 'Capacity Availability' function of the CPM, elements of Option 2, such as keeping the plant technology constant for a number of years, could be combined with elements of Option 5, by applying an index that is representative of the major cost drivers, possibly a basket of some metals and construction commodities.

Further Steps

Airtricity looks forward to actively engaging in the whole range of issues affecting the CPM in the SEM.

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