



Re: SEM-11-019 – CPM Medium Term Review Work Package 6 Onwards

Endesa Ireland welcomes the opportunity to respond to the publication of the *CPM Medium Term Review, Work Package 6 Onwards* Discussion Paper.

Overall Endesa Ireland feels that the Capacity Payment Mechanism is working well and should not be amended at this point in time. In particular, we note the comments of Prof. John Fitzgerald of the ESRI stating that the mechanism has ‘basically met its design requirements’¹ and Poyry’s comment that ‘the overall performance of the current CPM design appears satisfactory when considered in the context of the competing objectives of the CPM’.²

In this regard, Endesa Ireland notes the SEM Committee’s comments in SEM-09-105 that it is ‘mindful not to propose options that are disproportionately expensive or different to the current design relative to the benefits the changes would create’. It is Endesa Ireland’s view that the RA’s Discussion Paper and Poyry’s review do not illustrate that the benefits of proposed amendments justify the changes proposed.

In addition, uncertainty over changes to the design of the SEM in order to comply with the European Target Model mitigate against any substantial changes to the CPM at this point in time. Endesa Ireland would advocate that changes to the CPM are limited to those that are immediately necessary or those that help move the SEM towards the regional model.

Other factors which indicate that now is not a time for change are the questions raised by the RAs’ Dispatch and Scheduling Consultation and the doubts over delivery of forecast generation capacity due to economic difficulties and REFIT delay. We would note that the actual build out of wind is not in line with the assumptions in the CPM review. It is understood that there will not be substantial levels of wind penetration on the island prior to the introduction of the target model. Further instability over the future of the CPM will not aid projects in development, particularly proposals which reduce capacity payments to wind generators.

3. Work Package 6 – Treatment of Generator Types in CPM

Section 3.1.1 – The Capacity Credit Scenario & Section 3.1.2 – Capacity Credit of Wind Generation

Endesa Ireland believes that proposals to reduce capacity payments to wind will make it difficult for Ireland to achieve its 40% target by 2020. This target is already under threat due to economic difficulties resulting in difficulties in securing finance, and delays in the REFIT scheme.

Endesa Ireland believes that while the capacity credit suggestion may have some merit, as set out in the discussion paper, it fails to take account of the long-term contribution to security of supply provided by wind generation, it adds a significant layer of complexity and is likely to increase regulatory risk. Endesa Ireland believes that if it were to be implemented, it would not be appropriate to determine a standard capacity credit based on plant type, rather credit should be calculated for each individual unit, ensuring a proper reward for availability.

¹ Fitzgerald (2011) A Review of Irish Energy Policy, <http://www.esri.ie/UserFiles/publications/RS21.pdf>

² Poyry, *Capacity Payment Mechanism, A Medium Term Review*, page 23

Endesa Ireland also believes that if the proposed change was implemented, Ireland would need to make changes to the support mechanism for wind. These changes should be coordinated, so that there is not a further delay in wind investments.

4. Work Package 8 – Incentives for Generators

Section 4.1 – Ancillary Services and the CPM & Section 4.1.2 New or Modified Ancillary Services

Endesa Ireland agrees with the RAs that the CPM and the AS revenue payment streams should remain separate, and considers that flexibility should be reimbursed through Ancillary Services payments. Endesa does not consider that any portion of the capacity pot should be allocated to the Ancillary Services pot to pay for services related to “flexibility”. The need for capacity has not changed, and the underlying model for valuing that capacity should not change.

While much has been said about the need for flexibility, the SOs and RAs have yet to publish a paper setting out the system support service requirements that will be needed to support the changing generation landscape and the value of these services to the system. In this regard Endesa Ireland awaits the publication of the TSOs’ considered position on the system services that will be needed for secure and efficient operation of the power system in the coming years. It is likely that the value of these new flexible services will be dependent on the amount of wind on the system.

Ancillary Services are real services which impose costs on generators and require payment; therefore, if additional services are required, the Ancillary Services pot should be increased. Endesa Ireland considers that flexibility payments should not be a flat payment per MWh and that generators with greater flexibility should be incentivised with higher payments. It is felt that this can be achieved through an expanded Ancillary Services Payment framework.

Endesa Ireland considers that as a separate workstream, the RAs and the TSO should work to define the additional AS services required and the value of these services to the system. Investment in the equipment required to provide these services will not be set made until investors can be assured they will receive a return on their investment.

In addition, Endesa Ireland considers that the flexibility that can be provided by interconnector capacity owners should be recognised, as greater flexibility can be provided with the advent of intra-day auctions. In the longer term, Endesa Ireland would like to see a competitive ancillary services market develop.

Section 4.2 - Capacity Penalties

Endesa Ireland considers the suggestion in section 4.4 of Poyry’s paper that older plant is unreliable and receives capacity payments although unable to deliver capacity to the system is unproven. Poyry’s report also discusses the perceived problem of generators declaring themselves available but fail to respond when called upon; Endesa Ireland believes that the existence of this problem is unsubstantiated. Endesa Ireland notes that its stations are older than many on the system but their availability is very high.

Endesa Ireland also rejects the suggestion that there are insufficient penalties for failure to be available. The consultation paper states that generators lose capacity payments for the trading period in which they become unavailable. The existing penalties are much higher than inferred. In the case of a trip or a short-notice declaration, the generator loses capacity payments until it is able to resynchronise to the Grid, which can be more than 12 hours for some generators if it was deemed cold when called to run. In addition to the loss of capacity payments, a generator is subject to penalties for tripping (if the loss to the system is greater than 100MW), short notice declaration and potentially imbalance charges. All of these add up to a significant penalty for failure to be available. The recent AS consultation has already proposed an increase of the short-notice declaration charge of more than 56%. Any additional penalties would be excessive.

Endesa Ireland would also like to clarify that capacity payments only contribute towards a unit's fixed costs, and these fixed costs may not be fully recovered unless the unit generates and earns infra-marginal rent. Inefficient plant will not generate if it is not needed by the system and as a result it will be forced to retire. This imperative to generate ensures that the generating units on the system, be they old or new, do not have the luxury of performing poorly.

Section 4.3 – New Entrant Scenario

Endesa Ireland considers that special treatment for new entrants should only be offered if a capacity shortfall is identified; and should be a separate pot from existing generators ACPS. Existing generators will still be required and it is expected that the 'existing generators pot' would not change significantly in value as changes in the capacity requirement would be addressed by the 'new entrant' pot. Existing generators would still be subject to the annual BNE calculation.

If this were to come into effect, Endesa Ireland would advocate targeted capacity auctions to encourage the type of capacity needed by the system at the lowest cost in the most useful locations, for example small flexible plants close to windfarms.

Endesa Ireland recommends that this new entrant incentive should endure for 15 years to give stability to investors.

Section 5 - Work Package 9 – Timing and Distribution of Capacity Payments & Section 5.2 Fixed, Variable and Ex-post Allocations

Endesa Ireland considers that the division of fixed, variable and ex-post allocations should not be altered at this time as it would cause significant volatility and additional risk for generators. No clear justification for doing so at this time has been provided.

Endesa Ireland does not agree with the suggestion that capacity payments should move towards a more ex-post calculation, either under the 50/50 proposal or the SOCAP model. The CP mechanism was designed to ensure stable and predictable payments to generators, and weighting the payment more towards an ex-post payment would make the payment more unstable and unpredictable for generators. In Endesa Ireland's view, an increase to the flattening power factor would have the same effect, and is not desirable.

Endesa Ireland considers that the SOCAP model would constitute an extensive change to CMP design, and for the reasons set out at the beginning of this response it is not considered wise to radically reform the CPM with the uncertainty surrounding the future of the SEM.

A move towards ex-post payments is said to reduce payment for wind; as highlighted above, Endesa Ireland believes that such a change would make it extremely difficult for Ireland to reach its 2020 targets as potential wind developers will be dissuaded from proceeding with their projects.

Endesa Ireland also points out that unavailability is often not within a generator's short-term control – outages cannot be rescheduled at short notice if the capacity margin is tight on a given day as resources on the outage will have been arranged in advance and trips are wholly unpredictable. Conversely, it is difficult for a station who has declared unavailable to make itself available at short notice, particularly if a generator outage has been planned in order to align with a transmission outage. To further weight the CPM towards ex-post payment would constitute a futile incentive/penalty which generators would not physically be able to respond to. In addition, outage plans are approved by the TSOs. Currently, generators try to comply with TSO requests to reschedule outages. If a greater portion of the CP was calculated ex-post, generators would need certainty from the TSOs that they would not be at a loss if they moved their outage to comply with the TSO request.

Endesa Ireland notes Poyry's conclusion that the rebalancing proposal does not make a significant difference in capacity payments at this point in time. In the long-term, the proposal would only lead to '**marginal improvement in the efficiency of price signals relative to the status quo design**'.³ As set out above, Endesa Ireland has serious doubts about the assumptions in Poyry's paper given the economic climate on the island, particularly whether new generation capacity will be built as expected and whether older plant will be retired.

On this basis, Endesa Ireland does not believe that the proposal should be adopted at this time.

6. Work Package 10 – Impact of CPM on Suppliers

Endesa Ireland does not believe that it is necessary to more closely align supplier capacity charges with capacity payments on a half-hourly basis. It is considered that this would pose difficulties for suppliers in designing tariffs and would create uncertainty for suppliers. Endesa Ireland is unsure whether customers would be sufficiently informed to correctly interpret the signal of the true time-varying cost of their consumption decisions.

However, Endesa Ireland would welcome further elaboration of this proposal.

Other points

Endesa Ireland is disappointed that the RA's paper does not address regulatory risk arising from the annual review, particularly in light of Poyry's statement that annual changes to BNE and the capacity requirement increase the risk for new entrants⁴. Endesa Ireland agrees with the proposals in Poyry's paper to fix or index the BNE or constituent parts of the BNE for a

³ Poyry, *Capacity Payment Mechanism, A Medium Term Review*, page 70

⁴ Poyry, *Capacity Payment Mechanism, A Medium Term Review*, page 1



number of years. This would provide more certainty to all generators and will encourage new entrants.

Endesa Ireland has noted the use of the terms ‘firm generators’⁵ and ‘outturn availability’⁶ in the Discussion Paper and in Poyry’s review, and is not clear on what is meant by these terms.

Conclusion

Endesa Ireland believes that as the CPM is generally performing well and as a compelling justification for change has not been proven, it is not necessary to alter its design at this stage. To do so would significantly increase regulatory uncertainty.

The uncertainty faced by the SEM itself due to the development of the European Target Model has already increased the risk faced by market participants. Endesa Ireland considers that it would be more prudent to wait for these issues to be decided before imposing changes to the CPM, which will further increase market risk.

⁵ See section 4.1.1, page 22

⁶ Poyry, *Capacity Payment Mechanism, A Medium Term Review*, page 51