

European Commission
DG Energy – Unit B2: Wholesale markets, electricity & gas
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6th February 2013

European Commission public consultation on generation adequacy, capacity mechanisms and the internal market: submission from the Irish Business and Employers Confederation (IBEC)

IBEC welcomes the opportunity to respond to this important and timely consultation paper. As the largest business representation organisation in Ireland, we speak for over 7000 member companies across a range of industrial, commercial and non-profit sectors. These include a variety of electricity generators, suppliers, network operators and consumers. Given the diverse views of our members on some of the issues raised, the scope of this submission is necessarily restricted to the subset of questions on which a broad consensus can be reached. Nevertheless, we hope that the Commission finds these comments useful. We would of course be happy to engage directly with the relevant officials if requested.

Firstly, we would like to acknowledge and support the Commission's overarching goal of ensuring a more efficient wholesale traded market in electricity. One natural consequence of our current wholesale electricity market design (and generation fleet) is that average Pool prices tend to track UK natural gas prices quite closely; this can have the effect of making us relatively uncompetitive whenever gas prices are buoyant. Many of our members face increasing pressures from rising natural gas and electricity prices. Given Ireland's heavy dependence on manufacturing and services exports, it is vital for these firms to remain cost competitive against their counterparts both within the EU and elsewhere. IBEC would expect that a future levelling of wholesale prices across the EU by the removal of barriers to cross-border power trading could help to mitigate some of the current difficulties. In support of this objective, IBEC and the Confederation of British Industry (CBI) will shortly co-host an international conference, in association with the current Irish presidency of the European Council, on continuing the development of a regional electricity market in North West Europe.

That said, we wish to draw attention to certain characteristics of the wholesale electricity market on the island of Ireland that are almost unique within the EU. The Single Electricity Market (SEM), which has operated since 2007, is the end-result of a transparent consultation process that originally considered a range of design options for the mandatory Pool, including the possibility of an energy-only bidding regime. The regulatory authorities' rationale for including a capacity payments mechanism (CPM) within the SEM is well documented. The intention, and effect, of the market design has been to provide a stable regime for a small, relatively isolated island system with certain inbuilt safeguards both for end-users and investors. It is important to realise that the existing CPM in the all-island electricity market is not an 'add-on' to address market failure (perceived or otherwise) but rather an inherent and deliberate component incorporated into the market design.

Given the recent growth of capacity margin on the island (reflecting both a downturn in peak demand, an increase in interconnection and significant investment in renewable capacity pursuant

to EU targets) there is unlikely to be much need for additional large conventional fossil plant for some years to come. The significant and growing penetration of non-synchronous onshore wind capacity on the island may however necessitate additional thermal capacity investment. The existing market reflective CPM in the SEM has already adjusted downward the aggregate value of the capacity payments pot. However, a substantial amount of investment in thermal plant in previous years was made prior to the potentially far-reaching market reform proposals of the Commission and, on foot of sound market signals and the regulatory certainty of the current SEM regime. For this reason, any Commission-mandated changes to the existing capacity payments mechanism would probably need to be complemented by other market design changes, notably in respect of the Pool bidding rules, thus reducing the highly regarded transparency of the SEM market. Therefore, unless any EU-wide blueprint allowed for appropriate adjustments by national regulatory authorities, there could be unforeseen adverse consequences for generators and/or consumers in the Republic and Northern Ireland.

Incidentally, section 4.3 of the Commission's consultation paper makes reference to 'difficulties' arising in respect of trading between the SEM and Britain because the SEM capacity payments regime does not have a British equivalent. The SEM capacity payment is a fully transparent payment and as such has limited impact on cross-border trade. It should also be noted, however, that this mechanism is only one of several structural differences between the SEM and BETTA markets. Other factors, such as *ex-post* pricing, intraday pricing, and gate closure times have arguably constituted more significant obstacles to efficient interconnector usage. In this regard, a major reform project is under way to ensure that the SEM becomes fully compliant with the European Target Model by 2016, and that it is capable of interfacing with whatever the BETTA market evolves into over the next two years.¹ IBEC understands that this project naturally involves on-going liaison between the regulatory authorities in the relevant jurisdictions.

The Commission's consultation asks whether supports for specific energy sources are undermining investments needed to ensure generation adequacy. At a European level, national supports for nuclear, coal and other indigenous fuels can and do distort price information. In addition, mandatory European targets for RES penetration and the national supports introduced to achieve these – in particular increasing levels of REFIT backed wind generation in the SEM over the period to 2020 - will have an increasingly adverse impact on fossil plant load factors and (through merit order effects) on the average level of wholesale Pool prices that such plants receive.² However, for the reasons outlined above, this is not likely to create capacity constraints on the system for some time to come nor do such supports necessarily underline or create the potential to 'strand' assets, provided a well designed, proportionate, transparent and predictable CPM is maintained. It is critical however, that capacity payments are designed and implemented with a single policy objective in mind i.e. the provision and retention of sufficient generation adequacy. The temptation to morph or over-extend CPMs into proving technology dependent system services should be avoided. In the meantime, it is quite possible that the capacity incentives regime will need be modified to reflect ex-ante pricing as required for the Target Model.

¹ Unlike SEM, under BETTA there are no capacity payments. According to some observers, BETTA creates barriers to investment and makes new entry more difficult. Cited in Paul K. Gorecki, *The Internal EU Electricity Market: Implications for Ireland*, ESRI, 2011, page 77.

² REFIT stands for "Renewable Feed in Tariff" and is the primary means through which electricity is supported in Ireland.

In conclusion, the effective operation of the internal market for electricity in Europe could and should have a positive impact for energy cost and supply security in Ireland. However, the implementation of the target model will prove challenging for markets that operate a pool regime and along with other significant changes emanating from Commission policy, the risks of stranded costs for the SEM are heightened. Any changes to market design must be taken against the backdrop on the level and destination of future interconnection between Ireland and other electricity markets in the delivery of an integrated EU electricity market. At this stage, third party interventions related to the design of the market, however well intentioned, may lead to complications and unintended consequences.

Appendix

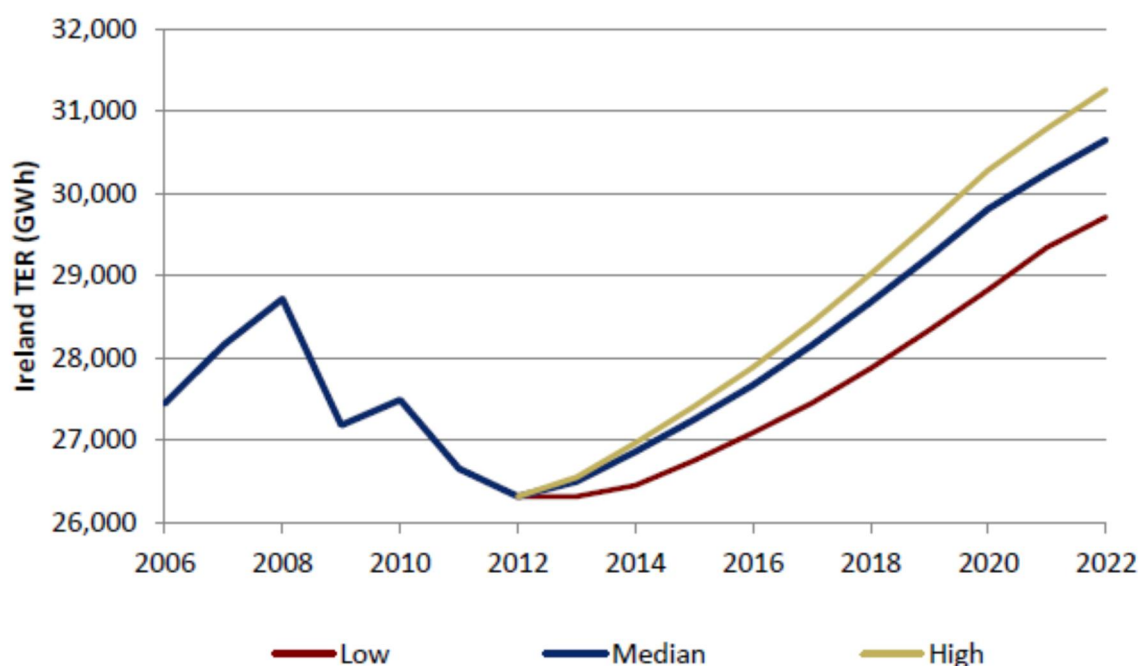
Some relevant facts and figures on Interconnection and Generation capacity

Currently, limited interconnection capacity between Ireland and Northern Ireland means that Ireland has an assumed capacity reliance of 100 MW on Northern Ireland. Similarly, Northern Ireland has an assumed capacity reliance of 200 MW on Ireland. However, with the commissioning of an additional tie line between the two jurisdictions, adequacy will improve further.³ Interconnection will continue to play an important role in future generation supply security.

The East-West Interconnector has connected the transmission systems of Ireland and Wales, and is expected to transmit up to 500 MW in either direction. Therefore, alongside the existing Moyle Interconnector that connects the transmission systems of Northern Ireland and Scotland, the overall interconnection between the island of Ireland and Great Britain has been significantly enhanced. The second major North-South tie line (planned to be operational by 2017) connecting Northern Ireland and Ireland will lead to a more secure, stable, and efficient all-island system.⁴

All-island capacity and demand forecast:

In summary, there is a considerable surplus of generation in Ireland. However, current transmission limitations restrict the amount of generation in Ireland that can be transferred to Northern Ireland. For Northern Ireland, with this limited support, the margin becomes tight after 2015 and will be in deficit from 2021.⁵



Source: SONI & Eirgrid

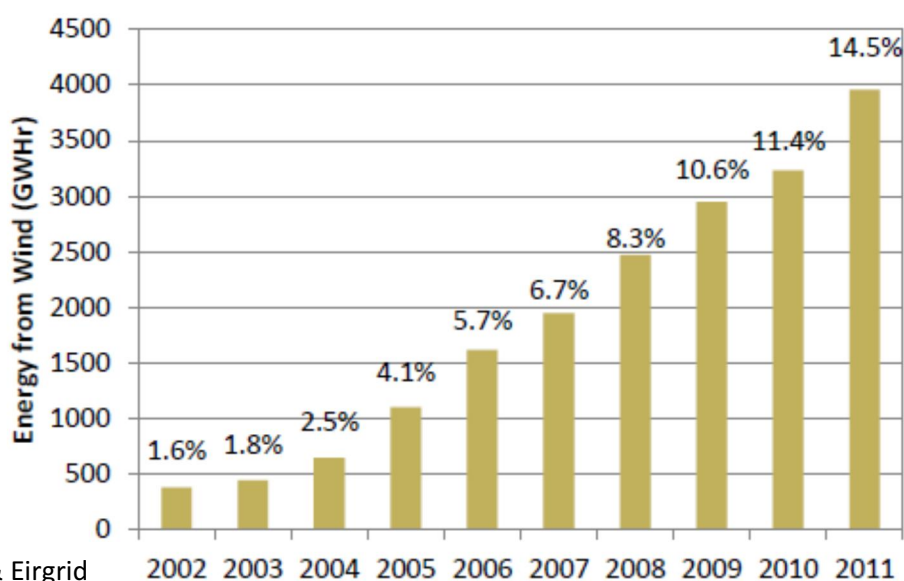
For both Ireland and Northern Ireland, the recession has led to a drop in demand in recent years. Although an increase was observed in 2010, commentators believe this was due to the extremely

³ SONI & Eirgrid, All-Island Generation Capacity Statement, 2012, page 6.

⁴ *Ibid*, page 26.

⁵ *Ibid*, page 28.

cold winters that affected both the beginning and the end of 2010. For both jurisdictions, low, median and high demand scenarios have been created to allow for uncertainty in forecasting, with the median forecast seen as most likely.⁶ The forecast of Total Electricity Requirement (TER) for Ireland (see above) shows a relatively slow recovery compared to the growth rates seen over the last two decades. It is expected that demand will not return to 2008 levels until 2018 in the median forecast.⁷



Historical wind generation in annual energy terms for Ireland (normalised), also given as a percentage of total electrical energy produced that year⁸.

Energy and Climate Targets:

The International Energy Agency acknowledges that while costs and competitiveness should remain a key focus of the new energy policy strategy, notably with regard to subsidies (e.g. REFIT tariffs for renewables, and the associated Public Service Obligation levy), there is potential for tension at times between the two objectives of promoting the transition to a low-carbon economy and ensuring that Irish consumers are provided with reliable and cost efficient sources.⁹

Alongside security of supply and competitiveness objectives, efforts to underpin sustainability concerns have resulted in targets across a range of policy areas. For example, there is the European Union target to reduce greenhouse gas (GHG) emissions by 20% by 2020.¹⁰ This is supplemented by a national target of 20% energy savings in 2020 (relative to the 2001-2005 average), complemented by an ambition to reduce energy consumption in the public sector by 33% in 2020.

⁶ *Ibid*, page 7

⁷ *Ibid*, page 7.

⁸ *Ibid*, page 33.

⁹ *Energy Policies of IEA Countries Ireland 2012 Review*, International Energy Agency, 2012. Page 23.

¹⁰ The 20% reduction is relative to 1990 emissions.

Government policy aimed at decarbonising of the economy has resulted in the ambitious target of producing 40% of electricity from renewable sources by 2020 - there will be a significant increase in wind generation (to reach between 4,800 and 5,300 MW of installed wind capacity in total), driven by both Governments' 40% renewables target in 2020.¹¹

This, combined with the shutdown of older flexible conventional plant, highlights the likely requirement for a more flexible generation plant portfolio to enable both Transmission System Operators to deal with wind management issues. Greater demands will be put on the flexibility of the conventional generation and their ability to provide system support and balancing services. Using the median demand forecast, it has been calculated that between 3500 and 4000 MW of wind capacity needs to be installed in Ireland to generate 40% of electricity from renewables.¹² This assumes average historical capacity factors, and a small percentage of wind generation being unusable for system security reasons.

Also, there are 77 MW of Waste-to-Energy projects connected or due to connect over the next few years. In addition, a significant growth in bioenergy is assumed.¹³

Capacity markets and constraint costs:

The Single Electricity market includes an explicit capacity payment mechanism whereby all generators available for dispatch receive a share of the allocated funds for remunerating available generating capacity, calculated *ex ante*.¹⁴ The calculation of this pot is based on the assessed total generating capacity required and the costs of a best-new-entrant peaking plant. In their current format, they do not account for either flexibility or reliability.¹⁵

As a result of the design of the central dispatch market, generators in the market schedule must receive the system marginal price, as well as the generators who are actually called on to run. The decision to implement capacity payment mechanisms was undertaken by the respective regulatory authorities in an effort to contribute to security of supply.

According to the IEA, redefining the criteria for capacity payments based on flexibility, alongside a regulatory framework focused on the development of a well-functioning ancillary services market, would complement steps already undertaken to improve demand side management and efforts to enhance flexibility on demand response technologies.¹⁶

¹¹ SONI & Eirgrid, All-Island Generation Capacity Statement, 2012, page 7.

¹² *Ibid*, page 8.

¹³ *Ibid*, page 9.

¹⁴ Energy Policies of IEA Countries Ireland 2012 Review, International Energy Agency, 2012, page 63

¹⁵ *Ibid*, page 79.

¹⁶ *Ibid*, page 80.