

**IWEA response to Consultation on Capacity Requirement and Annual Capacity Payment Sum for
Calendar Year 2016**

17 June 2015

IWEA welcomes the opportunity to respond to the consultation on Capacity Requirement and Annual Capacity Payment Sum for Calendar Year 2016 (SEM-15-032). IWEA has significant concerns in relation to the reduction of the annual capacity payment sum for 2016, and the knock-on implications this will have for generator revenues in SEM. In particular, IWEA has concerns in relation to the increased uncertainty which is now being introduced at a time when there is already considerable uncertainty in the market as a result from the market re-design, the introduction of the DS3 system services regime and the change to the capacity remuneration mechanism which is to be consulted on shortly. The impact of the reduced capacity payment sum on the PSO is also of concern to the wind industry. The following section outlines an overview of our main concerns in relation to this consultation.

- The Medium term review looked for price stability for 3-5 years, with a review in spring 2015 after 3 years. The SEMCs decision to index link the capacity pot was made to “bring some stability and certainty to the volatility in the capacity pot”. There is scope under this decision to continue with price stability for a further 2 years. The decision to revert to a full review of the BNE components re-introduces significant volatility and uncertainty to the Capacity Mechanism, which is particularly damaging given the added uncertainty in the market due to the introduction of I-SEM in 2017. The market re-design will mean significant changes to how generators and suppliers participate in the market and will introduce cost and revenue risk through the energy markets and the new capacity mechanism. In light of this uncertain environment for market participants, the index-lined approach of the past 2 years should be continued until I-SEM is delivered.
- The growing numbers of Merchant Wind generators will be directly affected by this unexpected reduction, as will RO-supported wind generators in Northern Ireland. This is being introduced at a time when other costs, such as those associated with rate increases, are having an impact on the financial viability of wind generators. The introduction of a material change in capacity payments should be impact assessed for all stakeholders.
- The reduction in capacity payment will have a significant impact on the available working capital of REFIT supported generators.
- The proposed changes will also increase the PSO levy for consumers. The **PSO Proposed Levy 2015/16 assumes** a reduction in the capacity payment from €7.29/MWh for 2014/15 to €5.77/MWh in 2015/16 and results in an estimated €9.3 million increase in the 2015/16 PSO forecast attributable to renewable generation. IWEA is concerned that the reduction in

market revenues which requires additional PSO support is not appropriate in a system with increasing levels of renewables.

- IWEA is concerned in relation to the Weighted Average Costs of Capital (WACC) that is used in the calculation of the capacity payments sum. These are outlined as follows:
 - The WACC assumes the investor is a vertically integrated utility (VIU). This assumption is not appropriate and the BNE should be assumed to be project financed.
 - The level of gearing is assumed at 60%, which should not be assumed for a project financed plant. A more appropriate level of gearing (e.g. in the region of 30%) should be used.
 - The Cost of Debt is under estimated in CEPAs paper.
 - Debt yields have increased since CEPA published their paper
 - It assumes VIU, credit rating of non-VIU may not be investment grade.
 - CPI is a more appropriate inflation rate to use to convert nominal yields into real yields in NI then RPI as used by CEPA
 - There is a higher risk premium in NI and ROI than GB or rest of EU
 - The risk free rate is too low.
- IWEA notes that it is proposed that the BNE value for the 2017 ACPS calculation will be derived from an indexing of the 2016 figure in similar fashion to exercises for the 2015 and 2016 ACPS, but the Harmonised Ancillary Services deduction will be replaced by a suitable deduction for Ancillary Service revenues under the DS3 programme. It is not clear when the decision in relation to the tariffs for 2017 will be made and it would be essential to ensure that these decisions have been made before the new tariffs are taken into account.

In summary, given the level of uncertainty within the market at this time of transition and the scale of the proposed changes, IWEA believes that the indexation approach should be maintained until the new I-SEM and capacity mechanism is in place. We also have concerns in relation to the assumptions used in the calculation of the WACC, and therefore the annual capacity payment sum.