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Dear Roy

I am writing on behalf of the SEM Committee. Thank you for your letter of 9 May 2008, and subsequent communications you and other PPB Staff have engaged in with the staff of the Regulatory Authorities in relation to Commercial Offer Data (COD) submitted for Ballylumford generating units.

These communications took place in the context of a larger inquiry by the SEM Committee into bidding in the SEM. This inquiry included the appropriate treatment of contract costs in relation to the calculation of opportunity costs. The Final Report on this inquiry was published on 12 June 2008.

Under condition 57 of the NIE Energy licence PPB is obliged to submit cost reflective COD for generating units for which it acts as intermediary. In particular cost items used to calculate Short Run Marginal Cost must be valued at their Opportunity Cost. The Bidding Code of Practice (BCOP) defines opportunity cost and sets out principles on how it is to be calculated.

Paragraph 8 of the BCOP allows for two possibilities:

- The usual case: generators calculate Opportunity Cost by reference to prices on generally accessible markets etc. where such markets exist, or by reference to replacement costs where there is no market in an item.
- The exceptional case: generators do not calculate Opportunity Cost by reference to prices on generally accessible markets etc., but instead use another, more appropriate method of calculation.

The exceptional case is applied only when it is the opinion of the SEM Committee that the generator has “good cause”.

The COD submitted for Ballylumford are not based on the market price of gas. The criteria on which the SEM Committee define good cause which allows a generator to base its calculation of Opportunity Cost by reference to contract rather than spot prices are clearly set out in the Bidding Inquiry Final Report at paragraphs 10.3 and 10.4.

These criteria are based upon the SEM Committee’s statutory duties. Essentially where the right to dispose of a cost item which a generator is entitled to use in the generation of electricity is encumbered, good cause not to reflect prevailing market prices may exist. However, this is subject to:

- the protection of the interests of consumers by promoting effective competition, which in this context revolves around whether allowing the generator to calculate Opportunity Cost by reference to prices other than prevailing market prices would facilitate the exercise of market power; and
- securing that authorised persons are able to finance their activities, which means that, where a generator does not have title to an asset, or where the disposal of that asset is encumbered, it must be able to demonstrate that such impediments to its disposal could not reasonably be removed or could only be removed at disproportionate cost to the generator.

Your letter of 9th May essentially contends that the “take or pay” element of the LTI Contract under which Centrica supplies gas to Ballylumford acts as an encumbrance on a minimum quantity of gas for Ballylumford.

In communications with staff at the Regulatory Authorities subsequent to your 9 May letter you also clarified that the LTI Contract was specific to gas supplied to, and consumed at, Ballylumford. You also provided references to the relevant section of the contract where this was set out.

The SEM Committee accepts that for this final year of operation of the LTI Contract Ballylumford faces encumbrances on the “take or pay” element of its LTI contract which may constitute “good cause” to reflect the contract price of gas for quantities sufficient in aggregate to ensure that Ballylumford meets its minimum take obligations.

The SEM Committee does not consider that allowing Ballylumford to account for the operation of the “take or pay” element of its contract would facilitate the exercise of market power or otherwise undermine the interests of consumers in the promotion of effective competition.

Finally, the SEM Committee accepts that the “take or pay” elements of the LTI Contract represent a valuable assurance to Ballylumford’s counterparty. So any renegotiation to remove this assurance would likely impose disproportionate costs on Ballylumford and NIE Energy. As these contracts are ultimately backed by Northern Ireland consumers, NIAUR has considerable experience of the difficulties and costs associated with the alteration of their terms and is satisfied that removing the

“take or pay” elements of the LTI contract would likely impose disproportionate costs on Northern Ireland consumers.

In conclusion, the SEM Committee accepts that PPB has good cause to calculate its commercial offer data for Ballylumford such that it is dispatched at a level that quantities of gas sufficient in aggregate to ensure that Ballylumford meets its minimum “take or pay” quantities under the terms of the LTI contract with Centrica are achieved, which is now in its final year.

Kind regards

Tadhg O’Brian

Copy

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