April 7th 2009

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Ms. Priti Dave-Stack,
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Bord Gáis Networks (BGN) welcomes the opportunity to respond to the consultation paper SEM/09/023, Fixed Cost of a Best New Entrant Peaking Plant Calculation Methodology. The purpose of the SEM consultation paper is to review the BNE calculation methodology and provide proposals on changing the methodology to potentially reduce the volatility of capacity payments and to examine the possibility of setting the BNE for longer than a year.

There are two aspects of this paper which BGN wish to comment on:

- the suggestion that some elements of the BNE calculation should be fixed for multiple years; and
- the choice of fuel, and any fixed costs elements associated with that, which should be included in any future calculation.

Fixing elements of the BNE calculation for multiple years

BGN welcomes the review proposed by the SEMC of the Capacity Payment Mechanism (CPM). In relation to the first phase of this review, we are supportive of the overall principle that the year on year variability in capacity payments is reduced, and that as a result, greater certainty is provided to potential power plant investors as to the level of capacity payments. A greater level of certainty should be beneficial to the overall investment climate.

However, there is clearly a trade-off between certainty on one hand and the appropriateness of signals provided to new investors (and paid for by electricity customers) on the other. We would not, therefore, support the fixing of all BNE costs for a significant period (e.g. 3-5 years). Given the volatility of a number of cost elements, we believe this could result in either:

- significant periods of time during which investors are insufficiently remunerated for capacity availability, which could jeopardise security of supply; or
- significant periods of time during which customers are paying for capacity remuneration which is unnecessarily high, pushing up overall bills.

We would therefore support fixing those elements of the BNE cost calculation which are most certain over, say, a 3-5 year period, and leaving the others to be recalculated annually. We believe that the calculation methodology should clearly specify the principle that the duration of any fixing of BNE calculation elements should be linked to their volatility.

On this basis, we strongly believe that fuel choice (and the associated cost items) should at least at present be re-examined on an annual basis. We believe there are a number of valid reasons for such an approach:

- **the basis on which the SEMC determined that distillate was the appropriate fuel choice is subject to change**. In the 2008 consultation paper, the SEMC outlined that the decision to run the BNE peaking plant on distillate was largely related to the lack of access to short term capacity and the illiquidity of the market in secondary capacity. Transmission arrangements and secondary market liquidity are far from a steady state (they have already developed subsequent to the SEMC decision), and will evolve further within the next one or two years;

- **the implementation of the Common Arrangements for Gas (CAG) programme could change the basis for fuel choice**. Under the proposed CAG arrangements, there will be a significant level of harmonisation between the tariff arrangements in place in the Republic of Ireland and in Northern Ireland. This could involve standardisation of short term tariff products which would be attractive to OCGT plant; and

- **the relative attractiveness of distillate and natural gas prices for an OCGT developer will change over time.** In an era of relatively volatile oil prices and fundamental changes to the GB and RoI natural gas supply structures, with significant ongoing uncertainty in relation to the future level of the carbon price (changes in which could be significant to the fuel choice decision) the relative attractiveness of the two potential fuels under consideration could change relatively quickly. In July 2008 oil prices topped 147 dollars a barrel and today, less than nine months later oil prices have reduced to circa 53 dollars a barrel. This sharp reduction in prices is due to the dramatic changes that economies around the world have experienced since last summer. Given the volatility of energy prices it makes sense to maintain flexibility within this cost category and allow changes to be made annually.

As a result of these significant factors which could shift the balance between distillate and natural gas as fuel of choice for a potential OCGT development, it does not seem appropriate to fix the fuel choice – and the various cost elements which are contingent upon it – over a multi-year period.

Choice of fuel in any future calculation

Going beyond the principles of the calculation methodology, BGN continues to believe that the BNE should be based on a Natural Gas Fired Plant. Natural gas brings significant environmental benefits and is the cleanest burning fossil fuel with up to 30% less emissions being emitted into the atmosphere as pollutants when compared to alternative fuel types.

We believe that it would be appropriate to change the fuel choice in the BNE calculation to Natural Gas because the availability of short term products (including within day), interruptible products and secondary market capacity has significantly reduced the cost of obtaining capacity for a peaking plant:

- **appropriate gas network capacity products are in place in both jurisdictions**: parties in RoI have access to both Short Term capacity (including within day) and Secondary Capacity and parties in NI have access to Interruptible Capacity. The RoI daily product price is linked to that of the regulated annual products, and the capacity charge for the NI interruptible product is effectively £0 per annum (and given the absence of congestion on the NI system, this product is close to firm). These products both enable a peaking plant developer to get access to gas capacity within the day that they wish to generate at minimum cost;
- **there is evidence of use of these gas network capacity products by power generators**: to date (Oct'08 to Mar'09) seven shippers have utilised the short term capacity products and we have seen Power generation using the booking of short term products as part of their SEM strategy. Only three shippers utilised the short term products in gas year 2007/08. In 2007/08 short term was only booked monthly at entry but in 2008/09 we have seen daily bookings at entry and exit for the first six months of the gas year; and
- **the secondary market for capacity would also facilitate short term access to the gas market**: there is a high level of liquidity in the secondary market and the majority of Shippers in the power sector are active in this market.

BGN is aware that there are a number of developers considering natural gas fired OCGT projects. In our view, this makes it clear that there are few **structural** barriers (e.g. related to gas capacity product definition) to burning gas in such plant. Rather, the barriers would appear to be **economic** – namely that the CPM does not provide sufficient revenue to facilitate such environmentally friendly developments, particularly given the connection costs associated with an OCGT plant connected to the gas network, of the order of €3-4m. The BNE does not allow for such gas connection fixed costs but it does allow for distillate facility costs.

Given the existence of these projects, it may be that a further consideration for phase 2 of the CPM review should be whether empirical evidence (i.e. the existence of gas fuelled project proposals at a reasonable stage of development) should be considered in the process of making the BNE calculation fuel choice and whether the BNE should allow an overall sum for the purpose of 'Fuel Facilities' which would allow the developer to run the plant on Natural Gas if that were the preferred fuel.

BGN are available to meet to discuss any aspects of the above at your convenience.

Yours sincerely,

Ann-Marie Colbert

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