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Commission for Energy Regulation
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30 June 2010

Dear Jody and Clive

**FIXED COST OF A BEST NEW ENTRANT PEAKING PLANT & CAPACITY
REQUIREMENT FOR THE CALENDAR YEAR 2011**

Thank you for this opportunity to contribute to the above consultation.

I trust you will find our comments below constructive but please do not hesitate to contact me if you would like to discuss this response in further detail.

Yours sincerely

A handwritten signature in blue ink that reads "K Hannafin".

Kevin Hannafin
Regulation Manager

Executive Summary

Generally speaking there is remarkable consistency between the detail of this year's consultation paper and the decision taken last year, with the possible exception of the initial fuel working capital assumption which we discuss in our detailed comments below.

Last year Viridian Power & Energy (VP&E) questioned the assumed weighted average cost of capital (WACC) but this year it is largely consistent with our expectations, research and analysis and we commend the regulatory authorities (RA) and their consultants for this. The prime reason for the reduction in the WACC is the reduction in the debt premium for UK debt from 3% to 1.75%. Whilst the debt premium analysis is consistent with our own analysis, we would note that over recent weeks due to ongoing sovereign debt fears spreads have further increased (including ESB's unrated 2020 nominal bond currently trading at 250bps over 10 year swaps) and we believe the debt premium should at a minimum be assumed at the high end of the range of 2.0% for Sterling and 2.5% for Euro and not the mid point.

We have remaining concerns that are not addressed in this year's consultation, particularly the assumed plant life of 20 years (versus 15 years used previously), the treatment of exchange rates, and the calculation of the capacity requirement. On the latter note we especially question how peak demand is extrapolated from demand forecasts which appear only to reference the state of the economy and ignore other significant factors such as weather which have led to record demand levels being reached in January this year despite a deep recession in Ireland.

Finally transmission loss adjustment factors (TLAFs) should be recognised in the best new entrant calculation. The proposed decision to move to a uniform TLAF of 0.98 should inflate the capacity pot as explained in more detail below.

The remainder of this response covers in more detail (and as applicable) the points raised above.

Detailed comments

1. TLAFs

The inclusion of TLAFs is of particular importance given the proposed decision for uniform TLAFs. Specifically if uniform TLAFs of 0.98 apply from 1st October 2010 then the BNE availability should be adjusted accordingly to $190.1\text{MW} \times 0.98 = 186.3\text{MW}$. The current BNE methodology has an implied TLAF of 1 but this would be clearly inaccurate in the context of a uniform TLAF of 0.98 and this is a fact any rational investor would take into account. Whilst this is only a proposed decision at this stage it would be important to revise the availability of the BNE as necessary once it is known how transmission losses will be treated from October 2010. There is precedent in re-visiting demand forecasts ahead of any final decision and the same should apply to loss factors (and exchange rates).

2. Capacity requirement

As noted above demand forecasts are seemingly made with sole reference to the state of the economy. Presumably peak demand is extrapolated from this (more transparency is required). We strongly suggest it would be prudent and responsible to calculate peak demand recognising that economic conditions are not necessarily the main driver. It would be hard to find a better example of this than in January 2010 when all peak demand records (with the exception of the summer night valley) were set in the midst of Ireland's deep recession.

System Records

	Value	Day of Week	Effective Date
Winter Night Valley	2860 MW	Friday	08-01-10
Summer Night Valley	1632 MW	Sunday	02-08-09
Mid-day Peak	4349 MW	Thursday	07-01-10
Evening Peak	4950 MW	Thursday	07-01-10
Saturday Peak	4524 MW	Saturday	09-01-10
Sunday Peak	4335 MW	Sunday	10-01-10
Maximum Wind	1120 MW	Monday	05-04-10

Source: Eirgrid website, accessed 30th June 2010

In terms of the capacity requirement calculation we would also emphasise that all plant availability should be based on historical data and not projected from expected

improvements. If improvements in performance do materialise then they will automatically be factored in future historical data.

3. Exchange rate assumptions

The consultants' report (accompanying the consultation paper) notes that the exchange rate of 1.1341 euros to the pound was the spot rate at the time of developing the document and is viewed as the best indicator of future rates. This exchange rate dates back to 14 April 2010 and is no longer the best predictor of future rates. At the time of writing the euro to sterling exchange rate published on <http://www.oanda.com/> was 1.2209 – significantly different and more reflective of future expectations. Apart from being significantly and avoidably inaccurate the exchange rate used in the consultation paper is also unhedgeable. Although investors should generally face exchange rate risk where applicable it is unrealistic for them to absorb an exposure they cannot hedge against. This will only discourage investment and make financing even more difficult. VPE would favour an alternative methodology that would fix the exchange rate at prevailing rates at an openly stated future point in time (closer to when the final decision is taken). Potential investors would then have the option of locking in at that rate, taking a forward position or even an open exposure at their discretion. We would again emphasise that there is precedent in re-visiting forecasts and assumptions prior to a final decision being taken and the same should apply to exchange rates.

4. Fuel working capital

It was acknowledged in last year's decision paper that the level of fuel stocking should be greater than the 3 day strategic requirement and it was subsequently increased to 3.5 days with consequent changes to the residual value for land and fuel and EPC costs to account for additional storage facilities required. It is stated in this year's consultation paper that "CEPA/PB has estimated an initial fuel storage fill cost of €3.6m for Distillate and €3.6m for dual fuel. This is based on a requirement to run for 72 hours full load..." (p.17). This clearly implies that this year's fuel working capital costs are based on 3 days (72 hours) full load. If this is correct it is clearly inconsistent with last year's decision and is not justified. VPE would therefore urge the RAs to revise the fuel working capital assumption in line with last year's decision and make any consequential changes necessary to residual values and storage facility requirements.

5. Plant life

We noted last year that ad hoc alterations to the CPM in the short term would seriously undermine the credibility of the mechanism and its ability to ensure efficient investment in flexible generating capacity and the orderly exit of existing plant from the market. In this context we raised serious concerns about the proposal to extend the plant life of the BNE from 15 to 20 years. We maintain that this is a fundamental change to the BNE methodology and should accordingly feature in the medium term CPM review. In the meantime the average output degradation of the machine should be reviewed in light of an extended plant life. A more prudent assumption would be an average degradation of at least 3.5% over a 20 year lifetime.