



Endesa Ireland response to SEM/10/034 Fixed Costs of a BNE Peaking Plant and Capacity Requirement for 2011

Endesa Ireland welcomes the consultation on the Fixed Costs of a BNE Peaking Plant and the SEM Capacity Requirement for 2011. Endesa Ireland considers that the majority of the costs outlined in the consultation paper are consistent with our findings. However, there are a number of areas where we consider that the proposed costs are not reflective of the current market prices, where other costs are not reflected in the BNE costs and where the selection criteria should be revised.

The methodology for calculating the capacity payments as approved by the SEM Committee is relied upon by market participants and investors to inform their revenue projections. The approved methodology seemed to provide regulatory certainty in the calculation of the capacity pot. However, there have been unexpected changes since Endesa Ireland entered the market – minor changes to the methodology or the inclusion of data that is not reflective of current market costs in order to reduce the level of the capacity pot. For the 2010 capacity pot, the lifetime of the BNE was extended, resulting in a reduction in the capacity pot. In the current consultation, the WACC proposed is very low, again reducing the capacity pot. This makes it very difficult to accurately estimate future capacity payments.

As new investors in the SEM who are seeking to make significant further investments, such decision / proposals significantly increase the regulatory uncertainty in the market and act as disincentives to investment. Endesa Ireland considers that the inclusion of objective values for the WACC used to calculate the capacity pot for 2011 would go a long way towards improving regulatory certainty and the investment climate. Endesa Ireland would suggest that it may be more appropriate to base cost estimations on actual consented sites and to take an average of the individual cost components associated with these plants, rather than estimating costs based on a theoretical Best New Entrant (BNE).

The investment climate will also be enhanced by the inclusion of selection criteria relating to the environmental impact of the different technologies considered. While Endesa Ireland appreciates the RAs motives for estimating the fixed costs of a Best New Entrant as a rational investor may, the RAs have a duty to have due regard for the environment. Endesa Ireland would consider that it is not sufficient for CER to ensure that the selected technology meets the minimum environmental standards. Additional consideration should be given to units that will reduce emissions on the island of Ireland.



The inclusion of such criteria would help to encourage rational investors to invest in environmentally-friendly technologies, helping Ireland and Northern Ireland to meet their environmental commitments. The environmental impact of fuel type selected for the BNE should have a significant weighting in the decision criteria when choosing the preferred technology. This would encourage investment in efficient, economic and environmentally-friendly peaking units on the island of Ireland. Endesa Ireland also considers that a rational investor must consider the costs of the proposed levy on CO₂ emissions when selecting a preferred unit, which would influence the fuel type selected.

There are a number of fixed-costs that are not included in the BNE calculations that are unrecoverable in the SEM. The Regulators have stated that prices within the market should reflect costs. However, there is no opportunity for generators to recover the fixed costs associated with gas transportation, nor is there an opportunity to recover the costs of holding strategic fuel stocks as required by the generation license in Ireland. Endesa Ireland considers that disallowing recovery of these costs acts as a significant disincentive to investment. In addition, the inability to recover the costs of holding strategic fuel stocks cause distortions between generators in Ireland and Northern Ireland, as the generators in Northern Ireland do not face these costs. The implementation of a levy on CO₂ emissions in Ireland will further distort the market in favour of generators in Northern Ireland. Such distortions in a single electricity market are unacceptable.

Below are Endesa Ireland's views on specific cost items within the consultation paper:

Capacity Requirement:

Endesa Ireland considers that the capacity requirement for 2011 is reasonable.

WACC:

Endesa Ireland has significant concerns with the proposed decrease in the WACC from 7.13% to 6.375%, with a decrease in the cost of debt cited as the main factor for influencing this decline. The consultation paper claims that the cost of debt included is appropriate for an international utility with a credit rating of BBB. Endesa Ireland considers that this discriminates against smaller market participants – a rational investor is not necessarily an international utility. In addition, although Endesa Ireland is an international utility with a Standard and Poor's credit rating of A-, we have a significantly higher WACC than the 6.375% proposed, which has increased over the past year, rather than decreased. The current pro-forma WACC for Endesa Ireland is 7.28%, with a cost of debt of 4.78%. While Endesa Ireland agrees that the economic situation has



improved, we do not consider that the cost of debt has reduced from last year. In particular, we consider that the risk-free rate of 1.75% is too low. Endesa Ireland considers that at a minimum, the WACC should remain at 7.13%.

Fuel:

Endesa Ireland is disappointed by the RAs proposal of distillate as the BNE fuel type, as this removes incentive for a rational investor to invest in units with lower NO_x and CO₂ emissions. Selecting a more environmentally-friendly fuel for use by a BNE is a key to encouraging investment in more efficient, environmentally friendly technology and reducing CO₂ emissions on a national level. This is in keeping with one of CER's primary goals outlined in its 2010 Strategic Plan¹, to ensure protection of the environment. Similarly working with utility companies and taking account of the environmental impact of the services they provide is a key objective outlined in NIAUR's Forward Work Plan².

Endesa Ireland also considers that the fixed costs of a BNE must incorporate the costs associated with strategic fuel stocks, as required by license in Ireland. The dual fuel costs as required by EirGrid. It is Endesa Ireland's opinion that in a common market such as SEM, with varying licence requirements for different regions, compensation should be available to ensure fair competition to all market participants. This is especially true in the case of SEM where full competition has yet to develop.

A further downside to distillate as the chosen fuel type is that gas connection costs are unrecoverable in SEM. This has been a gap in the market from the very beginning; Endesa Ireland considers that urgent resolution of this issue is necessary especially given the key role that gas units will play in catering for intermittent nature of wind as outlined in a recent study conducted by Pöyry³. For baseload CCGTs these costs may be recoverable by means of inframarginal rent, however in the case of a peaking unit there is a very significant gap in the market.

The selection of a distillate-fired BNE will result in additional costs being incurred in the planning permission and IPC licence application processes (relating to community / political resistance) that should be taken into account in the BNE fixed-costs.

¹ <http://www.cer.ie/en/about-us-strategic-plan.aspx?article=d60a49e4-4167-4119-95f7-99844e9f397a>

² http://www.uregni.gov.uk/uploads/publications/2010-11_FWP.pdf

³ <http://www.ilenergy.com/pages/Documents/Other/mps0110poyry.pdf>



Location:

The chosen site for the BNE is located in West Belfast. In order to facilitate an effective long-term signal and bearing in mind the significant rise in wind penetration, Endesa Ireland considers that it is more appropriate to locate the BNE plant near windfarms, perhaps on the west coast of Ireland to provide the necessary system support to accommodate the intermittency of wind. This would help in ensuring voltage stability which is a local phenomenon with potentially wide spread impacts as outlined in the recent All Island TSO Facilitation of Renewables Studies Report⁴.

The site is also in close proximity to water mains which the RA's believe would render the associated water connection costs to be zero. Endesa Ireland considers that this figure should be revised in order to incorporate the increased capacity of the water system necessary to meet the needs of the power plant. In Endesa Ireland's experience, even with a plant very close to water, any existing pipeline could have leaks which could cost in excess of €200,000 to repair.

Plant Life:

Endesa Ireland would consider it more appropriate for the plant life to be reduced from 20 years to 15 years as was set out in the RA's BNE methodology. Insufficient justification was presented for increasing the plant life from 15 to 20 years in last year's estimation of fixed costs for a Best New Entrant. There has not been a significant change in the technology since the implementation of the RAs BNE methodology. Such unjustified and arbitrary changes significantly reduce investor's views of regulatory certainty.

Electrical Connection Costs:

While electrical connection costs are site-specific, Endesa Ireland would consider the costs presented in the consultation paper to be too low. It is difficult to propose a more appropriate figure without greater detail on what has been included in the €7,492,999. It is only explained that this accounts for a 4km connection at 110kV. Endesa Ireland considers that costs associated with metering and protection as well as possible deep reinforcement works need to be addressed.

Ancillary Services:

Endesa Ireland considers that further justification of the ancillary services revenues is required, in particular the revenue from reactive power which amounts to over €13,000.

⁴ "All Island TSO Facilitation of Renewable Studies", Final Report for Lot3/ENQEIR132



It is Endesa Ireland's experience that significant discrepancies exist between what manufacturers state their generators to be capable of and their actual capabilities. CEPA⁵ states that it is unlikely that the BNE plant would be required for operating reserve and that provision of leading/lagging power factors would most likely not be required from a marginal plant. However, leading/lagging power factors are required under the Grid Code and all units must be able to provide this service.

⁵ "Cost of a Best New Entrant Peaking Plant for the Calendar Year 2011", Initial Report, May 2010