



Response to SEM Consultation Paper SEM-11-025

***Fixed Cost of a Best New Entrant Peaking Plant
&
Capacity Requirement for the Calendar Year 2012***

on behalf of

AES Kilroot Power Ltd and AES Ballylumford Ltd

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Queries to

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Introduction

AES Kilroot Power Limited and AES Ballylumford Limited (collectively 'AES') welcome the opportunity to comment on the Fixed Cost of a Best New Entrant Peaking Plant & Capacity Requirement for the Calendar Year 2012 Consultation Paper ('the Consultation Paper').

Comments

AES is concerned that for the third consecutive year the value of the Annual Capacity Payment Sum (ACPS) has reduced with the proposed value for 2012 dropping by 4.6% from €545m in 2011 to €520m in 2012. AES considers it unlikely that an investment in the Best New Entrant Peaking Plant (BNE) would be made on the basis of the proposals in the Consultation Paper.

Since 2009 the ACPS has dropped by 18.9% from €641m to the proposed €520m in 2012. This erosion has been accompanied by a significant increase in the capacity competing for the ACPS from the connection of both new conventional and renewable generators. Generators have therefore been exposed to significant dilution, volatility and risk in the capacity payment revenue stream. The dilution in the capacity payment revenue stream has also been accompanied by downward pressure on the System Marginal Price during this period which further increases the risk of operating in the Single Electricity Market (SEM).

Given that the ACPS calculation methodology adopted for 2012 is consistent with that used for 2011, other than a few minor refinements regarding the selection of the BNE technology which AES welcomes, AES continues to believe that the method of assessing some of the key ACPS components does not reflect the true risk of operating in the SEM and therefore understates the ACPS.

Weighted Average Cost of Capital

The Weighted Average Cost of Capital (WACC) is a key component of the BNE price. The pre-tax WACC used in the calculation of the 2012 BNE is 6.26% which is the mid point of the 2012 low and high values for the UK provided by CEPA. This is a reduction of 1.9% from the 6.38% used in the 2011 calculation of the BNE. AES is concerned that the continued use of the UK WACC as the range for the BNE WACC does not reflect the reality of an investor contemplating an investment in the SEM. While NI is jurisdictionally part of the UK AES does not consider that the UK WACC reflects the risk of the geographical separation of NI from mainland GB, the fact that energy policy is devolved to the NI Assembly and the unique circumstances of investing in a market that operates across two separate legal jurisdictions. The reality is that an investor considering an investment in NI generation assets will consider the risks and economic situation of both of NI and ROI.

Given that NI makes up only about 25% of the SEM total electricity requirement ROI is by far the dominant influence. An investor contemplating an investment in NI will therefore place significant weight on the economy and political stability of the ROI given that the financial returns from the SEM will be highly impacted by the economic and political situation in the ROI.

The risk of investing in the SEM has increased significantly over recent months due to a number of factors such as the financial stability of the ROI; the facilitation of aggressive renewables targets; the SEM Committee review of, for example, the Capacity Payment Mechanism and Scheduling and Dispatch; European Union legislation to integrate electricity and gas markets and reduce greenhouse gas emissions; and Electricity Market Reform in the UK which includes a tax on fossil fuels used to generate electricity. All of these would suggest that the BNE WACC should be higher than the value for 2011 and significantly higher than the 6.26% adopted. AES therefore urges the SEMC to recalculate the WACC taking these factors into account ahead of any final decision on the BNE cost for 2012.

Transmission Use of System

While the Generator Transmission Use of System (TUoS) charging methodology was in the process of being consulted on at the time of issue of the Consultation Paper the CEPA BNE analysis assumed that the existing methodologies for NI and ROI were adopted and used the current tariffs to estimate the charges the BNE would face. The RAs have however just published a consultation paper on the indicative harmonised tariffs for Generator TUoS for 2011/12 (SEM-11-036) which indicates an almost doubling of some of the Generator TUoS charges in NI which should be reflected in the BNE analysis. In addition a review of the indicative Generator TUoS charges highlights that the charges are generally higher in NI than the ROI providing the locational signal that new generation should locate in ROI. This obviously conflicts with the choice of NI for the location of the BNE.

Forced Outage Probability

The Consultation Paper outlines the RAs intention to retain a FOP of 4.23% in order to incentivise an improvement in plant performance over historical levels. 4.23% was the value calculated to reflect the improvements in plant performance following privatisation of the generating assets in NI in 1992. The Consultation Paper does not however publish the actual historical FOP nor indicate the stretch that a FOP of 4.23% is trying to achieve and AES requests that the RAs publish this information for transparency purposes. Given that privatisation took place almost 20 years ago, along with the increased age profile of the generation fleet, the increased cycling of the older plants and a diminishing scale of improvement AES considers that the FOP should be revisited in order to determine whether the principle and/or rate is still appropriate.

AES supports the RA's inclusion of the cable fault on the Moyle Interconnector during 2010 in its Forced Outage Probability (FOP) calculation since this is consistent with basing the FOP on historical data.

On page 21 of the Consultation Paper it states that 'growth in demand is partly offset by introduction of the new interconnector which has a higher availability than a traditional conventional plant'. It does not however state what FOP has been allocated to the East West Interconnector. AES believes that the FOP for the Moyle Interconnector should be used for the East West Interconnector until its history is established.