Fixed Costs of a Best New Entrant Peaking Plant and Capacity Requirement for 2012

Synergen's response to SEM-11-025

1 Introduction

This paper is Synergen's response to the consultation paper SEM-11-025, "Fixed Costs of a Best New Entrant Peaking Plant and Capacity Requirement for 2012" published by the RAs on 6th May 2011, along with supporting material including a report by CEPA and PB Power. References in this response are to SEM-11-025 unless otherwise stated. Synergen has no objection to this response being published.

Synergen is concerned that both the RAs' €/kW cost assumption for the BNE Peaker and the RAs' estimate of MW Capacity Requirement are too low, the combined impact of which would be to materially under reward capacity for 2012.

2 Locational Matters

2.1 General Approach

At a high level, the BNE candidate plant's costs are assessed on a locational basis, whilst other factors, notably revenues, are assumed to be generic across the SEM. Synergen considers it inappropriate to model some elements by region but make SEM wide assumptions on other financial elements that may be nodal.

Synergen is also concerned that the candidate NI BNE plant is unrealistic as the costs that it will face in 2012 and beyond are likely to be higher than set out. First, the indicative Generator TUoS charges for 2011/12 (SEM-11-036) appear to provide a signal to build in the RoI. Second, the carbon price floor arrangements (effective in 2013) would discourage such investments when the RoI is an option, as the operational cost base increases. Such factors are not considering within the BNE assessment. The assessment of the NI plant should be revised to incorporate the planned increases in TUoS.

2.2 WACC Proposals (section 8.3)

Synergen does not believe the assessment of the NI WACC is prudent, and that a number of elements of the WACC treatment are inappropriate given the assumed nature of the investment and the cross-jurisdictional nature of the SEM, including common market arrangements and a common regulatory regime. For example, a generator located in NI has the same exposure to a supplier default in the RoI as is faced by a generator in the RoI.

1. Within SEM-11-025, the WACC assumptions are locational based on country specific assumptions. However, the required returns are higher NI compared to the rest of the UK given the region's risk profile, as noted in a current British Government consultation which states "*… it is clear Northern Ireland faces a greater challenge than most other parts of the UK in competing in a global*

market, and attracting investment to grow the private sector and drive economic growth."[1].

2. Whilst the cost of debt may (theoretically) be considered on a jurisdictional basis, and for a network business this may be realistic. However, for a generation entity its risks and rewards are market wide as the SEM operates on the basis of common market and regulatory arrangements across jurisdictions.

3. The assumed level of required reward appears unrealistically low given the interest rate for recent NIE bonds (May 2011) was 6.375%. Clearly a merchant BNE would have a higher cost of borrowing compared to a network related business owned by the Irish Government.

Synergen thus believes that the wide differences in risk free rates between jurisdictions are not realistic in considering the BNE Peaker. On this basis, the RAs should re-visit the WACC assessment.

2.3 Ancillary Services Revenues (section 11)

The assessment of Ancillary Services revenue for the BNE Peaker is not jurisdiction specific but other significant elements of the assessment (e.g. gas transport / connection / WACC) are geographic. Indeed the TSO's recognise in the current consultation on harmonisation that AS requirements are jurisdictional and thus the likelihood of ancillary service rewards depends on the location of the BNE Peaker. On this basis, the RAs should re-visit the assessment of AS revenues.

3 Other Matters

3.1 Nature of the BNE Investment (section 8.2)

Synergen notes that the nature of the BNE investment assumptions are the same as for the existing year. That said, Synergen remains of the view that an anticipated project life of 20 years is longer than any investment project that may be undertaken in practice. A 15 year project life would be the normal financial assumption for a power sector investment of this type across the SEM. Thus Synergen considers that this assumption should be amended to reflect a realistic investment scenario.

3.2 Infra-marginal Rent (section 10)

SEM-11-025 assumes that the BNE Peaker runs in all periods where it would get IMR. In principle this is over-optimistic[2]; RAs should consider applying a probabilistic availability to it as a combination of scheduled and forced outages means that it would (in practice) not maximise its IMR in the assumed manner. Within the current CPM review[3] Poyry use an assumed capacity credit of 84% for distillate and 75% for "other gas" to reflecting realistic availability.

[1] HM Treasury : Rebalancing the Northern Ireland economy – March 2011 – Section 1.3.
[2] Synergen notes that this does not impact the BNE assessment given that the assumed level of IMR is zero within SEM-11-025.
[3] SEM-11-019a table 23, page 74.

3.3 Demand forecasts (section 13.3.2)

Synergen is concerned that the capacity requirement is suppressed because the assumed peak demand excludes demand driven by recent extreme weather events as "outliers" whereas such high peak demands driven by recent extremely cold winters may not be "outliers" but rather the new "average winter" peak situation. The RAs should revisit this assumption.

3.4 Forced Outage Probabilities (section 13.3.5)

The TSOs[4] recognise that forced outage probabilities are not independent during in cold weather events i.e. at times of peak. Thus the capacity requirement related assumption made regarding forced outage probabilities is unrealistically low and leads to suppression of LOLE at times of peak. The RAs should seek the views of the TSOs on the appropriate level of FOPs applicable at system peak in order to correctly determine the capacity requirement.

[4] Eirgrid / SONI - All-island Generation Capacity Statement 2011-2020 page 60.