



Endesa Ireland response to SEM/10/068
CPM Medium Term Review - Work Package 7
Calculation of the BNE Methodology

Endesa Ireland welcomes the opportunity to respond to the consultation on the BNE Calculation Methodology. We welcome the SEMC statement that the intention of this paper is to invite comments on improving the current BNE calculation methodology, rather than moving to a new methodology. Endesa Ireland considers that any movement to a new methodology for existing plant in the short- to medium-term would significantly undermine regulatory certainty and would have a negative impact on the investment climate in the SEM.

Endesa Ireland recommends that any proposed changes to the CPM must be viewed in relation to the long-term strategy for the SEM and the steps that must be taken to integrate the SEM into the regional market. The SEMC has not published any information in relation to this and we would encourage the SEMC to develop such a document, in conjunction with market participants, so that there is a framework in which to assess proposed market changes and their medium- to long-term impact. Changes to the CPM in the short- to medium-term should be justified by the way these changes will facilitate the implementation of the long-term strategy and greater competition.

As stated in our response to SEM/09/035, Endesa Ireland considers that the capacity payments for existing units should continue for the medium-term. However, access to these payments should be limited to existing units. For new build, capacity auctions should be introduced. This can help the SEM move toward a more competitive market.

In the long-term, Endesa Ireland wishes to see the SEM develop into a fully competitive market in which market participants that are not receiving capacity payments are not restricted to offer in to the market at their short-run marginal cost (SRMC). It is our view that in the longer-term, once current market participants have recovered their capital costs, capacity payments should cease, and these participants should be able to offer into the market without restriction on their offers.

The long-term strategy should include plans to move towards a competitive ancillary services market. Auctions for the provision of ancillary services should be developed, allowing new entrants to offer for long-term ancillary service contracts and existing market participants to offer for annual contracts. These auctions will increase market transparency, promote competition and will ensure the services are procured at the lowest cost to the end customer.



We would also reiterate our request for CER to develop an incentivisation package for EirGrid to deliver Grid25 and to minimise network constraints. The current level of constraints on the island limits the potential for a fully competitive market.

Of the options presented for improving the current BNE calculation methodology, Endesa Ireland prefers Option 5. This option provides the greatest certainty for market participants. Below are our comments on each of the options set out in the consultation paper:

Option 2 calculate BNEFC on an annual basis with some components constant for a number of years

This option proposes that some elements of the BNE FC would remain unchanged for a number of years, including the technology of the plant, including fuel choice and capacity, the location and the environmental standards to be met.

The RAs consider that the implementation of this option comes with the risk that the capacity pot may not reflect changes within the market place, however, it would provide some additional short-term stability for generators.

Endesa Ireland considers that this option does not go far enough to reduce investor uncertainty. This process would not be very different from the existing process and would do little to improve stability for generators.

Endesa Ireland has significant concerns that the consultation paper proposes that plant life is one of the variables that may be set for several years. Endesa Ireland considers that the 15 year plant life as set out in the initial design of the BNE is an appropriate plant life and that this should be returned to the original value and should remain unchanged until there is significant improvement in technology to justify the extension.

Option 5 calculate BNEFC and keep it in place for a number of years

Endesa Ireland strongly prefers this option. This would fix BNEFC significantly reducing volatility. Once the BNE plant technology and associated costs are calculated, they should be fixed for 3-5 years. The only change during the period should be in the determination of the annual capacity requirement and the indexation of costs.

Endesa Ireland accepts that the implementation of this option could result in significant changes to the capacity pot from one period to the next. In order to mitigate this, Endesa Ireland would strongly urge the SEMC to set published sources for the inputs to the BNE calculation that will be used for all periods, in particular the parameters utilised for the



calculation of WACC. This would minimize the negative impact of step changes from one period to the next as market participants would be able to forecast these changes.

Option 6 fixed capacity payment for new entrants

Endesa Ireland strongly supports the proposal for a separate capacity payment for new entrants. It is our view that capacity auctions for new investment should guarantee an annual capacity payment over 10-15 years, sufficient to enable investors to recover their capital costs. This will significantly reduce the risk of diminished payments once the guarantee is exhausted. We would expect that units that are supported by capacity payments would continue to offer into the market at their SRMC.

Units that are not receiving capacity payments, either because their explicit capacity payments have ceased or because they chose to invest without an explicit capacity payment, should be able to offer into the market without limitation by the regulatory authorities. Given the expected level of interconnection in the longer term and the investments in the transmission network to minimise congestion, there should be a sufficient level of competition on the island to ensure that prices are competitive.

We look forward to the development of scenarios including long-term capacity auctions for new entrants and the impact this may have on the market.

Indexing Options

Endesa Ireland considers that the consumer price index (CPI), the index that has been used in the BNE calculations since market start, is the appropriate index to use when adjusting costs associated with investment in a BNE in the SEM.

WACC Parameters and Alternatives

The consultation paper has stated that the WACC parameters are key to the establishment of the final annualized BNE cost. Endesa Ireland considers that the volatility of these parameters is a major cause of uncertainty for market participants. This uncertainty would be significantly reduced if the SEMC agreed fixed sources for these parameters that are utilized to calculate the BNE FC.

In the interests of transparency and regulatory certainty, Endesa Ireland would suggest that the RAs consult on appropriate public sources for the WACC inputs and commit to setting the WACC for the BNE at the mean of these values.

Alternatively, Endesa Ireland suggests that the WACC utilized in the BNE calculations should be the average WACC of SEM market participants. As the RAs are in receipt of the annual accounts for all companies, they can ensure that this information is reported accurately. As all rational companies seek to minimize their cost of capital, it seems



reasonable that utilizing the average WACC of market participants in the BNE calculation will result in an appropriate WACC for investment in the SEM.

Endesa Ireland does not consider that the methodology selected to assess the rate of return required from a capital project, rather the consistency of the inputs used. Should the SEMC determine that an alternative to WACC should be employed, Endesa Ireland would ask that the inputs to the calculation be publicly available and the sources be set for 10-15 years.

Gas Capacity Costs

Recovery of gas capacity costs continues to be a serious gap in the SEM market design which has yet to be addressed by the SEMC, despite the RA's insistence that prices should reflect costs.

Considering the likely running of a BNE, we would consider it appropriate that gas capacity costs are considered a SRMC. We would note that in a study published by the RAs into the impact of wind on the SEM in 2020¹, they included short-term gas capacity costs in the bids of the OCGT. Given the fact that it is required under EU law for short-term capacity products to be available, the lack of implementation of this requirement in NI is not sufficient reason for the SEMC to disallow the recovery of these costs in the SEM. The SEMC view that recovery should not be permitted because there is insufficient liquidity in short-term capacity products is not a logical argument, as the price for these products is set by the regulators. Gas capacity costs are a legitimate generation cost in the SEM. Endesa Ireland requests that the SEMC review their decision to disallow recovery of these costs.

Endesa Ireland looks forward to the publication of a further consultation paper that will provide greater detail in relation to these options and an assessment of how these options will progress the medium-term strategy of the SEM.

¹ http://www.allislandproject.org/en/market_decision_documents.aspx?article=f8de4cfd-9a6b-4c04-8018-b89e74d0f6ba