ESB International

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12th November 2010
Jody O'Boyle (NIAUR) &
Clive Bowers (CER)

Ref: CPM Medium Term Review, Work Package 7 – BNE Calculation Methodology (SEM-10-068)

Dear Sirs,

Please find attached ESB International's (ESBI) response to the above consultation

Kind regards

Andrew Burke
Operations Manager, Independent Generation, ESB International

ESB International

ESBI RESPONSE TO

CPM Medium Term Review, Work Package 7 – BNE Calculation Methodology (SEM-10-068)

1. Introduction

ESBI would like to thank the Regulatory Authorities (RAs) and the SEM Committee (SEMC) for inviting comments in response to the discussion paper published on 7th October 2010; CPM Medium Term Review Work Package 7 – BNE Calculation Methodology, (SEM-10-068).

2. ESBI's response

The Capacity Payment Mechanism is a fundamental building block of the Single Electricity Market and, as such, is a key determinant of the timing and type of new entry. As such, it is (in combination with the IMRs received by generators) the main driver for providing security of supply within the SEM.

ESBI believe that the current methodology serves its purposes, and is not fundamentally flawed. Any possible change in BNE Calculation methodology would create regulatory uncertainty and reduce the forecastability of capacity payments, which will give rise to consequential increases in the costs of capital and the financeability of projects. This will provide a deterrent to building plant within the SEM. Therefore, moving away from the existing methodology to any new or considered methodology must offer a significant benefit to that existing presently.

The objective, when determining the ACPS, is to provide the correct sum for each year, noting that there will be differences between years. The ability to forecast this is key in understanding the income that a unit will receive and so it must be as forecastable and transparent as possible. This is something that can be delivered without necessarily fixing some of the cost drivers, so long as the application of the existing methodology becomes more transparent, i.e. codified and formulaic, and less susceptible to judgement calls on key cost drivers – for example WACC assumptions.

This does not appear to be the case for Options 1 & 3 in Section 4; Options 2, 5 & 6 of Section 5; and Option 2 of Section 6. All these options appear to be susceptible to influence by the Regulatory Authorities, thus reducing transparency and increasing regulatory risk. Additionally Options 2, 5 & 6 of Section 5 do not seem to ensure that the correct sum is paid at the right time and possibly over a period of time too.

ESBI would not favour the use of specific indexation (Section 7) due to the difficulties in finding an appropriate index at present and the risk that this may have to change in future, which again would provide a deterrent to investment by reducing transparency and forecastability.

As previously stated, the pot needs to be forecastable and transparent, and whilst Option 5 (Section 8) leads to a greater pot stability it is implied that this stability will be for 3-5 years. This is significantly different to the actual or accounting life of a power station and so this option does not seem to offer anything extra to that currently in place, and indeed, may lead to the wrong sum being paid at the wrong time. Furthermore, whilst this may (subject to indexation questions) provide some stability over a 3-5 year period, it would not, in our view, create a fundamental shift in the ability to finance new entry, which is more likely to be facilitated by viable levels of CPM (where IMRs plus CPM for a BNE peaker are actually sufficient to cover the plant costs).

In its current state Option 6 (Section 9) is somewhat difficult to judge, given that the option has not yet been investigated by Poyry. However, the rationale for this option does not seem sound, specifically in relation to the difference between the period a plant would be paid the new entrant price for "a few years" and its actual or accounting life. If anything this appears to be less transparent than the existing methodology and may increase regulatory risk both for existing and new entrant plant as the period of "a few years" seems open to interpretation and redefinition in future.

As stated above, ESBI believe that moving away from the existing methodology to any new or considered methodology must offer a significant benefit to that existing presently. Therefore, as this does not appear to be the case for any of the options outlined in the discussion paper, ESBI believe that the existing methodology should continue to be used. However, in order to enhance security of supply, efforts to improve the transparency and robustness of the existing methodology should continue to be made.