



Endesa Ireland response to SEM/09/072 Fixed Costs of a BNE Peaking Plant and Capacity Requirement for 2010

Endesa Ireland welcomes the consultation on the Fixed Costs of a BNE Peaking Plant and the SEM Capacity Requirement for 2010. Endesa Ireland is in the process of developing our sites and has received estimates from a number of companies for mid-merit and peaking units, along with estimates for all related investment costs. As such, we consider that we are in a good position to evaluate the estimates included in the consultation paper for BNE fixed costs. The costs that the RAs have included in the paper are within the same ballpark as the costs that Endesa Ireland has received from the vendors. Endesa Ireland considers the proposed costs that are accounted for in the BNE for 2010 for a unit to be located in Northern Ireland to be reasonable¹. Similarly, Endesa Ireland considers that the capacity requirement for 2010 is reasonable.

However, Endesa Ireland does not consider it is appropriate to change the estimated life of the plant from 15 years to 20 years and does not consider the RAs have provided sufficient justification for this change.

In addition, Endesa Ireland has significant concern relating to the lack of incentives to secure the optimal network development on the island, the costs that are not included in the BNE fixed costs and the differences in investment costs in Ireland and Northern Ireland due to the dual-fuel requirement in Ireland.

Plant Life

The RAs have proposed that the economic life of the plant is 20 years, rather than the 15 year economic life that has been used since the introduction of the BNE concept within Ireland (December 2001).

The justification provided in the consultation paper is that “a trend for the economic life of peaking SCGT is moving from 15 years to 20 years”, which the RAs indicated in the Decision Paper for the 2009 BNE Peaker Calculations. In this consultation, it was stated that “a plant life of 15 years did not equate to a residual investment value of zero was brought to the attention of the SEMC. This is because a peaker will most likely not require a life extension or decommissioning until after 30 years. Any residual value of the plant (and the value of the site) should be recouped. This value should factor in the site cleanup costs, including dismantling of the plant itself.”²

“PB has advised the RAs that the life time of a plant can typically be longer than 15 years.... Considering in previous years a 15 year economic life with an unspecified residual value was assumed, it is appropriate to move to a 20 year economic life with no residual value”.

No concrete justification for this change has been offered, simply the “recommendations of consultants” paid by the RAs to develop the lowest-cost BNE model.

¹ The connection charges for generators in Ireland that have been included in the consultation paper are significantly lower than the cost included by EirGrid in recent connections offers, but as the proposal is for the BNE to be located in Northern Ireland, this will have no effect on the final investment costs.

² SEM-08-109



In its decision paper for the 2002 BNE, CER stated that

A plant life of 15 years only is considered. It appears that this is a reasonable time period for the investor to recover the required return on his investment. In practice, the plant would be expected to operate for a longer period (20 to 25 years) but may not be capable of commanding the same merit order position in a competitive market environment³.

Endesa Ireland considers that CER's initial justification that a plant life of 15 years is appropriate remains true. This value for plant life was carried through to the BNE fixed costs under the SEM.

Given the current energy climate - the significant advancement in renewable generation technologies and the projected reduction in the running order of all non-renewable generation, Endesa Ireland considers that the utilisation of 15 year plant life remains appropriate, as all projections show that an OCGT will be unable to command the same merit order position in a competitive market environment in 15 years time.

Lack of incentives

The proposed BNE plant for 2010 is the least-cost option. Endesa Ireland understands that the stated objective of the BNE methodology is to make a decision as a rational investor and such an investor would seek the least cost option, given the lack of any incentives to take other criteria into consideration.

The short-listed options for the preferred BNE were all units with an output greater than 160MW. This highlights the fact that the Regulatory Authorities have not implemented signals to secure investment in smaller-sized units, which are more appropriate for the island, both in terms of security of supply and system operation. In addition, the island would be better served by investments in conventional generation close to the locations for wind farms. Currently, there is little to no incentive for a rational investor to invest in the north or west coasts, where such investment is needed to provide support for wind generation. This should send a very strong signal to the Regulatory Authorities that additional incentives are needed to secure investment in peaking units in locations where wind farms are / will be located, which will be necessary for the efficient and secure operation of the network.

The choice of a distillate-fired unit shows that there are no incentives to invest in units with lower NOx emissions. The Regulatory Authorities should be working with government in Ireland and Northern Ireland to achieve the reduced emissions targets by providing incentives for development of conventional plant with lower emissions. One means of doing so would be by taking this into account when selecting the BNE. Endesa Ireland also considers that 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.

³ CER/01/180



Missing cost items

Long-term service agreement (LTSA) costs are not included. The consultation paper includes a provision for non-EPC costs of approximately €8 mil, although these are not fully detailed. This provision is insufficient for the LTSA costs, which are approximately €4 mil/year. Endesa Ireland would expect that a specific provision for LTSA costs is included in the BNE fixed costs.

While ancillary service payments are taken into account, there is no provision for the cost of “incentives” for failure to meet the Grid Code Requirements. A rational investor would include a provision for these costs.

Unrecoverable costs

In a common market, where licence requirements result in significant differences in investment costs among participants, some form of compensation should be in place to restore the balance among market participants.

Endesa Ireland has recently reviewed the costs associated with the dual-fuel requirements and has found these to be approximately €25 million⁴. These are fixed costs, which are currently unrecoverable in the SEM⁵.

Similarly, connection to the gas transmission network is an unrecoverable fixed cost. The RAs have been aware of this gap in the cost recovery mechanisms since market start, yet have not designed a mechanism for generators to recover these costs. Endesa Ireland considers this to be a significant issue that needs an immediate remedy.

In SEM 08-069, the RAs indicated that explicit capacity payments were introduced to reduce price volatility, while ensuring generators’ revenue adequacy. Currently, capacity payments do not take account of the costs for dual fuel requirements or gas connection costs. This leaves a significant portion of generator costs unrecoverable. For CCGTs with low SRMCs that receive the SMP and therefore can make a significant contribution to their fixed costs, the lack of a specific market mechanism to recover these costs can be managed. However, for mid-merit and peaking plant – the units that are needed in Ireland – this amounts to revenue inadequacy. This situation is critical. Needed investment in flexible generation to support the high levels of intermittent generation expected in Ireland will be deterred unless adequate cost recovery mechanisms are implemented in the near future.

Endesa Ireland considers the costs related to the LTSA contract and the proposed “incentive” charges for Grid Code compliance should be included in the BNE calculations and the plant life should be 15 years.. In addition, Endesa Ireland strongly suggests that the RAs implement appropriate incentives to secure investment in smaller peaking units in locations that are beneficial to the system and a mechanism(s) for recovery of costs associated with connection to the gas transmission network and the dual-fuel requirement.

⁴ These costs have been set out in Endesa Ireland’s letter to EirGrid (copied to CER) dated 07 July 2009.

⁵ As these are requirements for Irish generators only, it may be more appropriate to recover the dual-fuel related costs via the PSO.