Joint Development Agency Submission to the SEM Regulatory Authorities on the Fixed Cost of a Best New Entrant Peaking Plant & Capacity Requirement for the Calendar Year 2010 (SEM 09/072)

29th July 2009

The development agencies, Forfás, IDA Ireland and Enterprise Ireland, represent the interests of the internationally trading business sector in Ireland. The reported exports of all agency-assisted firms accounted for 71 percent of total Irish exports in 2007.
Total permanent full-time employment in agency-assisted companies operating in the manufacturing or internationally traded services sectors amounted to 305,121 in 2007.

We refer to the consultation process on the capacity payments requirement for the calendar year 2010. The development agencies, Forfás, IDA Ireland and Enterprise Ireland, welcome the opportunity to provide an input to this important review. It represents an opportunity to reduce cost pressures on Irish firms while maintaining market certainty for potential investors in the Single Electricity Market (SEM).

High electricity prices affect the ability of firms based in Ireland to successfully sell goods and services on international markets. Ireland's ability to continue attracting high levels of foreign direct investment, provide a supportive environment for Irish enterprise generally and sustain employment will depend on its capacity to quickly address the serious loss in price competitiveness of recent years while also delivering more secure and sustainable energy supply.

The introduction of the SEM in November 2007 was an important development and has led to greater efficiencies in electricity generation. However, it is timely to review the market rules to ensure the market is functioning optimally to the benefit of electricity consumers. The development agencies recognise the vital role of the capacity payments mechanism (CPM) in incentivising market entry and exit, encouraging generators to be available in order to ensure security of supply and encourage an efficient mix of plant types (e.g. flexible plants to meet peak demand needs). Capacity payments must be sufficient to incentivize generators to make capacity available even when it is not dispatched and to provide a support mechanism to invest in new, more efficient generation plant.

The agencies welcome the regulators' decision to reduce the level of the capacity payments pot in 2010. While the consultation document proposes to reduce the capacity payments pot to €547 million for 2010 (from €641 million in 2009), this is largely due to a lower capacity requirement for 2010 (6,832MW as compared with 7,356MW in 2009).

The agencies believe the level of the CPM needs to be revised downwards to fully reflect both the decline in electricity demand and the fall in capital costs for new plant. The consultation document proposes a Best New Entrant (BNE) peaker cost of €80.11 per kwh – this represents a reduction of eight percent on the 2009 level. In terms of the breakdown in costs for the BNE peaker plant given in Appendix 1, several cost categories stand out as being substantially higher in 2010 than in 2009 leading to a 28 percent overall increase in the capital cost for the BNE peaker and a four percent increase in total fixed costs of running the BNE plant. According to a recent report by the International Energy Agency, the unit investment and equipment costs of building new plant have fallen by 20-30 percent since 2008[1].

1. See: http://www.iea.org/textbase/Papers/2009/G8_FinCrisis_Impact.pdf.

The agencies would have expected the BNE cost to have fallen by more than the proposed reduction of eight percent given the continued, significant decline in capital costs internationally and the proposal to increase the plant life from 15 years in 2009 to 20 years in 2010. The agencies recommend that the regulators revisit the cost assumptions, particularly for capital costs, to ensure that they fully reflect the current cost of capital investment. The agencies also recommend, in the interests of transparency, that the regulators clearly indicate in their decision document what percentage of the fall in the BNE price is due to expanding the plant lifespan from 15 to 20 years.

As Ireland increases the penetration of wind energy in the electricity fuel mix in future years, flexible generation capacity will be needed to ensure supply when electricity generated by wind is unavailable. It is important that the market sends out the appropriate price signals to attract investment in flexible plant. The agencies believe it is important that the CPM is kept under review to ensure it is delivering on its longer term objectives of incentivising investment in new, efficient plant, especially flexible plant while also encouraging the closure of old inefficient plant. To this end, the agencies welcome the regulators' commitment to a medium term review of the CPM but would urge the regulators to publish its consultation paper at the earliest opportunity – it is currently proposed for Q2 2010. Ireland must continue to progress measures to improve energy competitiveness as a matter of urgency if Irish companies are to be competitive in international markets.