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Our Ref: DV01-003285

12 November 2010

Dear Sirs,

RES Response to the Discussion Paper CPM Medium Term Review: Work Package 7 – BNE Calculation Methodology

Introduction

RES UK and Ireland Ltd is part of the RES group of companies. RES has been developing wind projects on the island of Ireland since the early 1990s, having developed 14 operating wind farms and 1 single turbine in Northern Ireland and 4 operating wind farms in the Republic of Ireland, totalling over 241MW. RES currently owns or operates over 134MW of wind capacity across Ireland. In addition RES has a further 35MW in construction or with planning consent.

RES welcomes the opportunity to comment upon the discussion paper on the CPM Medium Term Review – Ref SEM-10-068. We commend the RAs on the work done analyzing different capacity payment mechanisms in different countries. This piece of work is particularly useful and demonstrates the SEM is built around a methodology and principles that have been proven elsewhere. The knowledge gained on the products / mechanisms identified, could also be used in any work carried out on ancillary services, in terms of structure of commercial products, etc. In this response we set out our views on the work package presented. However, as a further paper is due on other work packages, it is difficult to take a definitive view on the issues without sight of all the proposals together.

This response draws upon many of IWEA's comments.

RES's main comments on this paper are;

- The Capacity Payments Mechanism (CPM) needs to be stable and transparent.
- Conventional plant with the right characteristics in terms of flexibility, cost to produce, etc need to be sufficiently incentivised by the CPM and/or ancillary services.
- Wind needs to continue to be recognised in the capacity payments mechanism.
- RES strongly opposes the reasoning regarding renewable support schemes in Option 6.

- RES sees merit in options 2, 3, 4 and 5.

Below we give our comments on the specific options presented for consideration.

BNE Calculation Methodology 2006

RES believes that continuing to base the capacity pot upon a best new entrant is a much more stable and transparent methodology over basing the pot on VOLL and LOLP. The advantage of the current methodology is all the individual line items can be tested against market conditions. While VOLL and LOLP are credible economic parameters, they are much less understood and more difficult for investors to predict.

Review of Option 2 – Some components of capacity pot remain constant

RES sees merits in further investigation of Option 2 whereby some elements of the annual capacity pot would be fixed for a period of 3-5 years. It would bring a greater level of stability and certainty to the annual capacity pot calculation. It would be important that the items fixed are those which would not be expected to move to any significant degree over the time horizon. Indexation of the fixed items would also be appropriate. It is proposed that the items could be adjusted as necessary e.g. technology of peaker, choice of fuel, environmental standards to be met. We believe it is important to fix the items used to ensure consistency between years.

Review of Options 3 & 4 – Smoothing of capacity pot

Under an earlier SEM consultation Options 3 and 4 were proposed, whereby the annual capacity pot would be smoothed by using a rolling average of the previous number of years. We note that such an option is not considered further in this paper but believe it warrants further analysis and consideration under this consultation process.

Option 5: Keep pot stable for a number of years

RES agrees that this option, which would fix the capacity pot for a number of years, will most likely create a stepped change in capacity payments at the end of each period it is set for. It would also introduce the risk of providing a cyclic investment signal, where there would either be a flood of investments over the set period or a scarcity, depending on how the market costs move against the capacity pot. Such cyclical investment signals are undesirable and create unnecessary uncertainty in the market.

Option 6: Fix Price for New Entrants

We have very strong concerns over option 6. It is unreasonable to exclude wind farms from a market mechanism purely because they receive external support rather than on any technical or commercial rationale. This proposal is a worrying precedent and we strongly oppose such a concept. As pointed out in the recent proposed position paper on the 'Principles of Dispatch and Design of the Market Schedule' (SEM-10-060), whilst the SEM Committee is not tasked explicitly with delivery of renewable targets, it should ensure, as a minimum, that the SEM is not configured in a manner that actively frustrates the delivery of these targets.

In terms of what this proposal seeks to achieve, it appears that the current mechanism acts as a signal deterring plant to retire, as much as it does to incentivise new plant. Whilst this is not necessarily a bad feature it does not seem appropriate at the present time as there appears to be an over capacity on the system, with many plants not required to provide energy to the system. Furthermore the CPM should act to ensure that the conventional plant that enters the market has the right characteristics in terms of flexibility, cost to produce, etc.

RES views the ancillary services market as the best place to ensure new entrants have the 'right' characteristics. However the proposals introduced here certainly warrant further consideration.

Fixing Elements of WACC Calculation

RES recognises that there may be merit in setting those elements of the WACC calculation that do not change year-on-year in order to give investors greater certainty on the extent of the annual movement of the capacity pot.

Alternative Financial Methods

A greater level of analysis would be required before industry participants can give an informed view on the proposal to potentially move to a Discounted Cash Flow mechanism or Adjusted Present value mechanism.

If any points made in this response require further clarification, please don't hesitate to contact RES.

Yours sincerely,

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