ESB PG Response to SEM/10/038
CPM Medium Term Review Work Package 7
BNE Calculation Methodology

ESBPG is pleased to submit its response to this consultation on the BNE calculation methodology, work package 7 of the CPM Medium Term Review.

Section 3: CPM Design

In relation to the 3 possible market design options for delivering adequate market capacity, ESB PG, in principle, would favour either the quantity based methodology or the existing price based methodology.

Section 3.4.1. Time Horizon The current time horizon of setting the capacity pot each year for one year, introduces significant uncertainty and impedes investment decisions around both new and existing plant. Thus setting the capacity pot each year for a period of at least three years in the future would be preferable. It would be preferable that some of the component parts remained unchanged for a minimum of three years. The use of a longer time period gives more clarity on likely income streams for plants that may be considering exiting the system

Section 3.4.2 Cost of New Entry ESB PG do not believe that the cost of the BNE provides adequate reward for that plant in the market currently.

Section 3.4.3 Capacity Requirement ESB PG believe that the current methodology for calculating the capacity requirement is adequate.

Section 3.4.4 Differentiation: The paper mentioned the possibility for incentivising capacity and flexibility separately. This is appropriate. Provision of capacity is incentivised under the CPM and provision of flexibility should be incentivised under the HAS which is subject to separate consultation.

It is not appropriate to differentiate between new and existing plant as it would be against the fairness objective of the CPM as defined in SEM-53-05. ESBPG believes that the technical ability of the plant to deliver the contracted services should be the basis for any incentivisation and age should not be a factor in this decision. Incentivising additional new entry may lead to inefficient and expensive market entry if new entry is encouraged at a price over and above that which can be provided by existing plants.

There is merit in an auction mechanism being used to set the capacity price, however ESB PG would not favour any change in the market rules which would lead to increased and different regulation for ESB PG over and above any other generator.

Section 4: BNE Calculation Methodology 2006

This section revisits the 2006 consultation paper. In principle, option 1, marginal cost of incremental capacity, has merit provided that the methodology for calculating VOLL, FOP and LOLP is not subject to unforeseen swings. The use of the appropriate indices has to be further considered. The current regime, leaves itself open to criticism of being unduly subject to regulatory interference for short term objectives undermining some of the main longer objectives that a properly functioning CPM fulfils.

Section 5: Summary of the Options in the BNE calculation methodology Review 2009.

Option 2:
ESB PG has a strong preference for option 2 out of the list of 6 options and agree that keeping some of the components unchanged for a period of 3 to 5 years will lead to greater stability and certainty.

Option 5:
ESB PG is not in favour of this option and believe that it will lead to step changes in the CPM mechanism.

Option 6:
ESB PG is not in favour of this option and do not belive that the RA's or their consultants should devote further time to developing this option. The CPM is about provision of capacity and the assurance that the capacity will be there when required. Differentiating between old capacity and new capacity is not appropriate and goes against the fairness objective of the CPM and basic economic principles of economic efficiency whereby providers of the same service should face the same price. There are other, better ways of addressing the concerns over availability of capacity such as some form of rebate similar to the operating reserve rebate within the HAS.

Section 7: Indexing over several years

ESB PG suggest applying the most relevant index to the appropriate inputs of the calculation.

In looking at the range of indices available, it would appear that using the EPCCI would be most appropriate index for the investment costs of a peaking unit (i.e. EPC costs etc.) and HICP for the region of the selected BNE for localised costs (such as maintenance and operations costs)..

Section 10: Impact of Options on WACC calculations

In relation to the alternative methodologies to value a project, ESB PG agrees that the WACC methodology is most appropriate. Using other methodologies, such as a Discounted Cash Flow (DCF) analysis would not add further insight

to the calculation. However, the DCF analysis could be used as a verification of the WACC calculation.

ESB PG believes that all parameters of the WACC calculation should be reviewed on an annual basis. As many market participants, including ESB PG, disagree with the current values of the parameters set by the RAs, we feel that there is value in exercising the fundamental assumptions (e.g. time horizon, equity risk premium and debt) on an annual basis.