

CONSULTATION RESPONSE

Paul Bell and Kenny Dane
NIAUR
Utility Regulator
Queens House
14 Queens Street Belfast BT1 6ER

27th January 2010

ESBI response to the Consultation on Relevant Considerations in relation to the possible Cancellation of Generating Unit Agreements in Northern Ireland

Dear Messrs Bell and Dane,

We are pleased to have this opportunity to provide our views in relation to the possible cancellation of the Coolkeeragh OCGT Generating Unit Agreement (GUA). ESBI has restricted its commentary in the consultation response paper to specific questions contained in the document. We consent to the publication of this response paper.

As detailed in the document, we are of the opinion that the decision on GUAs cancellation should not be solely based on the results of economic analysis. We submit that a broader set of criteria should be taken into account including environmental, plant age, security of supply and efficiency of the grid capacity.

If you would like to discuss any of the points raised in this response in more detail, please feel free to contact me.

Yours sincerely,

Ramon Cidon
Market Strategy Manager
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ESB International

Whether cancellation of the GUAs (or any particular GUA) is likely to help further the principal objective of (a) the Authority and (b) the SEMC.

The kinds of effects, whether positive or negative, (if any) that a decision to cancel the GUAs (or any particular GUA) are likely to have on matters to which the Authority/SEMC must have regard. There may, for example, be particular effects of which respondents are aware that they might wish to bring to our attention on matters such as: prices paid by consumers; the competitiveness of the SEM; security and/or diversity of supply; environmental sustainability.

The following objectives are fundamental to NIAUR and the SEM Committee, and we believe that cancellation of the Coolkeeragh GUA would further these objectives:

a) Protect the consumers: One of the objectives of the Authority, as detailed in Article 12.1 of the Energy (Northern Ireland) Order 2003 is “*to protect the interests of consumers of electricity supplied by authorised suppliers wherever appropriate by promoting effective competition between persons engaged in or in commercial activities connected with the generation, transmission or supply of electricity*”.

ESBI believes that consumer’s interests will be better protected if the GUA is cancelled for the following reasons:

PPB does not have any financial incentive to optimise the operation of these assets. Currently, PPB does not assume any financial risk because in accordance with its licence provisions, PPB passes this profit or loss on to electricity consumers in Northern Ireland as one component of a levy known as the Public Service Obligation (PSO).

If the GUA for Coolkeeragh’s GT8 was terminated, ESBI would be in a position to generate and provide power to the SEM as an independent power producer. By doing so, it would be accepting the financial risk on its own, so if the power plant business is not profitable, then consumers wouldn’t be impacted.

This issue will become even more important after 2012, when Phase 2 of the Emissions Trading Scheme and the practice of granting free carbon allowances finishes. The ability of generators in this new market environment to fully recover their carbon costs will be all the more uncertain.

Additionally, due to the age of the generator, a number of contingencies could rise, so the risk assumed by the consumers due to potential pass through in the PSO levy will increase.

Finally, the cancellation of the GUA should not mean a reduction in the wholesale liquidity of the SEM market. The majority of current market liquidity is based on non-directed contracts which are at the discretion of all generators to offer. Currently PPB is not offering any directed contracts associated with Coolkeeragh’s GUA, and therefore is not offering any additional financial options for suppliers.

b) Security of supply: Another objective of the Authority as it is detailed in the Article 12.2: “*to secure that all reasonable demands for electricity are met*”

ESBI believes that the security of supply will be better protected if ESBI owns and markets the GT8 power plant.

The cancellation condition provides that the Authority may give a direction for a GUA to be cancelled at any time on, or after, it’s ECD. This introduces huge uncertainty for the generating unit owner after the ECD if the contracts are continued but are continually under review. This will make it impossible for the owner to make any decisions or even fully investigate possible upgrading or replacement of the plant.

In this uncertain situation the owner will definitely not invest, in fact it is likely that a lot of short term maintenance decisions will be made. With no power offtake certainty, each time an expensive generation unit part fails and you have a ‘temporary repair’ or ‘replace’ decision, the owner is forced to take the short term and least expensive repair solution. The Coolkeeragh OCGT will be 40 years old next year, more than twice the recommended life of a BNE peaking unit in the SEM, which was recently extended from 15 years to 20 years.

If the GUA is cancelled, the generator assumes full market risk for the availability and reliability of the generating unit. ESBI would have the freedom to analyse the possibility of an upgrade or new investment in the site. A new investment could contribute to improve security of supply, reducing the time needed to get to full load (which is critical to cover the variability of the wind generators) and also being able to offer voltage control.

The proposed approach of leaving 'profitable' GUAs in place and continually reviewing does not promote security of supply over the medium to long term. It will lead to lack of investment, short term maintenance planning and over time unreliable generating units. ESBI submits that the age of the generating unit must be a key consideration when deciding whether to allow early termination of GUAs.

Finally, ESBI would like to point out the importance of the capacity payment for peakers. This technology is designed to run for a few hours during the year and to recover the investment cost through this payment. So, in order to ensure sufficient investment and the security of supply of the consumers, this payment should be as stable and predictable as possible. Unfortunately this is not currently happening, as for example it was reduced in by 15% in 2010 compared to 2009.

c) Protect the Environment: Another objective of the Authority is “*to secure a diverse, viable and environmentally sustainable long-term energy supply*” as detailed in Articles 12(3) to 12(5).

ESBI believes that the efficiency and security of supply objectives will be furthered if ESBI owns and markets the power plant.

After 2012 when the allocation of free CO₂ allowances finishes, optimal plant dispatch to reduce plant emissions as much as possible becomes even more critical. ESBI operating under full SEM market conditions is the best way to ensure this happens.

Additionally, if the GUA is cancelled, ESBI could have the freedom to analyse upgrades or a new investment in the site. A new power plant would considerably improve the fuel and environmental efficiency assuring a sustainable long term supply.¹

Faced with actual SEM market conditions owners will replace, upgrade or close plant as the market dictates. In an uncertain GUA extension scenario, none of these things are likely to happen and outdated, inefficient and high emissions plant is likely to be just left in service.

In conclusion, ESBI submits that fuel efficiency percentages, and CO₂ emissions per MWh produced, should be key considerations of the Authority in deciding whether to early terminate GUA contracts. Maintaining the GT8 GUA does not promote research, development and use of new techniques, or methods of increasing efficiency in the use and generation of electricity as required in SEM Order article 9.1.

d) Promote Competition: According to Article 9(1) of the SEM Order, it is required to “*protect the interests of consumers of electricity in Northern Ireland and Ireland supplied by authorised persons, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the sale and purchase of electricity through the SEM*”.

ESBI believes that competition will be increased if the GUAs are cancelled. Currently PPB manages and markets a total capacity of 1548 MW. If these contracts are cancelled, the owners of these generating units will bid themselves into the market. This will make the market more transparent because individual generators will have to bid their own variable costs without an intermediary.

PPB does not assume any financial risk. PPB passes this profit or loss on to electricity consumers in Northern Ireland as one component of a levy known as the Public Service Obligation (PSO). Competition will be enhanced if the different generators will have to face their own financial risk. Currently if the SEM price and the capacity payments are not enough to cover the GUAs cost, the NI consumers will be affected as the PSO is adjusted to compensate.

¹ current peaker technology is twice as efficient and with half of the CO₂ emissions of GT8, and has improved SO₂ and NO_x emissions performance

In conclusion, the GUA contracts do not promote transparent pricing in the SEM and produce unfair discrimination between consumers in Northern Ireland and consumers in Ireland (objectives required in the SEM Order)

e) Diversity of Supply:

ESBI believes that the cancellation of the Coolkeeragh GUA could help to achieve the objective of improving the diversity of supply and environmental sustainability.

If the GUA is cancelled, ESBI could have the freedom to optimise the use of the grid connection. Alternative generating technologies would be considered, whereas nothing new would be considered if the GUAs are extended indefinitely. In particular the possibility of investment could be considered in new gas aero-derivative peakers, which are really flexible and can quickly respond to sudden decreases or increases of wind farm load. The wind regime in the North West is particularly attractive but investment opportunities are constrained by connection availability. Possible sharing of the GT8 connection between a wind generator and a peaker might be an option but ESBI is not in a position to begin analysing this without certain access to the connection.

ECONOMIC ANALYSIS

1. The proposed methodology for forecasting availability and energy payments for the GUAs.
2. The cost implications of the Large Combustion Plant Directive (LCPD).

ESBI would like the opportunity to analyse the results for our generating unit for the forecasted incomes from the SEM and forecasted costs from the GUA contracts.

In particular we would be interested in analysing and commenting on the demand and wind hypothesis as they are difficult to forecast accurately.

Another point that we would be very interested in checking is the forecasted availability of units. Due the age of the power plants, it is an issue that should be analysed and considered in detail.

With regards to the indices proposed, we would point out that a carbon index should be included as this will be increasingly important after 2012.

A further issue around commodity prices is that for any scenario beyond 4-5 years the level of uncertainty is quite high. Additionally, we would appreciate it if forecasted scenarios and assumptions are included for levels of future increases in interconnection, and the price assumptions used for the GB market.

We would like to point out that the majority of income for the Coolkeeragh OCGT power plant comes from capacity payments which are strongly linked to availability. Currently this power plant is nearly 40 years old, almost twice the expected life of a BNE peaker, so increased variability should be expected in coming years. It will be very difficult to develop an accurate availability forecast due to the age of this power plant.

We would like to ask that NIAUR publish as much detail as possible and put in place a process to validate these assumptions and numbers with generation owners so that we can assist in accurate modelling. In particular we would like to ask that a separate independent economic analysis is completed for each individual GUA.

The Coolkeeragh GT8 is a 58MW unit and is subject to the Large Combustion Plant Directive. The relatively low running hours of this unit has meant that so far no SO₂ or NO_x abatement equipment has been required. However, if the GUA running hours of the unit were to increase to the point that capital investment in abatement or monitoring equipment was required, CESB would seek to be reimbursed as per the AES Kilroot precedent.

Finally, we would like to ask that the final economic modelling numbers for each GUA are published privately to each generating unit owner as they could contain some commercially confidential information.