



Endesa Ireland response to NIAUR's consultation on Forward Work Plan (April 2010 – March 2011)

Endesa Ireland welcomes the opportunity to respond to the consultation on NIAUR's proposed work plan from April 2010 to March 2011. Endesa Ireland supports the priorities set out in the plan, in particular, Endesa Ireland agrees that increased competition in both the wholesale and retail sectors will help to protect consumers and reduce prices. In addition, Endesa Ireland would suggest that the work plan be amended to include increasing competition in the ancillary services market and improving the investment climate in the SEM by allowing full recovery of generator costs and reducing volatility in the application of transmission loss adjustment factors and the calculation of the annual capacity payment pot. These changes to the SEM would help to increase competition, resulting in further benefits to consumers.

Ancillary Services

The SEM is a competitive electricity market, but competition is limited to the sale of energy to the pool. The system operators also procure electricity via ancillary service contracts. In order to provide the full benefits of competition to final customers, Endesa Ireland encourages the Regulatory Authorities to look to developing a competitive, all-island ancillary services market. This would help to reduce costs for customers and will lead to more efficient dispatch of generation.

Currently, Ancillary Services are contracted on a bilateral basis between the system operator and the generators. There is little transparency in the System Operators' processes for selection of generators providing ancillary services, making it difficult to determine whether these services are being procured on the most economic basis.

The Regulatory Authorities have approved the introduction of a Harmonised Ancillary Services regime as of 1 February 2010. This should be seen as a first step towards a competitive ancillary services market. A further step would be the introduction of greater transparency in the Harmonised Ancillary Services regime. The System Operators should be required to publish information on the Ancillary Services provide by each generator on a monthly basis, along with the high level reasons for the need for these services (line outages, transmission constraints, etc.).



Endesa Ireland requests that NIAUR include steps to progress the development of a competitive Ancillary Service Market within their workplan, along with requirements for increased transparency in the existing ancillary services market.

Enhanced Investment Climate

Investor certainty is a key factor in the development of fully competitive markets. Endesa Ireland considers that the investment climate on the island of Ireland would be enhanced if the market provided greater certainty to investors and allowed generators to recover all costs associated with the production of electricity. Investor certainty would be enhanced by a reduction in volatility, particularly in relation to the capacity payment mechanism and Transmission Loss Adjustment Factors. In addition, full cost recovery for generators must be ensured. As stated by Iain Osbourne at the 2009 Energy Ireland convention, prices must reflect costs. Currently, this is not permitted within the SEM. The current market design does not allow generators to recover costs associated with gas transportation charges and licence requirements (secondary fuel requirements in Ireland).

Reduced Volatility

Investors within the SEM face significant risk due to the volatility of the Transmission Loss Adjustment Factors and the annual Capacity Payment Pot. As of 1 February 2010, the harmonised all-island loss factors will be introduced. The methodology for the calculation of these losses is opaque and the justification for locational loss factors is weak. Annual variations of TLAFs cause significant volatility in income and consequently generator risk, which results in higher costs to end customers. The proposals included in the Options for the implementation of Locational Signals on the Island of Ireland do little to address year-on-year volatility, which is of significant concern to generators.

The locational signals included in the TLAFs provide short-term locational signals. The siting of a generator is a long-term decision. A short-term signal is not an efficient or effective means by which to incentivise the choice of location as a generator cannot change its location in response to this signal. In order for such a locational signal to be effective, it must be a long-term signal. The result of including short-term locational signals in the TLAFs is that the prices faced by final customers are higher, as investors must include a risk premium to account for the potential volatility of the TLAFs.



Furthermore, generation losses are not metered within the SEM. The losses attributed to each generator are approximated based on an opaque methodology utilised by the System Operators. Such a methodology is not appropriate in a competitive market. Endesa Ireland encourages NIAUR to ensure that the decision on the Implementation of Locational Signals on the Island of Ireland includes signals to which a generator can respond. Endesa Ireland supports long-term locational signals which will enhance investor certainty. One possibility is to fix the losses applied to new and existing generators for a period of 10-20 years. Such a signal would incentivise investment in areas the system operators consider would be beneficial to the grid and would provide certainty for investors.

Endesa Ireland welcomes the proposed medium term review of the Capacity Payment Mechanism. Endesa Ireland considers that this mechanism can be modified to significantly reduce volatility and provide greater certainty to those generators required for system security, at a lower cost to final customers.

This can be achieved by the development of capacity auctions, which have been successful in other countries. These auctions can be designed to provide long-term income surety to new investments, which would significantly reduce their cost of capital. In addition, the auctions would ensure that the capacity margin is met at the lowest cost, resulting in lower costs for consumers. An auction mechanism can be designed to provide additional investment signals, including incentives for specific generation technologies or fuel types and incentives for investment in certain locations, providing a sharper tool to help meet government targets and to ensure system security.

Full Cost Recovery

The SEM market design includes a Capacity Payment Mechanism, which was designed to allow recovery of the fixed costs of a Best New Entrant (BNE) peaking plant. This should allow efficient generators to recover their fixed costs. To date, the CPM has not taken into account government targets for reduced CO₂ emissions and the selected technologies have been diesel-fired plant. Therefore, there has been no mechanism to allow for the recovery of the fixed costs associated with gas transportation charges. In addition, when the plant was sited in Ireland, the calculation of costs ignored the licence requirement to hold strategic fuel stocks. These are fixed costs for every generator in Ireland and there is currently no recovery mechanism within the SEM for these costs.



Capacity on the gas transmission network can be purchased on a daily basis, yet the RAs have determined that the market for daily capacity is not sufficiently liquid to allow the inclusion of variable costs in generator offers. This is a strong disincentive for investment in more efficient, environmentally friendly, lower-cost gas-fired generation. Endesa Ireland requests that NIAUR include a review of this decision in the forward work plan.

In addition, the inability to recover the costs associated with the licence requirements for strategic fuel storage in Ireland is a significant deterrent to investment. While the CPM may not be the appropriate recovery mechanism for these costs, it is important to ensure that there is some mechanism to allow generators to recover all costs associated with their licence requirements.

Endesa Ireland requests that NIAUR amends the forward work plan to include the enhancement of the investment climate in the SEM, particularly to ensure that all reasonable costs incurred by generators are recoverable.