



**Proposed RAs option for all-island  
harmonised Transmission Loss Adjustment  
Factors (TLAFs)**

**Response by AES Kilroot Power Ltd**

**13<sup>th</sup> August 2010**

## Background

AES Kilroot (AES) welcomes the opportunity to respond to the proposed decision paper on the “Proposed RAs option for all-island harmonised Transmission Loss Adjustment Factors (TLAFs)”.

AES has two OCGT units registered within SEM which are subject to the current TLAF arrangements and NIAUR have issued a notice indicating their intention to cancel the Generating Unit Agreements for AESs’ two 260MW thermal units (K1 and K2) from 1 November 2010. Consequently, AES will have significant exposure to any change to the existing TLAF methodology from 1 November 2010 and we have substantial and material concerns in relation to the Regulatory Authorities (RAs) proposed uniform TLAF option.

Our response provides general comments on the consultation paper and consultation process to date (including the RAs TLAF Workshop (TLAF Workshop) held on 26 July 2010) and then some additional comments in relation to section 2 of the RAs proposed decision paper.

## Regulatory Process

TLAF arrangements have formed an integral part of SEM since Go Live and are a key element in delivering the SEM High Level Design requirement for harmonised transmission arrangements that provide **locational** signals to users that reflect the costs that such users impose on the system. Since Go Live and in response to generally accepted concerns relating to current TLAF arrangements, there has been an ongoing review resulting in a formal locational signal work stream, led by the TSOs, which commenced in early 2009. The last consultation paper issued by the TSOs (SEM-09-107) provided key details on a range of TLAF options with supporting analysis. In relation to TLAFs the TSOs indicated that, on the basis their assessment, their preferred option was a three tiered approach based on compression, splitting and purchase of losses. The TSOs dismissed completely a uniform TLAF option as it removed the crucial locational signal, decreased dispatch efficiency, raised issues of cross subsidisation, increased overall losses to the system and most importantly was not compatible with the June 2005 SEM High Level Design.

Consequently we were surprised, disappointed and concerned with the RA proposed decision to implement a uniform TLAF approach from 1 Oct 2010. The proposed decision contradicts analysis and recommendations made by TSOs, is not compatible with the SEM High Level Design and in the absence of detailed cost benefit analysis and impact assessment it would appear to be a knee-jerk reaction in response to intense representations made by a few generators located in the highly constrained Cork area.

Furthermore, AES understands from the minutes of the SEM Committee meeting (number 27) held on 29<sup>th</sup> April 2010 that the SEM Committee has already approved the proposal to adopt a uniform TLAF:

*“The SEM Committee approved the proposal put forward for TLAFs in the short term, namely that from October 2010 the treatment of losses in dispatch and the market schedule are to be treated on a uniform basis.”*

We are therefore concerned that this consultation on the 'proposed decision' is merely a matter of process and puts at risk the integrity and robustness of the regulatory consultation and decision making process. Given the level of concern raised by a substantial number of Generator Participants (both North and South) it is evident that if the proposed decision is implemented, the perception of regulatory risk in SEM will be unnecessarily increased to the detriment of participants and customers alike.

We also note that under the Electricity (Single Electricity Market) (Northern Ireland) Order 2007 (the Order), the SEM Committee (SEMC) is required to:

*“protect the interests of consumers of electricity in Northern Ireland and Ireland”.*

Our recent experience of NIAUR's contract cancellation process has demonstrated that the primary focus of the above objective is ensure that customers access the lowest possible price for electricity, taking into account other important considerations in relation to security of supply, environment, ability of licence holders to finance their activities etc.

It is evident from the consultation paper (and also the July workshop) that there has been little detailed analysis on the costs and benefits of the proposed uniform TLAF option and we believe that such analysis is fundamental to the SEMC complying with its statutory obligations in order to make a well informed decision on such a fundamental change to SEM and its impact on customers.

As a final point in relation to the regulatory and consultation process, we understand that in compliance with good regulatory practice, NIAUR has committed itself to consultation periods of twelve weeks for policy matters and eight weeks for technical issues. We note that the consultation period for this paper was initially four weeks, although it has been subsequently extended by two weeks on two separate occasions. Whilst we welcome the extensions, the perception remains that this has been a disorganised process and that the RAs are attempting to rush the proposed decision without proper analysis and consideration. We are also of a view that the proposed move to a uniform TLAF approach, which contravenes the SEM High Level Design, is a significant policy change and we would therefore suggest that the appropriate consultation period should be twelve weeks.

## **Impact of the Proposed Uniform TLAF Option**

### Impact on SEM and Customers

It was evident at the TLAF Workshop, that there is consensus that a direct impact of implementing a uniform TLAF of 0.98 is to increase SMP. Analysis undertaken and presented by BGE, Energia and NIE Energy (PPB) consistently demonstrated that SMPs will be higher in 2010/11 if uniform TLAFs are adopted. It would have been helpful if the RAs could have shared their own analysis on this important point. BGE made the point that in later years this may not be the case, but this is an irrelevant point as the RAs have indicated that the proposed uniform TLAF option is only for tariff year 2010/11.

We note that the 0.98 TLAF proposal was based on initial analysis by the TSOs and this analysis has only be made available to Participants on the 11 August 2010.

Consequently we have not had time to review the analysis and the unacceptable tardiness of publishing this analysis again compromises the consultation process.

In addition to increasing SMP, a uniform TLAF approach will increase the level of constrained dispatch and associated costs. The TSOs confirmed at the TLAF workshop that they estimated the increase in imperfection costs for 2010/11 to be between 2 and 3%.

The overall effect then of the uniform TLAF proposal will be to increase energy payments to generators in merit and increase the costs of managing constraints and these costs will ultimately have to be borne by customers.

The TSOs have also confirmed that a uniform TLAF approach will also result in a less efficient dispatch across the Island, with increased losses both of which will have a negative impact on the environment in terms of higher emissions. We understand that the SEMC have statutory obligations in relation to carrying out its principal obligation "with regard to the effect on the environment".

Given the above it is difficult to reconcile how the SEMC have reached a conclusion that uniform TLAFs are in accordance with the principle objective set out in the Order or are consistent with the SEM High Level Design.

#### Impact on AES

AES's Kilroot power station is located in an optimum position on the transmission system very close to the major load centre of Belfast. Our TLAFs correctly reflect this position and reflect an appropriate locational signal (which tends to be greater than 1.0). The uniform TLAF proposal strips away this signal and has a material impact on AES's capacity and energy payment income streams from SEM.

Given the sensitivity of the scheduling of AES units in the market to movements in the dark spread it is difficult to quantify with certainty energy income for 2010/11 however it is clear that by adjusting any MSQ's by a TLAF of 0.98 will have a negative impact on our energy payments.

Our capacity payments are determined using the "Loss Adjusted Eligible Availability" in accordance with the Trading & Settlement Code (TSC) and consequently our capacity payments will be eroded by this arbitrary uniform TLAF proposal. We estimate this erosion in value to be c£1m.

Given the arbitrary nature of the RAs proposed decision, the above highlights the tangible increase in regulatory risk that an independent generator faces in SEM. It also gives us real concerns in relation to discrimination as the main beneficiaries of the proposed change are the BGE and ESB plants at Whitegate and Aghada respectively. We have some sympathy in relation to BGE and ESB's comments in relation to TLAF volatility and unpredictability but the situation they find themselves in is a result of poor investment decisions in what was readily identified by the TSOs as a constrained area.

## **RAs Objectives in relation to TLAF review**

We note that the RAs are silent on the ensuring that the principle objective of transmission loss arrangements is consistent with the SEM High Level Design. This surely must be an integral part of the TLAF review, and as such the location element of TLAFs should not and cannot be set aside without proper detailed analysis, impact assessment and consultation.

We share the concern of most participants in relation to volatility and predictability, however whilst far from perfect (we do not accept that it is “broken” as referred to by RAs, BGE and ESB at the TLAF Workshop), the current TLAF methodology has been in place for nearly three years and we believed that the issues were being addressed as part of the TSO locational signal work stream. We are concerned that the RAs are short-circuiting the TSO work stream and are unhelpfully pushing focus away from the more pressing need to find an appropriate enduring solution which addresses all the key criteria (predictability, volatility, cost reflectivity, dispatch efficiency etc) in a balanced way through detailed cost/benefit analysis and impact assessment.

## **RAs view of TSOs proposed options**

### Long Term Options

It is difficult to meaningfully comment on splitting as a potential long term TLAF solution given the lack of detail or analysis provided by the RAs to support their view. In our previous response to the TSO consultation paper SEM-09-107 we indicated a preference to move to a ‘purchase of losses’ approach at the earliest possible opportunity and we are disappointed that the RAs have dismissed such an approach without proper consideration of its feasibility. Whilst no doubt it would require careful consideration, we believe that it could be introduced substantially quicker than the 5year timeframe stated. In any case, the long term solution whether splitting, purchase of losses or some other approach must be determined through detailed analysis and impact assessment.

### Short Term Options

The RAs seem to focus on three main objectives or criteria in assessing the short term options – increased predictability, reduced volatility and transparency. We agree that these are important fundamental objectives however compared with the TSO criteria, these are particularly narrow objectives. We believe the objectives and any SEMC assessment of the options must also align with the SEM High Level Design and statutory duties set out in the Order.

We absolutely agree that a long term solution is essential but we do not accept that the uniform TLAF proposal is an improvement on existing TLAFs, nor will the uniform TLAF proposal assist in progressing the long term solution. Indeed we are concerned that, if implemented, the uniform TLAF proposal could end up becoming the default long term solution.

The uniform TLAF proposal offers a significant improvement to a limited number of participants as their TLAFs substantially improve but most other participants (including customers) are disadvantaged.

## **RAs Proposed Decision**

AES acknowledges that the current TLAF is not without its flaws, particularly in relation to predictability, stability and transparency and we believe that it is vital that an appropriate long term solution is implemented as soon as practicable. However, whilst the RAs proposed decision to adopt a uniform TLAF approach may seem to address these issues, there is consensus that costs to customers will increase as a direct result and that the uniform option is not compliant with the SEM High Level Design.

In addition, there is a question as to whether the adoption of such a uniform TLAF approach is consistent with SEMC statutory obligations in relation to the protection of the interests of customers and having regard to the environment. Furthermore, without detailed analysis and impact assessment, it is difficult to see how the SEMC could approve the adoption of a uniform TLAF arrangement. The SEMC decision was made back in April 2010, and to date the RAs have either been unable or unwilling to make their analysis available to interested parties.

Given the above, AES do not support the implementation of a uniform TLAF solution. We believe that the TSOs, RAs and Participants should focus their efforts on determining an appropriate long term solution, ideally for October 2011 (or earlier if possible) and that in the interim the existing TLAF methodology should remain given that it has been the approved methodology to date and complies with SEM High Level Design.

## **Conclusions**

In summary, AESs' conclusions are as follows:

1. We have substantial concerns in relation to the decision making process and compliance with good Regulatory practice and statutory duties;
2. TLAF/TUoS proposals have been extensively consulted upon by TSOs (and involved substantial effort and analysis) – Uniform TLAFs were dismissed by TSOs primarily on the basis that the locational incentive is totally removed, dispatch inefficiency increases and it is not compatible with the June 2005 High Level Design.
3. We believe that the RA's (after extensive lobbying by BGE and ESB) are opting for an arbitrary solution which has been dismissed by TSOs and does not comply with SEM High Level Design.
4. The RAs have provided no cost benefit analysis or impact assessment in relation to their decision to allow Participants an opportunity to assess assumptions and commercial impacts. In addition the RAs have not consulted upon the Uniform TLAF option – they have simply moved to make a minded decision (albeit the SEMC seem to have already approved the introduction of uniform TLAFs).
5. If implemented the RA decision will have an immediate impact on AES's market revenue in relation to material reductions to both capacity and energy payments. This is a direct result of ill-thought through regulatory decisions and will lead to increased levels of concern in relation to Regulatory Risk both for existing and potential new investors.
6. Uniform TLAF's lead to inefficient dispatch (with increased emissions to the environment), will increase constraint costs and will increase costs to customers

- in 2010/2011. This is not consistent with SEMC's principal objective to protect the interest of customers.
7. If implemented the decision will also result in generators in NI which are located in optimal positions in relation to mitigating transmission losses (i.e. close to load centres) are being unreasonably penalised to subsidise generators in the Cork area who have made ill-informed investment decisions.
  8. AES accepts that the current TLAF methodology has issues with respect to volatility and predictability, but it has been the chosen methodology since SEM Go Live and is consistent with the SEM High Level Design. A proper enduring solution must be found based on detailed cost/benefit analysis, impact assessment and open and appropriate consultation.
  9. A very strong focus should be place on implementing an enduring solution for 2011/12 – for 2010/2011 we firmly believe it is only fair and reasonable that the existing methodology, which all participants have lived with since 2007, should be applied.