## *http://upload.wikimedia.org/wikipedia/de/thumb/2/2e/AES_Logo.svg/800px-AES_Logo.svg.png*

## *Response to SEM Consultation Paper SEM-10-073*

## *Acquisition of Premier Power Limited by AES Corporation*

## *Consultation on the Requirement for Enhanced Market Power Mitigation Measures within Generation Licences*

**on behalf of**

**AES Kilroot Power Ltd and AES Ballylumford Ltd**

**29 November 2010**

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**1. Introduction**

AES Kilroot Power Limited (“AES KPL”) and AES Ballylumford Limited (“AES BL”) (formerly Premier Power Limited) (collectively “AES”) welcome the opportunity to comment on the Consultation on the Requirement for Enhanced Market Power Mitigation Measures within Generation Licences (“the Consultation Paper”) following the acquisition of Premier Power Limited by the AES Corporation.

The AES Corporation acquired AES BL on 11 August 2010. AES received non legally binding comfort from the Department of Enterprise, Trade and Investment (“the Department”) and the Northern Ireland Authority for Utility Regulation (“the Authority”) that, on the basis of the information provided, the Department and Authority did not intend to exercise their powers of revocation under the Change of Control provisions contained in AES BL’s Generation and Gas Supply Licences.

The Office of Fair Trading (“OFT”) recently raised and investigated two possible concerns namely that AES post-merger may have the ability and incentive to:

* raise the System Marginal Price (“SMP”) in the Single Electricity Market (“SEM”) or mange its portfolio to maximise revenue by withholding capacity on its contracted plant; and
* increase constraint payments.

The OFT assessed the merger on both a SEM basis and a Northern Ireland basis and decided not to refer the merger to the Competition Commission under the provisions of the Enterprise Act 2002.

**2. Summary**

AES believes that it does not have the ability or incentive to exercise market power either in the SEM or behind system constraints locally in Northern Ireland following the acquisition of AES BL for the following reasons:

* The SEM is highly regulated and has a number of mitigation measures expressly designed to address market power concerns, comprising bidding principles for generators, a Market Monitoring Unit (“MMU”), Directed Contracts and ring-fencing arrangements for the incumbent generators (ESB Power Generation (“ESB PG”) and NIE Energy Power Procurement Business (“NIEE PPB”)) and local power mitigation measures (capping of constraint payments and Reliability Must-Run contracts).
* The generating licences of AES KPL and AES BL direct cost-reflective bidding and compliance with the SEM Bidding Code of Practice (Conditions 17 and 18), prohibit cross subsidies between affiliates (Condition 3) and require affiliates to produce separate accounts (Condition 2).
* Regarding the ability to exercise market power behind system constraints locally in Northern Ireland, a key limitation on a party’s ability to manipulate the level of constraint payments it receives is the fact that bids must be submitted ahead of time and on an unconstrained basis. This means that, even in the absence of market power mitigation measures, any attempt to increase the levels of constraint payments is likely to decrease wholesale revenues (or vice versa). The constraints imposed by the system operator (primarily the requirement to keep three Northern Ireland thermal units synchronised at all times (including one Kilroot unit for voltage stability in the Belfast area)) have been in existence since the start of SEM and are therefore unaffected by the acquisition.
* 51% of the combined portfolio's output (931 MW out of 1,831MW) is sold under long-term contract to NIEE PPB. NIEE PPB bids this capacity into the SEM and AES is compensated according to a contractual formula unconnected to the operation of the SEM. AES therefore considers it inappropriate to view market power in relation to Scenario 1.
* The size and composition of the combined AES portfolio means that there would be little or no ability or incentive for AES to withhold capacity in order to increase SMP as the loss of availability income associated with the contracted plant and capacity payments associated with the uncontracted plant is more than likely to off-set any additional energy payments gained. In any event, AES KPL and AES BL would be in breach of their respective Generation Licences and Grid Code requirements if they withheld capacity from the system operator that was technically available for dispatch[[1]](#footnote-2).

AES believes that the current AES KPL and AES BL Generation Licence’s are fit for purpose and that the licences should not be amended to include Directed Contract, ringfencing conditions or any other additional local market power mitigation measures beyond those which are already in place.

**3. Comments**

**3.1 Market Power Assessment**

**3.1.1 Scenarios**

The Consultation Paper assesses market power under two scenarios:

**Scenario 1**: All Kilroot and Ballylumford units combined in to a single entity (1,831MW).

**Scenario 2**: Kilroot and Ballylumford uncontracted units grouped together (900MW) and the contracted PPB units considered separately (931MW).

As the paper rightly points out several of the generation units at Kilroot and Ballylumford totalling 931MW (51%) are under contract to NIEE. Effectively this means that NIEE PPB is responsible for the commercial activity of these in the SEM rather than AES. NIEE PPB bids the contracted capacity into the SEM and retains sole commercial interest for the units in the SEM. AES is compensated under the respective Power Purchase Agreements which are unconnected to the operation of the SEM.

AES KPL and AES BL have Intermediary Agreements (IAs) which outline the terms under which NIEE PPB bids the contracted plant into the SEM and the obligations of the respective parties. Under the terms of their respective IAs AES KPL and AES BL provide NIEE PPB with Technical Offer Data and some Commercial Offer Data (start up costs, no load costs and variable operating and maintenance costs). AES KPL and AES BL do not provide NIEE PPB with commodity prices (fuel/carbon) or exchange rates. NIEE PPB constructs and submits the price/quantity pairs for the contracted plant using its commodity prices and exchange rates and the variable operating and maintenance costs provided by AES KPL and AES BL. Condition 18 of the AES KPL and AES BL Generation Licences requires that the components of the Commercial Offer Data provided to NIEE PPB under the terms of the IAs should enable NIEE PPB to comply with its obligations under Condition 57 (Cost-Reflective Bidding in the Single Electricity Market) of the NIEE Supply Licence.

Furthermore under the AES KPL and AES BL IAs NIEE PPB has the ability to seek confirmation of the accuracy of the data provided by AES KPL and AES BL if it believes that it contains a manifest error. NIEE PPB ultimately has the right to refer the matter to the Authority and request the Authority to investigate whether AES KPL or AES BL is in breach of its Generation Licence.

AES KPL and AES BL do not bear the risks or rewards of operation in the SEM but are instead remunerated in accordance with the contractual formulae set out in the individual generating unit agreements for the generating units under contract.

AES therefore believes that it is inappropriate to consider market power by viewing all of the Kilroot and Ballylumford units as a combined single entity of 1,831MW (Scenario 1).

If however the market power of AES is considered as a single entity (Scenario 1) the combined shareholding of 17% is well below the thresholds identified for similar market screening purposes in the US Federal Energy Regulatory Commission (20%) and Holland (30%) as set out in the Consultation Paper.

**3.1.2 Market Share Results**

***By Capacity***

The Consultation Paper sets out the current and forecast capacities of the various market participants. For clarity these have been reproduced below. As the table in the Consultation Paper combines the contracted and uncontracted plant for AES the table below separates these out since AES considers it inappropriate to consider market power on this basis (see Scenarios section above). The table below also includes the pre acquisition shareholdings. It should be noted that the analysis reflects the cancellation of two of the contacts at Kilroot even though cancellation took place after the acquisition of AES BL.

|  |  |  |  |
| --- | --- | --- | --- |
| **Owner** | **2010 Pre Acquisition** | **2010 Post Acquisition** | **2012 Post Acquisition** |
| ESB PG | 34% | 34% | 31% |
| NIEE PPB | 10% | 10% | 9% |
| Endessa | 10% | 10% | 9% |
| ESB I | 8% | 8% | 8% |
| Viridian | 8% | 8% | 7% |
| AES | 6% | 9% | 8% |
| Premier Power | 3% | - | - |
| Bord Gais | 4% | 4% | 7% |
| GB I/C | 4% | 4% | 8% |
| Tynagh | 4% | 4% | 4% |
| Bord na Mona | 2% | 2% | 2% |
| Others | 7% | 7% | 8% |

As can be seen from the above table AES has commercial control over 9% of the 2010 post acquisition capacity and 8% of the 2012 forecast capacity which is similar in magnitude to several other owners who are not being considered for further licence modifications. Based on these shareholding levels it is very unlikely that AES will be in a position to exercise market power.

The local Northern Ireland position is addressed under Section 3.2 on Local Market Power below.

***By Energy***

The Consultation Paper states “both Kilroot and Ballylumford power stations contain units that are rarely run and deemed uncompetitive for most of the time. Because these units are uncompetitive, they have less opportunity to influence market prices and hence are less likely to exhibit market power”. This is consistent with recent independent analysis undertaken on behalf of AES.

For clarity the table below separates out the contracted and uncontracted unconstrained energy shareholdings.

|  |  |
| --- | --- |
| **Owner** | **2012 Post Acquisition** |
| ESB PG | 29% |
| ESB I | 17% |
| GB I/C | 11% |
| Bord Gais | 9% |
| Viridian | 7% |
| PPB (contracted) | 5% |
| AES (uncontracted) | 3% |
| Other | 19% |

The above table indicates that AES will have commercial control over 3% of the 2012 forecast energy and therefore is very unlikely to be able to exercise market power. As far as AES is aware the above figures were based on commodity prices and exchange rates in June 2010. It is worth noting that AES’s recent independent forecast indicated that AES would not earn any infra-marginal rent from the uncontracted units in 2012.

The Consultation Paper also highlighted that even in a ‘low coal’ scenario with coal prices modelled at 50% of their forecast values AES would only provide 13% of the SEM generation.

The local Northern Ireland position is addressed under Section 3.2 on Local Market Power below.

**3.1.3 HHI Analysis**

In the table below the Herfindahl-Hirschman Index (“HHI”), a standard measure of market concentration, indicates that the position pre and post acquisition is virtually unchanged for both capacity and energy under Scenario 2 (contracted and uncontracted units separated).

While AES does not believe it appropriate to consider market power on the basis of Scenario 1 (contracted and uncontracted units combined) there is only a slight increase (12%) in the HHI by capacity under Scenario 1 which is still well within the moderately concentrated band (below 1,000 is considered unconcentrated and above 1,800 is considered highly concentrated).

|  |  |  |
| --- | --- | --- |
| **HHI by Capacity** | **SEM** | **% Change** |
| Pre Acquisition | 1,404 |  |
| Scenario 2 | 1,436 | 2% |
| Scenario 1 | 1,574 | 12% |
|  |  |  |
| **HHI by Energy** |  |  |
| Pre Acquisition | 1,620 |  |
| Scenario 2 | 1,620 | 0% |
| Scenario 1 | 1,654 | 2% |

**3.2 Local Market Power in Northern Ireland**

**3.2.1 Ability to Manipulate Constraint Payments**

The Consultation Paper highlights the transmission constraint between Northern Ireland and the Republic of Ireland and the fact that the System Operator for Northern Ireland (“SONI”) keeps three of the large thermal generator units synchronised at all times for system stability reasons. For these reasons the Consultation Paper states that the impact of the acquisition should be considered in a local Northern Ireland context. However these constraints have been in existence for many years, pre-dating SEM, and are therefore unaffected by the acquisition. The parties bidding in the units behind the constraints have exactly the same ability or incentive to try and increase constraint payments as they did prior to the acquisition.

The SEM High Level Design Decision Paper (AIP/SEM/42/05) published on 10 June 2005 stated on page 8 that

“Where a plant is regularly constrained on to resolve transmission constraints it has market power. There is an incentive on a plant in this position to maximise its constrained up payments by bidding as high as possible for the portion of its plant that is outside the merit order. Plants in such a situation shall be subject to close scrutiny and monitoring. They may also be subject to regulation of their bids where appropriate.”

Since the constraints in Northern Ireland have been in existence since the start of SEM it must be assumed from the above statement that the Northern Ireland generators have been under constant scrutiny to ensure that they have not abused their market power. AES would therefore expect this to continue until such time as the constraints are removed. AES is not however aware of the Authority having to take action against any of the thermal generators in Northern Ireland on the basis of them increasing their bids to increase constraint payments. In addition, since all of the AES portfolio has been in the SEM since its beginning (other than the Kilroot GTs 3 and 4) there is a long history of bids and any attempt by AES to increase its bids would be clearly visible.

In addition to the above scrutiny there are two key limitations on a party's ability to manipulate the level of constraint payments it receives. Firstly the fact that bids must be submitted day ahead of time and secondly because the SMP is based on the unconstrained market schedule. This means that, even in the absence of market power mitigation measures, any attempt to increase constraint payments by inflating bid prices will reduce the likelihood of being included in the unconstrained market schedule. Since a party’s only opportunity to earn a profit (and therefore a contribution to fixed costs) is when it is in the market schedule (given that constraint payments reflect a party’s bid price which is in turn reflects short-run marginal cost) it is more incentivised to keep bids as low rather than high. Pure cost recovery is not a sustainable long-term position for a generator.

Currently only limited ad hoc information is published in relation to constraints with no breakdown of constraint costs. AES would urge that greater transparency be provided regarding the nature of constraints and their relative costs and that incentives are introduced within SONI’s (and NIE’s) price control to increase focus on the management and resolution of constraints.

**3.2.2 Ability to Withhold Capacity**

The table below summarises the market power analysis presented in the Consultation Paper. As has been stated previously AES believes that it is inappropriate to consider market power on the basis of Scenario 1 (contracted and uncontracted units combined).

|  |  |  |
| --- | --- | --- |
| **Capacity** | **NI** |  |
| PPB (contracted) | 33% |  |
| AES (uncontracted) | 30% |  |
|  |  |  |
| **Energy** |  |  |
| PPB (contracted) | 18% |  |
| AES (uncontracted) | 12% |  |
|  |  |  |
|  |  |  |
| **HHI by Capacity** | **NI** | **% Change** |
| Pre Acquisition | 2,059 |  |
| Scenario 2 | 2,490 | 21% |
| Scenario 1 | 4,272 | 108% |
|  |  |  |
| **HHI by Energy** |  |  |
| Pre Acquisition | 2,020 |  |
| Scenario 2 | 2,020 | 0% |
| Scenario 1 | 2,463 | 22% |

Under Scenario 2 (contracted and uncontracted units separated) the table indicates that AES has market power in terms of Northern Ireland capacity but not in Northern Ireland energy (it should also be noted that AES’s recent independent forecasts indicate that AES would not share any of the unconstrained energy in 2012). However there would be little or no ability or incentive on AES to withhold capacity in order to skew generation towards its uncontracted plant as the loss of availability income associated with the contracted plant and capacity payments associated with the uncontracted plant is more than likely to off-set any additional energy payments gained. In any event, AES KPL and AES BL would be in breach of their respective Generation Licences and Grid Code requirements if they withheld capacity from the system operator that was technically available for dispatch[[2]](#footnote-3).

The incentive to withhold capacity requires losses from the withheld units to be offset by primarily increased energy revenues from the remaining units. However in order to benefit from increased revenues the remaining units have to be scheduled in the market.

A brief description of the Kilroot and Ballylumford units are set out below along with their forecast merit order position for 2011 as provided by recent independent modelling.

| **Unit** | **Effective Capacity** | **Fuel** | **Contractual Position** | **2011 Forecast Merit Order** |
| --- | --- | --- | --- | --- |
| Ballylumford Unit 4 | 170 | Natural gas | Contracted with NIEE PPB until 31 March 2012 but can be cancelled earlier. To be retired 2015 | Peak |
| Ballylumford Unit 5 | 170 | Uncontracted. | Peak |
| Ballylumford Unit 6 | 170 |
| Ballylumford GT 1 | 58 | Distillate | Contracted with NIEE PPB until 31 March 2020 but can be cancelled earlier. | Peak |
| Ballylumford GT 2 | 58 |
| Ballylumford CCGT 1 | 245 | Natural gas | Contracted with NIEE PPB until 31 March 2018, with an option to extend to 2023 at NIEE PPB's election. | Mid-merit/Peak |
| Ballylumford CCGT 2 | 245 |
| Ballylumford CCGT 3 | 97 |
| Kilroot 1 | 238 | Coal & HFO | Uncontracted | Peak |
| Kilroot 2 | 238 |
| Kilroot GT 1 | 29 | Distillate | Contracted with NIEE PPB until 2024 but can be cancelled earlier. | Peak |
| Kilroot GT 2 | 29 |
| Kilroot GT 3 | 42 | Distillate | Uncontracted | Peak |
| Kilroot GT 4 | 42 |
| **Total** | **1831** |  |  |  |

The size and composition of the above portfolio is unlikely to incentivise any withholding of capacity due to the relatively small capacity that would benefit from an increase in SMP. As can be seem from the table the only potential mid-merit units are the Ballylumford CCGT units (587 MW) which are under contract to NIEE PPB until at least 2018 and therefore AES would not benefit from any SMP increase. Ballylumford Unit 4 (peaker) is also under contract to NIEE PPB until 31 March 2012 so again AES would not benefit from any increase in SMP from that unit.

The Kilroot units are therefore effectively the only units that could potentially benefit from an increase in SMP but, since the independent analysis indicates that these are also peaking units, this would require the withdrawal of some of the Ballylumford CCGT units which are ahead of Kilroot in the merit order. The loss of availability payments is however more than likely to outweigh any energy payment increases.

The table below sets out the implications of withholding the various AES units.

|  |  |
| --- | --- |
| Withdrawal Option | Assessment |
| Withdraw one, two or three of the Ballylumford CCGT units | Deterred through size of foregone availability payments |
| Withdraw one or two of the Ballylumford thermal units | Not despatched in energy market, so no influence on price. Withholding deterred through the loss of either availability or capacity payments |
| Withdraw one Kilroot unit | No impact from the acquisition as the only benefit is on the remaining Kilroot unit. Withholding deterred through the loss of capacity payments |
| Withdraw two Kilroot units | No merchant generation left to benefit. Withholding deterred through the loss of capacity payments |

**3.3 Market Power Mitigation Measures**

As has been pointed out above AES has no incentive either to increase bid prices (in an attempt to increase constraint payments) or withhold capacity (in an attempt to increase energy payments) as increased bid prices reduces the likelihood of earning profits as part of the market schedule and withholding capacity incurs the loss of either availability or capacity payments.

Market power mitigation is a key component of the SEM and the Regulatory Authorities (“RAs”) have put in place a number of market power mitigation measures as outlined in the Consultation Paper. The market power mitigation measures currently applicable to AES are the Bidding Code of Practice, the MMU and potential local power mitigation measures.

**3.3.1 Bidding Code of Practice**

Condition 17 of the AES KPL and AES BL Generation Licences applies to the uncontracted units. Condition 17 (6) requires the licensees to comply with the Bidding Code of Practice. This can be enforced under Condition 17 (7) which enables the Authority to issue directions to the licensees to ensure their compliance with the Bidding Code of Practice.

Condition 18 of the AES KPL and AES BL Generation Licences applies to the contracted units. Condition 18 (5) requires the licensees to ensure that the components of the Commercial Offer Data provided to NIEE PPB under the terms of the IAs for the contracted plant enable NIEE PPB to comply with its obligations under Condition 57 (Cost-Reflective Bidding in the Single Electricity Market) of the NIEE Supply Licence. Further under the AES KPL and AES BL IAs (Clause 5.6) NIEE PPB ultimately has the right to request that the Authority investigate whether AES KPL or AES BL is in breach of its Generation Licence if it does not believe the Commercial Offer Data provided to be in accordance with the terms of the IA.

The above licence and IA conditions therefore ensure that the Authority has the power to enforce the Bidding Code of Practice.

**3.3.2 Market Monitoring Unit**

The MMU also plays an important role in ensuring that generators adhere to the Bidding Code of Practice and has the authority to conduct investigations into potential market abuse. Since the start of the SEM the MMU has conducted a number of investigations on behalf of the SEM Committee and AES understands that the MMU currently conducts three to four investigations each month indicating that it is actively carrying out its duties. As a result of these investigations the RAs have issued various pieces of guidance on what costs can or cannot be included within Commerical Offer Data.

It is worth noting that in 2008 the SEM Committee investigated complaints that the Commercial Offer Data submitted by some participants was not in compliance with the Bidding Code of Practice. The complaints were not that participants were trying to keep SMP high but rather that the bids were keeping SMP artificially low.

In addition we note that, given the highly transparent nature of the SEM, there is a high degree of ‘peer review’ within the market as Participants can monitor the behaviour of other Participants and raise concerns with the MMU.

**3.3.3 Local Market Power Controls**

Section 5.5 of the 2006 Market Power Mitigation in the SEM Decision Paper (AIP/SEM/31/06) outlines the local market power controls available to the RAs. Section 5.5 states that

“The RAs will implement a three strand strategy for the control of local market power. First, there is a dependence on the monitoring of bidding principles. If these are successful, then nothing more is needed. Second, where the administration of these principles becomes burdensome, either because the number of inquiries is excessive or the issues in particular inquiries become intractable, the RAs will seek through the imposition of targeted capping of constraint payments to limit the scope for the presumed exercise of local market power to levels which send strong signals that changes are needed without excessively enriching the player with market power. Third, should those capped levels be intolerable to the generator with local market power, full Reliability Must-Run (RMR) treatment becomes the third, and final, fall-back position.”

The above provisions therefore permit the RAs to either cap constraint payments to generators or ultimately direct the generator to enter into Reliability Must-Run contracts which require the generator to open its books and be compensated outside of the SEM. As far as AES is aware the RAs have not implemented any local market power controls presumably on the basis that the Bidding Code of Practice and MMU have been effective in preventing market abuse.

**3.3.4 Directed Contracts**

One of the key pillars of the SEM market power mitigation strategy is the sale of DCs by the incumbent generators (ESB PG and NIEE PPB). Since the start of SEM the RAs have used an HHI market concentration level of 1,150 to set the level of DCs. At this threshold ESB PG has consistently had to sell DCs, albeit at a decreasing quantity. NIEE PPB has only been required to sell a modest quantity of mid-merit DCs for the latter two quarters of 2009.

The Consultation Paper states that the RAs are minded to amend the AES KPL and AES BL Generation Licences to include a similar Condition to that contained within the ESB and NIEE licences. AES disagrees with this proposal for the following reasons:

* There is no merit for assessing market power by viewing the Kilroot and Ballylumford units as a single entity (1,831MW) given that 51% (931 MW) of the capacity is under contract to NIEE PPB and it is NIEE PPB who constructs the bids and bids these units into the market. This is supported by all of the historic DC HHI market concentration calculations which have treated the contracted capacity in Northern Ireland as under the control of NIEE PPB. Further in the ‘Ownership Groups for the HHI Calculation’ section 3.8 of the 2010 Market Power Mitigation in the SEM Directed Contract Implementation Report Consultation Paper (SEM-10-005) the ownership groups for Premier Power and Kilroot are listed as “those units that are not under contract with NIE Energy PPB”.
* Prior to cancellation of 476 MW of the Kilroot capacity on 1 November 2010 NIEE PPB controlled 1,460 MW of capacity under contract in the SEM which only brought NIEE PPB within the DC threshold for the latter two quarters of 2009 (and then only for modest quantities of mid-merit products). Given that AES has 900 MW of uncontracted capacity it is impossible to see how AES would fall into the DC threshold and even more so given that capacity has increased in the SEM while demand has fallen.
* AES’s potential market power stems from the constraints in Northern Ireland. As discussed previously the RAs have a number of local market power controls (monitoring of bidding principles, capping of constraint payments and Reliability Must-Run contracts) in addition to the standard market power mitigation measures (Bidding Code of Practice and MMU) and generating licence conditions (Conditions 2, 3, 17 and 18) which are more than adequate to prevent market abuse.
* The RAs themselves acknowledge that DCs are inadequate in addressing local market power. Section 3.8 of the 2006 Market Power Mitigation in the SEM Directed Contract Quantification Methodology Decision Paper (AIP/SEM/208/06) states

“The Regulatory Authorities reiterate that the directed contract quantification methodology is conducted on an all-island basis and considers only SMP effects. Directed Contracts would not reduce the incentive to drive up constraint payments that would result from the exertion of local market power.”

* To include such a provision would be discriminatory and expose AES to additional risk as there are a number of other participants who control greater or equivalent levels of capacity than AES such as Endessa, ESBI, Viridian and BGE (see capacity table in Sectioni 3.1.2 above) who would not have such a provision in their licence. In addition, AES would have no opportunity to recover any losses should the price of the DCs be out of market due to movements in commodity prices or the quantity of DCs be excessive resulting in AES being burdened with an over-contracted position. As NIEE PPB has the ability to recover such losses through the Public Service Obligation this would further discriminate against AES.
* The RAs and many other Participants have indicated a desire to improve liquidity in the SEM (which AES supports) but both have acknowledged that directing specific contract structures and prices often stifles the competitive market[[3]](#footnote-4).
* The alteration of generating licences is likely to increase regulatory risk in the market, raise the cost of capital and potentially deter entry.

AES therefore strongly disagrees with the view that the Ballylumford and Kilroot Generation Licences should be amended to include a DC Condition similar to that contained within the ESB and NIE Energy licences.

**3.3.5 Ringfencing**

The Consultation Paper asks whether there is a need for any additional measures such as the ‘ring fencing’ of generation businesses now or in the future. AES considers that the existing market power mitigation measures are more than adequate and that there is no need for any further measures. Indeed the primary market mitigation measures (Bidding Code of Practice, MMU and generating licence requirements) have been so effective in preventing market abuse that the RAs have not (as far as AES is aware) had to implement the further local market power controls (capping of constraint payments and Reliability Must-Run contracts) at their disposal.

A number of ring fencing conditions already exist in the AES KPL and AES BL generation licences. Condition 2 ‘Separate Accounts for Separate Businesses’ requires the Licensee (and any affiliate or related entity) to maintain separate accounting and reporting arrangements. Condition 3 ‘Prohibition of Cross-Subsidies and of Discrimination’ prevents the Separate Businesses from cross-subsidizing each other.

There are a number of other reasons why further ringfencing is not considered appropriate:

* Prior to cancellation of 476 MW of the Kilroot capacity on 1 November 2010 NIEE PPB controlled 1,460 MW (Ballylumford 873 MW, Kilroot 534 MW and Coolkeeragh 53 MW) of capacity from three different generators under three different IAs. As it has never been considered necessary to direct NIEE PPB to ring fence the data and bid construction for the three different generators it is impossible to see why ring fencing should be required for the Ballylumford and Kilroot units given that AES only has 900 MW of uncontracted capacity which is very similar to the 873 MW of Ballylumford contracted capacity managed by NIEE PPB and significantly less than the 1,460 MW of capacity previously managed by NIEE PPB.
* The AES KPL and AES BL Generation Licences already include a requirement to annually certify that Commercial Offer Data has been submitted independently and that their submissions have not been co-ordinated with another party. Condition 17 (11) of the licences (which applies to the uncontracted plant) states

“The Licensee shall by 1 June in each year submit to the Authority a certificate, signed by at least one director on behalf of the board of directors of the Licensee, to confirm that during the period of twelve months ending on the preceding 31 March:

1. it has acted independently in relation to all submissions of Commercial Offer Data that have been made, by it or on its behalf, under the Single Electricity Market Trading and Settlement Code; and
2. no such submissions made by it or on its behalf have been co-ordinated with any other submissions made by or on behalf of any other party to the Code.”

* It would discriminate against AES as there are already a number of ownership groups in the SEM which are not required to ring fence their individual generation businesses such as ESB PG, NIEE PPB, Endessa, and BGE.

As noted under the DC Section above (Section 3.3.4) the alteration of Generation Licences is likely to increase regulatory risk in the market, raise the cost of capital and potentially deter entry. AES therefore strongly disagrees with the view that there is a need for further market power mitigation measures.

**3.4 Additional Local Market Power Mitigation Measures**

AES considers that the existing local market power controls are more than adequate and that there is no need for any further measures. Indeed the primary market mitigation measures (Bidding Code of Practice and MMU) and generating licence conditions have been so effective in preventing market abuse that the RAs have not (as far as AES is aware) had to implement the further local market power controls (capping of constraint payments and Reliability Must-Run contracts) at their disposal.

1. Generation Licence Condition 4/SONI Grid Code SDC1.4.3.2 [↑](#footnote-ref-2)
2. Generation Licence Condition 4/SONI Grid Code SDC1.4.3.2 [↑](#footnote-ref-3)
3. Market Power Mitigation in the SEM Decision Paper (AIP/SEM/31/06) section 3.2.3 [↑](#footnote-ref-4)