Response to SEM Consultation Paper SEM-10-075

Harmonised Ancillary Service Arrangements and the Bidding Code of Practice

on behalf of

AES Kilroot Power Ltd and AES Ballylumford Ltd

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Introduction

AES Kilroot Power Limited and AES Ballylumford Limited (formerly Premier Power Limited) (collectively "AES") welcome the opportunity to comment on the "Harmonised Ancillary Service Arrangements and the Bidding Code of Practice Consultation Paper" ("the Consultation Paper").

Comments

AES agrees with the SEM Committee's ("SEMC") view in the Consultation Paper that the new Harmonised Ancillary Services ("HAS") feature some payments, such as primary reserve, that are paid as a function of the running pattern of the plant and can therefore be argued to be avoidable on a short-term basis. AES also agrees that customers should not pay twice for HAS.

AES considers that the variable elements of HAS payments clearly meet the definition of a Short Run Marginal Cost (SRMC) as set out in the 'Cost-Reflective Bidding in the Single Electricity Market[i]' condition of generation licences and as such should be included in a generator's Commercial Offer Data (Option 1) with a corresponding adjustment to the Best New Entrant revenues when calculating the Annual Capacity Payment Sum.

In the Consultation Paper the SEMC appears to accept that the variable HAS payments do fall within the definition of a SRMC ("the incremental cost which a generator incurs to generate an incremental unit of power[ii]") but propose to ignore this and instead treat the payments as fixed on the grounds of simplicity. The SEMC committee adds that such a policy "*would probably not* introduce a material distortion to the signals presented by the SMP and by the CPM" (emphasis added) and "would thus not present material harm to consumers" however no analysis is provided to support this.

AES is concerned that such an apparent disregard of fundamental SEM principles could present material harm to consumers by increasing regulatory uncertainty which is in turn likely to reduce investor confidence, increase financing costs, deter investment and ultimately erode security of supply. It would appear from both the Consultation Paper and the recent consultation paper "The Treatment of the Carbon Levy in SEM Commercial Offers" that the SEMC is prepared to ignore fundamental SEM principles on a relative whim. This is extremely concerning for both existing market participants and potential new entrants as it completely undermines Generation Licence requirements and BCOP principles and does not constitute good regulatory practice. AES considers that it is important to preserve the principles outlined in Generation Licences and Bidding Code of Practice and that these should only be amended as part of any holistic review of the SEM. AES does not therefore support the SEMC's selection of Option 2 (treating variable HAS payments as fixed).

AES does not consider Option 3 (which is not to clarify the interpretation of the BCOP with regard to variable HAS payments and therefore allow generators flexibility in the bidding of variable HAS payments) to have any merit. The arguments for and against this type of approach were well considered and rejected in the consultation paper "Bidding the Opportunity Cost of Carbon Allowances" (SEM-08-05) and subsequent decision paper (SEM-08-35) on the grounds that it would create regulatory risk, raise the cost of capital, harm investment, distort market price signals, inhibit efficient entry/exit decisions, make monitoring of the SEM more difficult and diminish the effectiveness of the bidding principles as a market power mitigation tool.

The Consultation Paper does not go into the detail or make any proposals as to how Option 1 (treatment of variable HAS payments as variable) might be implemented although some thoughts from the MMU are provided in the Appendix. At a high level AES would support the MMU's thoughts that there is an avoidable benefit of the variable HAS payments between off load and minimum generation and that these should be deducted from No-Load costs. AES would also support the view that there is an incremental relationship between generation output and the level of ancillary services provided and that this should be factored into P/Q pairs (maximum variable HAS payments are received at minimum generation and none are provided at maximum generation). It is important to note that there are risks and penalties associated with the receipt of HAS payments and it cannot be assumed that maximum HAS payments will be received. The risks/probability of receipt should therefore to be taken into account when compiling Commercial Offer Data.

AES considers that a separate consultation is required regarding the elements of HAS payments that are considered to be fixed and those that are variable and how these should be reflected in Commercial Offer Data and the Annual Capacity Payment Sum.

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[i] Condition 15 in the Republic of Ireland and Condition 17 in Northern Ireland

[ii] Section 1 AIP/SEM/73/06 Market Power Mitigation in the SEM Bidding Principles and Local Market Power