Response to Offers in the I-SEM Balancing Market consultation paper

SEM-16-059

On behalf of

AES Kilroot Power Ltd and AES Ballylumford Ltd

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1. Introduction

AES Kilroot Power Limited (“AES Kilroot”) and AES Ballylumford Limited (“AES Ballylumford”) (collectively “AES”) welcome the opportunity to comment on the consultation paper relating to Offers in the I-SEM Balancing Market (SEM-16-059).

AES is a global energy company with assets in the all island market consisting of CCGT plant, coal and gas fired conventional units, additional distillate fired peaking gas turbine plant and new technology Battery Energy Storage Array (BESA). AES is a non-vertically integrated independent generator which owns and operates Kilroot and Ballylumford power stations in Northern Ireland with a combination of merchant and contracted base load, mid merit and peaking plant. The responses to this consultation are therefore conditioned by the nature of our current position and portfolio of assets operating in the SEM.

OFFERS IN THE BALANCING MARKET – HIGH LEVEL MESSAGES

This response is submitted with reference to the specific questions raised in the consultation paper and based on our current knowledge of the detail that is available on the design of the I-SEM Balancing Market.

SECTION 3

1. *Do you agree with the proposed approaches to offer controls in the Balancing Market for I-SEM outlined above? If a respondent does not agree with any part of a proposed approach, please specify why and provide detailed alternative.*

AES understand that the objective of the proposed approach is to control the offers of plant in the I-SEM Balancing Market which are located behind known constraints on the system which are therefore viewed as non-energy action offers. AES supports the proposed 3 part offer format but believes it is important to ensure that any controls placed on offers to the balancing market do not prevent full cost recovery for participants.

Three options are proposed to be applied to non-energy action complex offers only although may be extended to individuals or across all participants if observed behaviour is deemed to warrant:

- Update of the existing BCOP - to reflect the changes under I-SEM
- Option 1 – Offer Principles – the transfer of bidding control from generating licence to a revised code
- Option 2 – Offer Limits - the introduction of explicit offer limits.

AES does not support the view that the making changes to the existing BCOP is not a viable option. The current BCOP, by nature a principles approach, affords a degree of flexibility to allow accommodation of offer formats to allow for different plant characteristics and circumstances where more prescriptive rules could prevent efficient cost recovery.

AES views that it is not possible to be proscriptive in relation to every cost item due to variation of plant technology, design and particular circumstances that prevail in different jurisdictions and areas of the Island. This is highlighted within the consultation document itself with the probable accidental exclusion of commodities such as NOx, Particulates, and Coal. Attempting to capture all current and potential future aspects of generation costs in a single the Balancing Market Operating Principles Code of Practice (BMOP CoP) will result in a reduction in flexibility and impact on cost recovery for participants.

The introduction of additional BM offer caps in combination with CRM and DS3 price caps adds to the impression of increasing regulation in the I-SEM and the concern regarding the increased risk of under recovery of costs.

The proposed relocation of the current generating licence conditions referencing compliance with the BCoP under the SEM to a subsidiary document in the Balancing Market Operating Principles Code of Practice presents an associated risk to participants. AES believes this creates uncertain governance arrangements, unspecified potential for review and change impacting the ability to efficiently recover costs in the Balancing Market. AES believes that the Licence conditions should be exhaustive and detailed, should contain the explicit requirements and not refer to a subsidiary document. Therefore AES does not support RA's proposal to reference a subsidiary document

SECTION 4 OFFER PRINCIPLES

2. *Which of the options identified within this Consultation Paper would be most appropriate for the introduction of offer controls under I-SEM? If a respondent does not agree with any of options identified, please specify why and provide detailed alternative. If a respondent has a preferred option, please indicate whether any aspect of the preferred option should be amended?*

Of the Options proposed in the consultation paper AES supports a continuation of the current Bidding Code of Practice process which sets out the general principles for valuing cost items for generators operating in the SEM on a short run marginal cost basis with cost items valued at their opportunity cost. It has also relied on prudent operator behaviour, which is a core function of the Electricity Industry and embodied within the Grid Codes.

Cost reflective bidding is a current requirement for participation in SEM and an approach with which most participants are accustomed to and favour, and which had resulted in little if any evidence of abuse of market power as confirmed by the TSO in the Market Power Mitigation Consultation paper and decision.

A reason given for the current BCoP being non-viable in the I-SEM is the level of disputes and ongoing legal challenges, however in the significant examples given in the consultation paper these challenges were raised by the CER challenging the generators right to recover additional costs incurred due to external changes impacting on their SRMC recovery.

The current BCoP makes provision for the recovery of fuel, ETS, VOM in addition to start up, no load and incremental costs as well as “any other relevant costs”. This structure allows the participant the flexibility to recover current and future unforeseen short run marginal costs and to ensure that the MMU is informed and aware of the impact of any offer revision. AES has significant concern that this flexibility would be lost in a revised arrangement.

Of the proposed other options AES would have the following comments.

Option 1 – Offer Principles –

This option constitutes a revision to the terms of the generators licence placing offer principles and requirements under a Balancing Market Offer Principles Code of Practice underpinned by a licence requirement in the generators licence requiring compliance with such a code. AES has a concern regarding the Governance arrangements for the BMOP CoP and the process by which changes to the process can be implemented such as, consultation requirements, the frequency with which items can be changed and the nature of the approving authority.

The Offer Principles approach appears to redefine some of the principles in the BCoP with a view to constraining costs that can be recovered:

SRMC - the proposed redefinition of SRMC is to include only the incremental cost of the next MWh but also accepts the fact that this cost is relative to the current state of the plant and therefore includes start-up costs if the generator is required to start. It also proposes redefining SRMC based on an ISP of 30 minutes. The number of start-ups, shut downs, ramping up and down requirements impacts on the levels and frequency of maintenance activities and therefore a portion of the maintenance cost is due to this variable and short run operating nature of the plant.

In the Eligible cost Items the option 1 proposes that maintenance variable operating costs are in fact not considered as variable in nature and not considered as eligible for inclusion in offers. The footnote statement (9) stating that maintenance and overhauls at power stations typically occur periodically on an annual or multiannual basis and do not vary with generation is not correct. All machine maintenance schedules are impacted by the running regime and especially the number of starts and shut downs which are the most onerous.

Specific reference is made, under Option 1, that maintenance costs are not considered variable. This appears not to align with the Capacity Remuneration Mechanism (CRM) Parameters Consultation Paper, which clearly states -

- “Variable Operating and Maintenance Costs (VOMs), which, being a variable function of output”
- “Variable Operating Maintenance (VOM) costs covers major maintenance (which is start-based)”

The frequency and nature of the maintenance can vary greatly with the operating regime and this approach could lead to under recover of costs in the BM or lead to the inclusion of risk premium in the DAM and IDM offers.

This constraining of cost recovery is also apparent in the proposal to remove wording allowing the inclusion of a “reasonable provision for increased risks to plant and equipment as a result of the operation of a generating set”. For the reasons set out above AES does not agree with this proposal or support the removal of this wording

As stated above AES disagrees with the statement that “operating mode today leads to loss of revenues in the future is arguably speculative” There is evidence that a plants operating regime will impact significantly on its maintenance requirements and therefore ongoing maintenance costs. This is evidenced by the Equivalent operating hours methodology used to determine gas turbine inspection and outages as more onerous operation reduces the time between inspections and increases the maintenance requirements. This potential for incurring increased maintenance costs and loss of opportunity due to the operating regime in a centrally dispatched market must be incorporated into the relevant market offer to ensure adequate cost recovery.

AES supports the proposal to include long term gas capacity costs as part of their offers due to the inability of generators to procure short term gas capacity products and to facilitate equitable treatment of generators on Northern Ireland.

Option 2 – Introduction of Offer Limits - This option proposes the introduction of explicit offer limits calculated and published by the RAs into the I-SEM regulatory framework to control generator behaviour. AES does not support the introduction of a series of offer limits and the removal of the flexibility afforded by the interpretation of offer principles. AES believes this approach to be too rigid as it limits cost recovery to start up, no load and inc/dec price only.

In the absence of any detailed information on how the level of the offer limits are determined, the frequency and governance arrangements concerning the review of the offer limits and the stated ability for adhoc review at any stage, results in a process that is vague, uncertain and again has the potential for under recovery of costs.

Applying offer limits to clusters of generators or each individual generator represents unequal treatment of generators and would require a substantial and transparent process to determine appropriate limits. A technology neutral and principled approach is preferred.

Developing a further consultation document and response would only prolong the uncertainty in the market development at a time when certainty is desired and the program for delivery of the I-SEM is extremely challenging. The proposal also introduces the requirement to manage exceptions which would mean the introduction of another process with the opportunity for delay in market interaction for the market participant.