



Response to SEM-11-106
Consultation Paper on Generator Financial Reporting
in the SEM

on behalf of

AES Ballylumford Ltd and AES Kilroot Power Ltd

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Queries to

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Introduction

AES Ballylumford Limited and AES Kilroot Power Limited (collectively “AES”) welcome the opportunity to respond to the Single Electricity Market Committee’s (“SEMC’s”) “Consultation Paper on Generator Financial Reporting in the SEM” (“the Consultation Paper”).

Summary

AES is extremely concerned at the extent of the financial reporting and publication proposals outlined in the Consultation Paper. AES fully supports the SEMC’s principle objective of protecting the interests of consumers of electricity in Northern Ireland and Ireland by promoting effective competition and the need to ensure transparent pricing in the SEM¹ but believes the proposals outlined in the Consultation Paper are neither necessary nor proportionate. Furthermore AES questions the legal basis for the proposals. The SEMC has also made reference to the financial reporting obligations in GB but has failed to taken into account the fact that it is a bilateral market, without transparent pricing, and that the obligations are much less onerous.

AES believes that the SEMC went to great lengths at the time of the establishment of the SEM to ensure that the market would deliver transparent pricing, through cost-reflective bidding licence conditions, a Bidding Code of Practice and a Market Monitoring Unit, and these remain fully effective. Indeed transparent pricing is one of the regularly quoted benefits of the SEM design by both the SEMC and third parties.

Transparency

The Consultation Paper states “that there is genuine interest from stakeholders regarding the financial performance of generators operating in the SEM”². This is not surprising nor is it something that is limited to generators operating in the SEM. Many stakeholders in many sectors would be extremely interested in the cost base of suppliers or competitors but a level playing field and commercial confidentiality are cornerstones of a competitive market. Indeed much time and effort has been spent establishing the appropriate balance between transparency and commercial sensitivity over the years though the various Companies Acts and for example the Rules of the London Stock Exchange.

The Companies Act 2006 and Rules of the London Stock Exchange set out very clearly what information has to be made publicly available for private and public companies and in doing so strikes the balance between disclosing sufficient information about a company to satisfy both current and potential investors but at the same time maintaining the commercial confidentiality of organisations. AES would suggest that this explains why the reporting requirements in generation licences reflect company law requirements.

¹ Article 9 (2) (a) The Electricity (Single Wholesale Market) (Northern Ireland) Order 2007

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The Consultation Paper also states that “the publication of information on generators’ financial performance, especially with regards to profitability, would increase transparency in the SEM”³.

Transparency is however already a key feature of the SEM and was a key feature of its High Level Design:

“The gross pool is particularly suited to the needs of the SEM, as it is more likely to provide both the economic signals and the price discovery to encourage timely entry of new generation, and the certainty of generation source to encourage new supplier entry. The model is also recognised as being more suitable for the participation of renewable and CHP generators, since all energy can be sold directly to the pool and off-take contracts are not a prerequisite to market entry. Transparency is a key feature of the design of this market.”⁴

The SEMC in deciding on the High Level Design also stated:

“It is the view of the Regulatory Authorities that market data play an important role in facilitating efficient market operation and transparency. Exactly what data will be published will be determined in the light of commercial sensitivity, practicality and opportunities that publication may provide for collusion for market manipulation.”⁵

Since its commencement the SEMC has regularly quoted the transparent pricing that exists in the SEM. Only recently in SEM-12-004, published on the 24 January 2012, the SEMC stated:

“The above [High Level] design of the SEM was judged by the Regulatory Authorities to be a robust internally consistent set of rules that meet regulatory and government objectives and under which the new wholesale market could successfully operate.”⁶

The SEMC goes on to state:

“It is the SEM Committee’s view that the SEM has served electricity customers in Ireland and Northern Ireland well. This is due to a number of reasons including market prices closely reflecting costs, new entry which has been forthcoming and the penetration of renewables which has reached a high level. There are also high levels of grid connections planned in the coming years, reserve margins have risen and the lights have stayed on. Furthermore, the SEM has substantially mitigated market power and provided a liquid and transparent spot market which has contributed to market stability. These benefits are tangible and a direct result of the market design that was chosen in 2005.

...The SEM model of setting prices in a transparent and cost reflective manner is not only assisting to promote competition and attract new investment, it has also resulted in improvements in the availability of generation plants...

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⁴ Section 2.2 AIP/SEM/42/05 High Level Design Decision Paper

⁵ Section 3.9 AIP/SEM/42/05 High Level Design Decision Paper

⁶ Section 4.1 SEM-12-004 Proposals for Implementation of the European Target Model for the SEM

As with previous years, the SEM Committee [in its 2010 Annual Report] noted that ‘the System Marginal Price (SMP) in 2010 tended to rise and fall in alignment with rises and falls in the key underlying fuels (notably gas) and carbon price’. This suggests that SEM energy prices are as would be expected in an efficient market and reflect the underlying marginal costs of generation...

The Economic and Social Research Institute in Ireland (ESRI) in its recent *Review of Irish Energy Policy* (Research Series No. 21 April 2011) argues that the SEM has been one of the key successes of Irish energy policy in recent years and the transparent wholesale price of electricity in the SEM reflects long run marginal cost of production on the island...”⁷

Since by its own admission and analysis the SEMC has concluded that it has met its legal objective of ensuring transparent pricing in the SEM, the SEMC is trying to go beyond this. AES can therefore only assume that the reason for the financial reporting and publication proposals outlined in the Consultation Paper is to satisfy what the SEMC has called the “genuine interest from stakeholders regarding the financial performance of generators operating in the SEM”⁸. As noted earlier, interest in a company’s detailed financial performance is inadequate justification for the proposals contained in the Consultation Paper.

It is also important to note that in carrying out its legal functions “the SEM Committee shall have regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed;...”⁹. Since it is clear that the objective of transparent pricing in the SEM is being met the SEMC is therefore going beyond its legal requirement and intervening in an area where no action is required. Furthermore as far as AES is aware AES does not recall the SEMC ever raising a concern that the objective of transparent pricing in the SEM was not being met.

GB Requirements

As part of its justification for introducing the financial reporting and publication proposals outlined in the Consultation Paper the SEMC states that the proposals would be in line with the practices in other markets, such as GB. The circumstances and market arrangements in GB are however entirely different and there is a widely recognised issued with transparency.

The GB market is a bilateral market and the additional financial reporting requirements were introduced as a direct result of the Ofgem Energy Supply Probe in 2008. It is also clear that the additional financial reporting requirements apply only to licensees that hold both supply and generation licences and who supply electricity or gas to more than 50,000 customers, and the purpose is to improve the transparency between the financial results of its generation and

⁷ Section 4.1 SEM-12-004 Proposals for Implementation of the European Target Model for the SEM

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⁹ Article 9 (7) (a) The Electricity (Single Wholesale Market) (Northern Ireland) Order 2007

supply businesses.¹⁰ The SEMC proposals are not comparable in that they apply to generation companies with a combined installed capacity equal to or greater than 20 MW.

The weakness of the bilateral market in the areas of competition and transparency (amongst others) was recognised by the SEMC at the time the SEM High Level Design was being considered and were part of justification for rejecting this type of market:

“The view of the Regulatory Authorities is that a gross pool provides advantages over a bilateral contracts market in the areas of security of supply, efficiency, practicality, equity and competition, while being equally stable.”¹¹

The SEMC reporting proposals are at a significantly greater level of detail than those required in GB. In GB the virtually integrated utilities are required to split their financial results into the two headings of generation and supply with supply being further separated into electricity supply (both domestic and non-domestic) and gas supply (both domestic and non-domestic). On the other hand the SEMC is proposing that each generation licensee separate out the results of each individual generating plant. Regarding revenues GB only requires revenue to be split between the revenue from electricity or gas sales and other whereas the SEMC is proposing that revenues are separated into pool revenue, contract for difference payments, capacity payments and other revenue. The proposals once again are neither necessary nor proportionate.

Legal Basis for Disclosure

As outlined above AES believes that the SEMC is exceeding its duties under The Electricity (Single Wholesale Market) (Northern Ireland) Order 2007 by intervening in an area where no action is required. In any event the rationale that the SEMC’s uses to request the information is flawed.

The SEMC’s rationale relies on Condition 2 of the Electricity Generation Licences in both NI and ROI. AES believes that the SEMC has both failed to understand the purpose of the Condition and recognise that there are differences between the NI and ROI generation licences. The Consultation Paper therefore only considers the drafting in ROI generation licences thereby ignoring important differences in the NI drafting. Since AES holds generation licences issued in NI it will respond in relation to the drafting of the NI generation licences rather than the ROI licences.

Firstly it is important to understand the purpose of Condition 2 which is entitled ‘Separate accounts for Separate Businesses’. While the title itself gives a good summary the detail is set out in Clause 2 which states that:

“The remaining paragraphs of this Condition apply for the purpose of ensuring that the Licensee (and any affiliate or related undertaking of the Licensee) maintains accounting

¹⁰ Ofgem Financial Information Reporting: Amended Guidance published 23 May 2011

¹¹ Section 2.2 AIP/SEM/42/05 High Level Design Decision Paper

and reporting arrangements which enable separate accounts to be prepared for each Separate Business and showing the financial affairs of each such Separate Business.”

Separate Business is defined in Condition 1 as:

“each of the Generation Business and the Supply Business (if any) each taken separately from one another and from any other business of the Licensee or any affiliate or related undertaking of the Licensee, but so that where all or any part of such business is carried on by an affiliate or related undertaking of the Licensee such part of the business as is carried on by that affiliate or related undertaking shall be consolidated with any other such business of the Licensee (and of any other affiliate or related undertaking of the Licensee) so as to form a single Separate Business.”

In simple terms AES understands this to mean that licensees must separate out their generation and supply activities and produce separate financial information for each.

Clause 3 of Condition 2 specifies that the form of the accounts to be prepared by the generation and supply businesses should follow that set out in the Companies (Northern Ireland) Order 1986 (which has now been superseded by the Companies Act 2006) whether they are a private company or not. Presumably this format has been chosen as it is the legal format for private companies, which has been developed over the years, and strikes the appropriate balance between transparency and commercial sensitivity.

While there is drafting in clause 5 of Condition 2 which permits the Utility Regulator to specify the form and content of the accounting statements this is only with regard to the purpose of Condition 2. As noted above the purpose of Condition 2 is to ensure that accounting information for the individual generation and supply businesses is separately disclosed.

AES does not therefore believe that Condition 2 permits the Utility Regulator to require generators to provide the information proposed in the Consultation Paper for the purpose of “improving transparency, therefore assisting competition in the SEM, and allowing comparisons to be made between generator profitability levels in the SEM and other markets.”¹²

In any event it is clear from clause 5 of Condition 2 that the basis of charge or apportionment between the generation, supply and other businesses will not be published, presumably as this would be considered commercially sensitive. Clause 5 (c) states:

“(with the exception of the part of such statements which shows separately the amounts charged, apportioned or allocated and describes the bases of charge or apportionment or allocation respectively), be published with the annual accounts of the Licensee.”

Clause 6 of Condition 2 in the NI generation licence requires the licensee to prepare current cost accounts and clause 7 clarifies that tax etc is excluded if it does not relate to the separate business. Clauses 6 and 7 of Condition 2 of the NI generation licences do therefore not permit

¹² Section 4

the Utility Regulator to specify the form and content of the accounting statements as stated in the Consultation Paper.

Even if the drafting of clauses 6 and 7 was as stated in the Consultation Paper this would still be subject to the restrictions on the purpose ie separate accounts for separate businesses as outlined above and the limitations in publication contained in clause 5.

One further concern is that the Consultation Paper also states that the proposed financial information will inform policy decisions.¹³ The Consultation Paper does not elaborate further and therefore AES is unsure what the SEMC has in mind, other than to assume that the information could be used to cap generator profits. It is therefore worth reminding the SEMC that it has put in place highly regulated market arrangements with a Bidding Code of Practice and Market Monitoring Unit and that as outlined earlier the SEMC (and others) considers these arrangements to be working well. AES would therefore request the SEMC to clarify its intention to use the information to inform policy decisions.

Publication of Information and Commercial Sensitivity

As noted above clause 5 of the NI Generation Licences restricts the information which can be published by the Utility Regulator.

Article 63 (General restrictions on disclosure of information) of Part VIII of The Energy (Northern Ireland) Order 2003 (“2003 Order”)places further restrictions on the disclosure of information. Article 63 states that information obtained under the 2003 Order or the Electricity (Northern Ireland) Order 1992 or the Gas (Northern Ireland) Order 1996 cannot be disclosed while the business is being carried on unless either consent of the business has been granted or unless it is required to facilitate the performance of the Utility Regulator’s (amongst others) functions. This takes us back to the arguments outlined earlier and the fact that the principle objective of the SEMC is protecting the interests of consumers of electricity in Northern Ireland and Ireland by promoting effective competition while ensuring transparent pricing.

Article 30 (Right of access to accounts) of Directive 2009/72/EC (Common rules of the internal market in electricity) also places restrictions on the preservation of commercially sensitive information. Article 30 states:

“Member States or any competent authority they designate, including the regulatory authorities referred to in Article 35, shall, insofar as necessary to carry out their functions, have right of access to the accounts of electricity undertakings as set out in Article 31 [unbundling of accounts].

Member States any designated competent authority, including the regulatory authorities shall preserve the confidentiality of commercially sensitive information. Member States may provide for the disclosure of such information where this is necessary in order for the competent authorities to carry out their functions.”

¹³ Section 2

Interestingly Article 31 is very similar to Condition 2 of Generation Licences requiring electricity undertakings to produce and publish (if legally required) accounts in the format of private companies. It also requires electricity undertakings to keep separate accounts for their transmission and distribution activities and consolidated accounts for other electricity activities not relating to transmission and distribution. It notes that until 1 July 2007 separate accounts were also required for supply activities for eligible and non-eligible customers.

Conclusion

On the basis of the arguments above AES does not see the need for the publication of additional financial information as outlined in the Consultation Paper, nor does it consider the information to be proportionate even if there were a need. In addition AES does not believe the SEMC has an appropriate legal basis on which to request the information. AES therefore rejects the proposals outlined in the Consultation Paper.