



Response to SEM-12-105
Proposed Next Steps Decision Paper
on Implementation of the EU Target Model for SEM

on behalf of
AES Ballylumford Ltd and AES Kilroot Power Ltd

21 December 2012

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”) “Proposed Next Steps Decision Paper – Implementation of the European Target Model for the Single Electricity Market” (“the Paper”).

We have structured our response to comment on the key SEMC Decisions and Recommendations set out the Paper.

Performance of SEM to Date

Whilst AES would agree with the general sentiment that SEM has performed well by delivering cost reflective prices to customers, we also believe that the current SEM design has not addressed some significant deficiencies:

- Highly constrained market particularly in relation to N-S infrastructure limitations;
- High constraint costs; and
- Lack of generation investment signal for Northern Ireland.

Any revision to SEM design and operation must take these factors into consideration.

High Level Design Principles

AES agrees that the current High Level Design principles are as relevant now as when SEM was first designed. We also accept that the additional principle in relation to the Internal Electricity Market is entirely appropriate.

As stated in our response to SEMC Consultation Paper SEMC-12-004, we would continue to emphasise that it is important to ensure that the future SEM structure/design is non-discriminatory and that participants in SEM can compete on a level playing field compared with their counterparts in Europe. Furthermore, the SEMC need to be very cognisant of the need to ensure that participant’s ability to secure financing is fully considered within the overall assessment of market design options.

SEM Design and European Target Model

AES welcomes the SEMC’s commitment to maintain the current SEM structure until 2016 with as few material market changes as possible in the interim. We also welcome the decision not to adopt an evolutionary approach rather to focus on a ‘top down’ approach, fully engaged with all stakeholders.

We note the decision to review bidding zones within SEM to determine the merits or otherwise of introducing an additional bidding zone(s). We think this is prudent course of action although we would have some concerns that the SEMC seems minded to ask the TSOs to undertake this review. AES strongly believes that this analysis should be undertaken by an

independent expert who has substantial experience of other markets and bidding zone dynamics within and between markets.

We welcome the commitment to undertake regulatory impact assessments, however we have substantial concerns in relation to the SEMC comment "...cost benefit analysis, **where appropriate**, that take into account the **key energy policies** that are **materially affected** by the wholesale electricity market". We believe that this 'loose' approach will not properly consider the potential impacts on the diverse range of participants within SEM, and that such assessments must consider much more than just key energy policies. We believe that robust and comprehensive cost benefit analyses and impact assessments must be undertaken prior to any key decisions are made throughout the project, particularly when evaluating design options and making final decisions.

We note the SEMC decision that there will continue to be market power mitigation measures within SEM. We presume that SEMC is not welded to the current market power mitigation measures and that the project will review the need for and structure of market power mitigation measures in parallel with the evolution of SEM design and integration with other markets.

Central Dispatch

The SEMC has asserted that there is a 'working assumption' that central dispatch will underpin future work in relation to SEM redesign. Whilst at this stage, AES has no particular preference for or against central dispatch, we do believe it is premature for the SEMC to have made the decision in advance of detailed design work or engagement with industry on the merits or otherwise of central versus self-dispatch. We believe it would be better for the SEMC to facilitate a consideration of all potential options, with input from participants and other independent market design expertise, before deciding on the final dispatch solution. Having now made the central dispatch decision, this may limit options for the final design resulting in a less than optimal long term solution.

Renewable Energy Sources

AES accepts the decision that SEM redesign should support use of renewable energy, as set out in legislation. However, we would suggest that this is not an isolated issue to be addressed on its own within the project, as legislated renewable energy targets will only be achieved when and if an appropriate balance is struck to facilitate the commercial and technical viability of a diverse range of generation technologies including renewable and conventional generation.

Capacity Payment Mechanism

AES endorses completely the SEMC decision that remuneration from the market must be sufficient to ensure security of supply. We would also contend that remuneration must be stable, transparent and predictable enough to allow participants to finance their businesses in the long term.

There are a number of substantive security of supply challenges that will need to be considered

in terms of designing remuneration within a new Target Model compatible market:

- delays to the second N-S tie-line;
- retirement of conventional generation capacity in Northern Ireland;
- lack of investment in new Northern Ireland generation;
- concerns over reliability of interconnectors with GB;

Given the above, AES believes that a capacity payment mechanism could have a very important role in mitigating some the challenges, although we accept that the design of the current capacity payment mechanism will need to be revisited and that any design will need to comply with EU regulations (or seek derogations as appropriate.)

Governance and Project Management

We welcome the SEMC recommendation to establish a range of Committees and arrangements to ensure co-ordination between DCENR, DETI, DECC and Ofgem. However, whilst we believe it is imperative to establish a Regulatory Authority Project Office and we welcome the statement that the SEMC is “committed to ensuring that both current and prospective market participants are fully involved in the implementation of the Target Model...”, the Paper does not appear to make explicit provision for formal industry engagement within the SEM integration project. AES, in conjunction with other EAI members, have made a number of representations on this issue and we would endorse fully the EAI comments in relation to the establishment of an Industry Governance Group, as set out in their response to this Decision Paper (summary below).

- *The addition of a ‘SEM Integration’ specific stakeholder group to the project governance arrangements to incorporate:*
 - *A ‘project’ stakeholder forum, inclusive of government departments, regulatory authorities, industry participants and system operators, to meet monthly or more often as necessary, to receive reports on the progress of the project;*
 - *A ‘design’ stakeholder forum to discuss the various and specific topics under consideration **both before and during** the formal consultation process;*
- *A project work programme detailing timelines, milestones, key activities, consultation periods along with the appointment of an experienced and dedicated programme manager.*

We believe that the latter point in relation to a detailed work programme and independent programme manager will be crucial in terms of successfully delivering such a complex project within the prescriptive compliance timetable.

AES, in its previous response to Consultation Paper SEM-12-004, raised concerns about the influence of SEMO and the TSOs within the process. We retain these concerns and on the basis of non-discrimination and to avoid any perception of conflicts of interests (e.g. Eirgrid have both

technical and commercial interests in relation to EWIC), we would suggest that an Industry Governance Group is vital to ensure successful completion of the project.