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Assembly

Committee for Enterprise, Trade and
Investment

OFFICIAL REPORT (Hansard)

Electricity Policy Review: AES Briefing

26 September 2013

NORTHERN IRELAND ASSEMBLY

Committee for Enterprise, Trade and Investment

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Members present for all or part of the proceedings:

Mr Patsy McGlone (Chairperson)
Mr Phil Flanagan (Deputy Chairperson)
Mr Steven Agnew
Mr Sydney Anderson
Mr Sammy Douglas
Mr Gordon Dunne
Mr Paul Frew
Mr Alban Maginness
Ms Maeve McLaughlin
Mrs Sandra Overend

Witnesses:

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|-------------------|------------------|
| Mr Roger Casement | AES Ballylumford |
| Mr Ian Luney | AES Ballylumford |
| Mr Mark Miller | AES Ballylumford |

The Chairperson: We have with us today Mr Mark Miller, vice-president UK and Irish markets, AES Ballylumford; Mr Roger Casement — a historic name — UK plant manager, AES; and Mr Ian Luney, UK commercial manager, AES Ballylumford. You are very welcome. You have up to 10 minutes to make your presentation, and then we will have questioning from members. I am under instruction to watch the clock in the interests of Committee efficiency. Thank you for giving of your time to be with us.

Mr Mark Miller (AES Ballylumford): Good morning. Thank you, Chair, ladies and gentlemen. I will run through a brief statement that will amplify the paper that we submitted last week outlining the position of our assets and how we fit in with the market. We will then be more than happy to answer questions. My colleagues and I thank the Committee for the opportunity to discuss the issues of security of supply and how our business's operations in Northern Ireland are impacted by changing conditions in the single electricity market (SEM).

By way of background, the AES Corporation has its headquarters in Arlington, Virginia, and is a global power company. We own and operate generation and distribution businesses in 21 countries around the globe. Through a diverse portfolio of thermal and renewable sources, we provide affordable and sustainable energy. We are supported by a global workforce of some 25,000 people, who are committed to operational excellence in meeting the world's changing power needs.

AES has been part of the Northern Ireland energy landscape since 1992. With the acquisition of Premier Power Ltd at Ballylumford power station in 2010, we now own and operate two generating

stations in Northern Ireland, with a total installed capacity of some 1,900 megawatts. That comprises about 16% of the single electricity market capacity. AES Kilroot Power Limited, Carrickfergus, and AES Ballylumford Limited, Islandmagee, are wholly owned subsidiaries of the AES Corporation. AES in Northern Ireland employs 248 people across both sites. We also contribute significant indirect benefits to the local community through a range of contracted services, most of which relate to technical support for the businesses. That equates to about 85 people, with a routine maintenance and services expenditure of about £8 million per annum. Additionally, we contribute nearly £6.5 million annually to rates in the Carrickfergus and Larne areas to fund local and regional services. We are proud to sponsor a comprehensive apprenticeship, undergraduate and graduate scheme, offering opportunities for two dozen candidates to learn trade skills, enhance their university educational curriculums and further develop their CVs through postgraduate employment contracts.

As the Committee was supplied with detailed statistics of each of the stations, I will summarise each of the businesses based on the commercial position in the SEM. In respect to merchant positions in the SEM, Kilroot has two main units fired on coal and heavy fuel oil of 260 megawatts each, fitted with seawater flue gas desulphurisation (FGD). Ballylumford B station has three gas-fired units of 180 megawatts each. Between the two sites, we have 258 megawatts of open cycle gas turbine peaking capacity that is fuelled by distillate. In respect of contracted units, the Ballylumford C station consists of three gas-fired closed cycle gas turbine units totalling nearly 600 megawatts and is under the last of the legacy contracts from privatisation.

As you are fully aware, contractor units through an intermediary contract and uncontracted units managed by AES compete within the single electricity market and are bound by a series of regulated rules. The commercial position in the SEM is driven primarily by commodity relationships between coal, gas and carbon, and the efficiency of the individual units. The commercial position is also highly influenced by the level of system demand, the extent of wind generation on the system and the availability of other generators. Irrespective of committed competitive commercial positioning in the market, generator units can be dispatched by the system operator to support system needs as required.

All AES's assets must comply with the EU's large combustion plant directive (LCPD) until the end of 2015 and its successor, the industrial emissions directive (IED), from 1 January 2016. Several options are available to AES in order to comply with the more stringent emission limits under IED, including limited hours of operation up to 2023; operating under a transitional national plan (TNP), which would allow restricted operation until 2020; or investing to make the plants fully compliant with IED emission limits from 1 January 2016. Our current view is that Kilroot will opt into the TNP. Assuming no further significant capital investments under the TNP option, the capacity factor of the Kilroot main units will be limited to approximately 45% from 2016 to 2020, with a further reduction in operations to 1,500 hours per annum from June 2020. Ballylumford C station is currently compliant with IED emissions requirements while firing on gas, but investment will be required in one of the units, unit 10, to enable running on backup fuel, which is distillate. Ballylumford B station was opted out of the LCPD in 2007 by the previous owner, Premier Power Ltd, and is scheduled to cease operations on 31 December 2015.

On the basis of discussions with the Systems Operator for Northern Ireland (SONI), the Department and the regulatory authority, it is our understanding that there is an increased risk to Northern Ireland's generation security from 2016. That is driven by a combination of the continued delay of the second North/South interconnector, closure of the Ballylumford B station at the end of 2015, as I just said, reduced capacity of the Moyle interconnector and further repairs to it, and potential restrictions on Kilroot due to capacity limitations under IED. The generation risk remains material until the completion of the North/South interconnector or additional capacity becomes available in Northern Ireland. Clearly, there are many issues at play, and, as a result, numerous levers that could be pulled to mitigate future risks.

I will briefly update you on the two elements that involve our assets in Northern Ireland. At Ballylumford, as raised previously, the most effective solution for all stakeholders would be to obtain a derogation of the IED emission limits for the B station, but it is our understanding that that is not allowed under the current legislative structure. A second option could be to make the B station IED-compliant through further investment and modifications to the boiler units. AES has carried out preliminary engineering assessments, and we believe that it is technically possible to modify the units to comply with IED requirements. In order to fully understand the total investment likely to be required, a more extensive engineering evaluation will be completed by the end of 2013 to outline the full business case and the full extent of investment required. However, anticipated changes to the electricity market in 2016, including the likely restructuring of capacity and ancillary service payments,

will play a key part in determining the overall project risks. At first glance, and given those uncertainties, it is likely that a capacity contract could be required to make this a commercially attractive project. That will be confirmed by the total cost estimates as they become clear later this year.

At Kilroot, AES is evaluating the economics of making the main units fully IED-compliant from 2016. However, given its merchant status, that is heavily impacted by its commercial position within the SEM. Uncertainty over future coal, gas and carbon pricing, and the relationships between them, the limited ability to hedge long-term fuel positions that align with market rules and vagueness over energy-market structures also play a very important part in our investment decision.

Setting aside those uncertainties, our initial view, based on current market conditions and discussions with several equipment suppliers, is that the investment metrics look promising but are subject to further engineering design review this year and the development of an appropriate risk mitigation strategy to manage commodity risk. Investment at either site would be subject not only to AES internal approval processes but obtaining all relevant environmental and planning consents.

In summary, AES has demonstrated its long-standing commitment to providing a safe, reliable and cost-efficient supply of electricity to Northern Ireland and the SEM. Once again, we stand at the threshold of significant change in the energy markets in the next few years. These changes, driven by policy and regional market integration requirements, will require a new view on the needs of the energy market. Indeed, the targeted addition of renewables to the generation mix by 2020 will require new generation strategies and innovative technologies to deliver higher reliability and cost-effective energy to the end consumer. Those new market dynamics are key considerations in determining our strategic positioning and will guide us in evaluating new opportunities that we have identified for growth. AES is committed to engaging with all stakeholders to assess our role in addressing post-2016 generation security risks and offering energy solutions that serve the needs of all stakeholders.

Thank you for this opportunity. We will be pleased to answer any questions.

The Chairperson: Thank you very much. Will you clarify a wee technical point for me, please? Your submission states:

"Under PPA until 31/3/2018".

What is PPA?

Mr Ian Luney (AES Ballylumford): It is a power purchase agreement, Chair, the legacy contract with Power NI. It is the last one.

The Chairperson: That is grand. A number of members wish to speak. I remind them of the time constraints that we agreed the other day.

Mr Flanagan: Thank you, gentlemen, for your presentation. It was very helpful. Recently, we engaged with trade union representatives. What level of engagement have you had with them to get their insight into this?

Mr Roger Casement (AES Ballylumford): We constantly engage with the trade unions. We are very open and transparent about what is down the road and the options that are open, so it is a continual process.

Mr Miller: It is fair to say that we are fully aware of them making an approach on security of supply issues at the B station, long-term employment and investment. As Roger pointed out, it is about a continuing dialogue and making people in the businesses fully aware of what is coming down the road so that we understand the various solutions.

Mr Flanagan: It was the unions who put the matter on the Committee's agenda, so they should be commended for that. Have you any further information on your continuing engagement with the Department of Enterprise, Trade and Investment (DETI) and the Utility Regulator?

Mr Miller: We have been in constant dialogue about the B station security of supply issues. We are trying to give the Department and the regulatory authority a clear picture of what we understand to be

our range of options, primarily for the B station. The Kilroot aspect is a more recent manifestation. It has been part of that dialogue, but there has not been nearly as much discussion on that. Clearly, for the past nine months or so, the B station has been the main part of that discussion. We are trying to give as clear a picture as we can, and it is an evolving process of understanding the investment required to provide a solution.

Mr Flanagan: To make the B station compliant with the new IED emission limits, what sort of investment are you talking about?

Mr Casement: It is very difficult to be precise about the amount before the engineering scoping study is complete. I could give you a number now, but it would not be accurate. I would rather wait until we go through the scoping study. The amount of investment depends on three factors. The first of those is the amount required for the NOx plant to reduce its emissions. Then, we have to work out whether that will change — when you change something in a unit, it has a consequential effect on something else. Finally, we might have to change major steam components, which would increase the capital cost significantly.

Mr Flanagan: Have you a budget for the investment, or are you seeking funding from Government or the Utility Regulator?

Mr Casement: Whether it makes sense as a stand-alone project, simply going into the merchant market, depends on the capital required. On the basis of our current numbers, which are historical figures, it does not make sense.

Mr Flanagan: If derogation were granted for the B station, what kind of investment in time and financial resources would be needed to prolong its productive life?

Mr Casement: I am not clear on the question. In that case, there would be no commitment, so we would carry on with our operation as usual.

Mr Flanagan: If you got derogation, do you think that you would be allowed to carry on without making any kind of investment?

Mr Casement: Absolutely.

Mr Flanagan: Is that likely?

Mr Casement: The information that we have is that it is not likely.

Mr Flanagan: Is there anything that the Committee can do to help you to get derogation? Is there anybody we need to contact and raise the issue with?

Mr Casement: It is certainly a political issue with the local environmental regulator. In the current IED legislation, there is no room for manoeuvre. Therefore, as we understand it, it would need EU derogation.

Mr Flanagan: You said that you were evaluating the economics of making Kilroot fully IED-compliant from 2016. However, to do that, you have to take into consideration the wider impacts of the single electricity market. Will you explain why the SEM is the key factor in your considerations?

Mr Luney: We understand very well how the SEN works and how it remunerates our plant. The real issue is the regulators, North and South, launching a major reform project to ensure that the market complies with European directives. The evolution of that change means that there is a lot more uncertainty about our revenue stream. So, as we look to invest, we also need to look at how we would recover that investment. There are a lot more risks going forward than there are today, and that is our concern. We are trying to understand better what that market list looks like. From our perspective, the sooner we become engaged in the process and the sooner that process takes shape, the sooner we will have a better understanding of the likely risks.

Mr Flanagan: Is creating additional generation capacity in the North the best long-term solution for achieving security of supply, or is the best solution getting a North/South interconnector that works and having sufficient generation across the island of Ireland?

Mr Miller: At this stage, our view is that a second North/South interconnector is a key element in the long-term strategy because that would allow access to the most cost-efficient unit at any one time. Clearly, the annual constraint costs, which are sizeable and caused by the lack second interconnector are a primary driver in wanting that project to be completed as quickly as possible.

Mr Flanagan: This is my final question: are you looking for derogation until the North/South interconnector is built, or are you looking for permanent derogation?

Mr Miller: In respect of which station?

Mr Flanagan: The B station.

Mr Miller: At a minimum, I think that we would have to be able to cover off the period operationally until that interconnector is complete. If we invest in the business to extend its life and to comply, that opens up a range of opportunities for further growth, although those are rather limited given where the B station sits within the market structure. It really turns out to be a service provider. It is a capacity backup option more than a market-value option for us.

Mr Frew: Thank you very much for your presentation, gentlemen. AES is very important to Northern Ireland. It is a major business and, of course, a major employer. It is also very important because of the energy it produces.

I want to delve a bit more into derogation. You say that you are not hopeful that you will get it. However, we have been able to get derogation on the carbon price floor, which has been essential in enabling Northern Ireland to carry on and not hit the buffers, so to speak, in a certain period. You say that, if you get derogation, you will not have to invest. If you can show a willingness to invest, adapt, change and advance, does that make getting derogation more likely? Is it like that, or do you just want derogation to continue doing what you are doing?

Mr Miller: If you stand back and look at all the stakeholders involved, not only us but everybody who is involved — the consumer, the regulatory authority and government — you see that the simplest and most cost-effective solution is derogation, because that turns into a "business as usual" scenario. We would continue to invest annually in our normal operating costs and in maintenance repair, and the station would continue to exist, doing exactly what it is doing right now, and it would compete on that basis.

The limit of our ability to influence the push for derogation really stops at the environment authority and our discussion with the Department and the regulatory authority. That is what we can put on the table. We can provide the technical analysis to say, "This provides us with a potential solution to fill a gap from 2016". Certainly from our perspective, that is what we have been able to do. The derogation process, as we understand it, is rather complex, especially when you get into the level of EU interaction. As we found out with the carbon price floor derogation earlier this year, it is a very complex process. Other than our being able to provide baseline information, it is really in the Department's hands to be able to manage that interaction for the derogation process.

Mr Frew: You talked about a need for legislative structures to change. Is that at regional, UK or European level, or all three?

Mr Miller: That is a good question. I am not sure to what extent the different legislation would change. We have been advised by the environment authorities that the internal review of the legislation that manages the IED component — the aspect of compliance of units — as well as further discussions with DETI has shown that there is no way for a plant that has opted out right now. The B station has opted out; that decision was made back in 2007. Legally, there is no opportunity for it to go through a derogated process. We would have to invest to be compliant with the new emissions standards.

Mr Frew: Any investment in the future would be vital. We have to balance the security of supply against the cost of the supply of energy. How can you assure us and the wider community that whatever investment you can make, the cost passed on to the customer will be proportionate and fair?

Mr Miller: There are two routes of remuneration. Let us just say that, if we get comfortable with our expectations of what the market would deliver post-2016, we would bear the risk of that investment, as it currently stands. If we struggle based on the investment required to make that into a measurable investment metric — in other words, that we will recover our investment over a certain period — we could be forced down the route of asking for some sort of surety through a capacity contract, as we outlined in our opening statement, to ensure that we will get our investment back.

When you think about it from an investment strategy point of view, the B station is nothing more than a backup supply. It runs very little but is an inherent part of the system needs because we need that backup capacity in the event of significant failures of any other units. History has shown that Northern Ireland's generating units are very reliable. We have had our problems along the way, but, generally speaking, we continue to provide a very reliable service. It is about understanding the ability to get comfortable with that. If it is a capacity contract, it would be borne by the consumer to a certain extent. If it is done by us, it is merchant exposure, and we bear the risk. That is why it is very important to us to understand the full investment cost structure. Right now, there is no contract for us. We have to go on the premise that we will invest in our own typical return hurdles and risk mitigation strategies to make the investment work.

Mr Dunne: Thank you for coming today, gentlemen. Most of the questions have already been asked, but I have a couple of points to make. We welcome the investment that AES makes in Northern Ireland and the employment that you provide. If the B station at Ballylumford ceased to operate, what would be the impact on employees there in the long term?

Mr Casement: There would be a reduction of approximately 85. We would have to do a benchmarking assessment of the numbers that would be required to run the remaining combined cycle gas turbine (CCGT), but it would be roughly that number.

Mr Dunne: Would any of those employees be offered an alternative?

Mr Casement: There would not be any, to be honest.

Mr Dunne: It is quite significant, then.

Mr Casement: It is.

Mr Dunne: I want to ask about fuel generation. Do you use coal and oil at present?

Mr Casement: At Kilroot?

Mr Dunne: Yes.

Mr Casement: At Kilroot, we use coal 99% of the time. Oil is just the backup fuel that we use in the event of —

Mr Dunne: Is coal the most cost-effective fuel at present?

Mr Casement: It is the most cost-effective in the market.

Mr Dunne: Does it come from all over the world.

Mr Casement: Generally, it comes from Russia and South America at present.

Mr Dunne: I also want to ask about upgrades. I take it that you are negotiating with the Utility Regulator on possible funding for any upgrade that will be needed?

Mr Luney: We are not negotiating. We have had discussions to outline what we need to do in technical terms. We also have concerns about the commercial arrangements and whether there is a merchant position or, as Mark suggested, whether we need some sort of capacity contract to secure the investment. That is the extent of the engagement to date.

Mr Dunne: It is early days, then, on that.

Mr Luney: It is early days. From our side, technically, we are getting a far better handle on what we need to do to make it comply. The concern is that, commercially, we are still a bit uncertain about the options that would be open to us to secure the investment. The sooner we can get clarity on that, the better it will be for all stakeholders.

Mr Miller: We should be clear that two different investments have been mentioned this morning. The one that seems to get the most focus is the B station investment, because it has the potential to fill the largest gap in shortfall of capacity from 2016. The second area of investment, which it is up to us to decide to do, relates to the commercial position of Kilroot. Kilroot will still be a going concern and provide capacity into the market from 2016. However, under current IED legislative requirements, for parts of the year we will be restricted in our ability to offer the full capacity of the project. Therefore, there is a layer on top, and those IED emission limits would force down our ability to compete in the market.

The investment decision is for us to decide whether we think that there is enough value — as I said in my opening statement, we think that there is enough value under current commodity positioning — for Kilroot to avail itself of the plant's maximum ability to compete in the market for the long term. The Kilroot investment is a long-term play in the market. It does not require any investment or discussion, other than by AES internally, to understand how the return fits with us.

Mr Dunne: Is the interconnector key to your long-term plans? If you are to invest to upgrade your power stations and make them compliant, will you see yourselves as a major player in the all-Ireland market when the interconnector comes into service?

Mr Luney: The interconnector's coming into service should be welcomed by all. We support that fully. However, the interconnector will not actually affect our position, setting aside the B station, which is slightly different because its revenue stream is from a capacity payment. For the C station and Kilroot thermal units, the interconnector's being there will not affect our merchant position. It will be judged by commodity prices. If commodity prices stay in our favour, our commercial position is secure for that period. If commodity prices move against us, we will fall out of a competitive position and back to the position of electricity being dispatched to meet system need. The North/South interconnector is more of a strategic issue for the market and for Northern Ireland plc than for the commercial position of AES.

Mr Dunne: We are not experts on energy in any way, but will the interconnector not mean that you will be a player across the island?

Mr Luney: We already are.

Mr Miller: We already are, because we all compete within the same market structure. The constraints are more of a technical management issue in respect of getting power flows to the right spot.

Mr Dunne: The right volumes.

Mr Miller: Yes, exactly. It is the volume side of it.

The Chairperson: You were on the five minutes there, Gordon.

Mr Douglas: Thank you for your presentation. I have just joined this Committee, and, to be honest, I am struggling with all this stuff about the LCPD and the IED.

Mr Flanagan: You are not the only one.

Mr Douglas: I want to talk to you about the TNP.

The Chairperson: That is just the computer.

Mr Douglas: Yes, how do you switch this on? *[Laughter.]* You talk about Kilroot and say that you are going to opt into the transitional national plan. You say that that will reduce your capacity by 45% but that it should still be sustainable, or perhaps that is me using my own term. For my own information, how can you reduce the capacity by opting into a TNP yet remain viable and sustainable?

Mr Miller: It is a great question. We are throwing around acronyms such as LCPD and IED. The whole structure is very complex, and it is difficult even for those of us in the industry to get our heads around the range of available options.

I will try to distil this down to its simplest form. There are three options. The opt-out says that we elect to have a certain number of hours allocated to us, and, when we run out of hours, we have to shut down the plant. That is the case with the B station right now.

Mr Douglas: I assume that that would mean workers having to be paid off or taking reduced hours.

Mr Miller: That is correct. The project would cease to exist.

The TNP is a kind of middle ground. It is an attempt to transition — as the name suggests — the market into long-term compliance to meet long-term emission goals. Kilroot is in a fortunate position, because we have such an historical high-load run. In the past decade, the plant has run at 80% or 85% capacity. It has been a very large contributor to the market, especially under the previous contract structure. The way in which the TNP is calculated means that you get a bubble — an allocation — of SO₂, NO_x and particulate —

Mr Douglas: Sorry, is that an emission bubble?

Mr Miller: Yes, it is an emission bubble — an allocation per year. We are eligible for that. Essentially, we can run the plant up to the point at which we run out of those emissions. When we run out, we have to shut down the plant until the next year, when we get a new allocation. The intent of the TNP is to allow the sustained performance of the units and meet the energy needs of the market but still allow some investment.

The final option is to invest immediately and be compliant. Given our operating history, that 45% capacity factor is probably the most generous in the whole of the UK. Therefore, we are actually well-positioned to avail ourselves of that option. Our point is that, given current commodity forward prices, we expect the plant to run at 70% or 75% capacity factor. We would be forgoing that layer of value. Therefore, we have to make a decision on whether we want to free up the plant and invest in it to be compliant and give us full access to the market. The challenge is that that is based on current forward prices of coal, oil, gas and CO₂.

Mr Douglas: Would Labour coming into power have implications for all that, given some of the statements that its leader made this week? I know that that is a political question, but it is also an economic one.

Mr Miller: You are champing at the bit to answer that.

Mr Luney: I am not champing at the bit, but we are all wrestling with what exactly Labour is proposing, as it is very uncertain. The UK market structure is entirely different from the Irish market structure.

Mr Douglas: You also operate in England and Scotland, is that right?

Mr Luney: We have wind assets that operate under a contractual arrangement, but they would not be impacted on. The Labour policy is focused on the big six energy suppliers in a different market structure. We are wrestling with what he is proposing, but we do not think that it applies to the island of Ireland.

I will clarify one of Mark's points. He said that, given the commodity prices that we see forecasted for 2016-17 and beyond, our capacity factor could be at 70%, and that if we are operate within the TNP and are limited to 45%, we will potentially suffer a loss because we will have lost that revenue. However, from talking to SONI, I know that it also has a concern. If you are dispatched strongly throughout the year and hit your capacity factor limit in September, you are not available for the rest of that year. You have gone through your bubble, so you cannot emit. Therefore, there are two elements to it: there is an issue for us, and there is also an issue for the system operator concerning security of supply.

Mr Douglas: That is very helpful. Thank you very much.

Mr Anderson: Thank you for your presentation, gentlemen. Like Sammy, I have just come on to the Committee. I do not want the lights around my home to go out, so I am prepared to have some discussion on the issue.

In the summary position in your submission, you state:

"AES has demonstrated our long-standing commitment to providing a safe, reliable and cost efficient supply of electricity to Northern Ireland".

That is to be commended. You also talk about assessments and things that you are carrying out, and you state:

"In order to fully understand the likely investment required, a more extensive engineering evaluation will be completed by the end of 2013".

Will you have that completed by then? What is the present position?

Mr Casement: It will be completed. The first stage is complete, and we are waiting for a report on the initial stage. We then have to run the units and do what is called computerised fluid dynamic modelling, which essentially tries to model what will happen the boiler when you make this change to the NOx burners. That will determine whether we need to change some of the major steam components. If we have to change some of steam components, the big issue will be time, because it will take 18 months to order those. That has a big impact and would make a decision a much more urgent issue than if we did not have to invest in the steam components. That will be completed by the end of the year.

Mr Anderson: I am trying to tease out the issue of security of supply. I know that we have touched on it, but how do you see that going forward post-2016?

Mr Casement: If we are able to make the investment through whatever mechanism — contract or in the market — security of supply will be a much less urgent issue. That would bridge the gap until the second interconnector came online. You still have the issues that you have with any power system, in that you will lose items of plant, but that will help to militate against those losses.

Mr Anderson: Are you fairly confident that security of supply will be addressed and that we will not have blackouts?

Mr Casement: If the investment does not happen, you have a very small margin when it comes to security of supply. If you lose a major item of plant, you could be in difficulty.

Mr Miller: It is fair to say that our understanding, from talking with SONI, is that it will not be short-term loss of plant for a couple of days. There will be sufficient capacity to meet the peak of the day, but the worry is sustained failure, and, unfortunately, we had a failure on GT22 at Ballylumford early last year, and it was a high-impact, low-probability event. Significant failures do happen periodically on large equipment. That is exactly what people are worried about. Not only AES but Coolkeeragh is worried about a sustained loss of any one of the units, as well as our ability to deliver for a long time. That is where the risk really sits.

Mr Anderson: How deep is the worry about the sustained loss?

Mr Luney: SONI, which is the system operator, made it public that it is very concerned that, post-2015, it could be in a position in which there is a deficit of generation in Northern Ireland to meet supply. The conversation is focused on the B station, but we are aware that SONI is looking at other options alongside the Utility Regulator. If Moyle could be increased to 500 MW on a more reliable basis, that would help. Looking at our assets, we are very mindful of the fact that the B station is closing, but if we can get some clarity around what the commercial arrangements look like going forward and get a sense of what investment we require, the B station can play a really important part in mitigating any concerns that people would have about security of supply and the reliability of Moyle.

The Chairperson: Is derogation the only option?

Mr Luney: No, it is not the only option. We have talked about derogation. The precedent has been set for the other dynamic around derogation. If Northern Ireland is asking for derogation, the rest of the UK might want one, so there is an issue around that, but it is not the only option. If we do not get a derogation, the decision is what other options there are. Looking at the B station, we must ask whether we can technically make it comply. We believe that we can make it comply. Then we must ask how much it is going to cost, what we can have in a commercial arrangement to ensure that we can recover our costs. Part of that may be that we just go into the merchant market and be comfortable with how that works.

The Chairperson: You are sharp businesspeople. That is why you are in the trade that you are in. Surely you have done the evaluation of all that, such as the cost options, the potentials, what-if this, what-if that. That is why you are where you are.

Mr Miller: Exactly. We have alluded in our paper to the fact that we understand that there could be the need for a contract. We have modelled what we think the market looks like. That is our best guess as to what we think the market structure is going to look like and the allocation of value within that market. We have to set that against how much it is going to cost Roger and his team to make the change. It depends on the size of the investment. If the investment is relatively modest and at the lower end of the range, it offers an opportunity in which market remuneration might be more than enough for us to get comfortable, and we would just go ahead and do it. If the investment cost moves to the upper range, it might make it questionable as to whether the market will fairly remunerate us for taking on that investment, given that it has a limited life and a sole need, which is to sit there and get paid capacity. There is a regulatory risk associated with the capacity element. Although our view is that the capacity element is a fundamental part of the market, there is a lot of discussion on how it will be allocated in the long term and to whom it should be allocated. We need to be comfortable that the regulatory risk associated with that remuneration structure satisfies our return criteria. The engineering side is not just a simple case of saying, "This is what we can and cannot do", because there is a potential range of options on the engineering side as well. It is about finding the most optimum solution.

The Chairperson: Forgive me for saying so, but I would have anticipated that you would have had some more commercial clarity by now on the best option for the company. I thought that you might be in a better place to know that.

Mr Miller: We have been considering a few legs. The first is the remuneration part and the market-income side, and the second is the extent to which capacity is required. That discussion is on how much capacity is required. We have several options. We have three units, so do we do one unit, two units or three units? That determines the extent of the overall investment, and that is matched to what SONI, the system operator, requires. The last element is — sorry, I have lost my track.

Mr Luney: Trying to read your mind, I will say that the last element is on the commercial side.

Mr Miller: The market structure, yes.

Mr Luney: I mentioned earlier that we know that the market will change but have no idea what it will change to. That is not in our gift. The regulators, North and South, are leading that project with newly appointed consultants. We understand the market today very well, but it is very difficult to understand where the regulators will land in the future. That is our primary concern.

The Chairperson: The regulators, North and South, shed the primary element of clarity on the project, and you need that to be in a better place to make the decisions that you need to make. Is that what you are saying?

Mr Luney: Having clarity on where the market is going will reduce our view of market risks. That is one element. As Mark said, if the investment is not at the upper end of what we need to do, we could take a view of the market risks and say that, for a certain amount of investment, we are willing to withstand a certain amount of market risk and make a decision to invest off our own bat without recourse to anybody else. If the investment is at the upper end, and the risks remain, it is more difficult to justify that investment. That is why we alluded to some sort of capacity contract whereby, as long as you perform, you have more certainty on what your revenue stream will look like.

The Chairperson: Is that capacity contract a new idea or is it unique to your situation? Have those types of capacity contracts been tried and tested elsewhere?

Mr Luney: Great question. Back in 2000, those types of contracts were put in place to resolve the very issue that we are talking about today. The B station was due to close in 2001-02 when the C station was built, but there was a concern in Northern Ireland that there was not sufficient capacity, and there was not sufficient capacity in the South. Therefore, those units were extended to provide energy for the North and the South. Those arrangements have been in place before. That having been said, it was an entirely different market structure then. That is a fair point. However, where there is a will, there is a way to try to facilitate that sort of contract. In the current market, there are ancillary service contracts for the provision of services to support the system, such as reserve reactive power. We do not see any reason why you could not offer an ancillary service contract that is tweaked to reflect a capacity support mechanism for a period when Northern Ireland is in difficulty.

The Chairperson: Thank you very much indeed. That concludes —

Mr Flanagan: Patsy, can I ask a question that may have a yes or no answer?

The Chairperson: Very briefly.

Mr Flanagan: Is the implementation of the IED uniform across Europe or do different member states have different time frames for implementing it?

Mr Luney: The IED is uniform, in that it is a directive for Europe. There could be subtle differences in how member states apply it. I am not that close to it. The UK having a transitional national plan is one of those subtleties that the UK managed to secure. I am not sure what other countries will do, but every EU nation has to comply with IED.

Mr Miller: The emission limits are uniform. How member states implement those —

Mr Flanagan: Did Europe set a time period and different member states have decided to comply early? Does the IED state that it has to be implemented somewhere in the mid-2020s?

Mr Miller: No. On 1 January 2016, the change in emission limitations and structure will be cut to a much more stringent level.

Mr Casement: For new plant. For old plant, there is a transition period until 2020 to reach the new limits.

Mr Flanagan: Do you have to close on 1 January 2016 even if you are an old plant, from before 1997?

Mr Casement: If you opted out of the LCPD. That is the difference.

Mr Miller: If you opted out.

Mr Casement: That is why the UK will see that big capacity squeeze in 2016.

The Chairperson: OK, thank you for that. Part of your submission deals with Northern Ireland's generation security outlook, stating:

"In order to fully understand the likely investment required, a more extensive engineering evaluation will be completed by the end of 2013 to outline the full business case."

Presumably, that evaluation will be done by AES.

Mr Miller: That is correct.

The Chairperson: How far advanced is that, and will it be completed by the end of 2013?

Mr Miller: It will be completed. As Roger said, the last phase of it is understanding the investment cost. We have got comfortable with what we think the range of options is on the market so that we can do the scenario analysis to understand how much risk is involved.

The Chairperson: What factors do you need in place to be best placed to understanding those investment costs? I heard mention of the regulator earlier. I ask just to comprehend where you are likely to be placed by the end of 2013. Will you be best placed?

Mr Casement: On the modifications, the important bit is the fluidised modelling. That will happen in the last quarter of this year. On the market changes, the more clarity that there is, the better that we will understand whether we get a return on that investment.

The Chairperson: What are the factors for clarity? OK, there will be other things in the markets that could just ping away off in an instant, and that is why you are in the industry that you are in. You understand the risk aspects. However, what are the key elements of clarity that you require to try to make that package come together by the end of this year? We heard what the regulators, North and South, are doing.

Mr Casement: The impact on capacity payments post-2016 is the crucial factor that is currently in flux.

Mr Luney: We need to get a sense from the Department and the regulators together. They published a paper in the summer outlining the whole issue. We are keen to see how they are following that up. The B station is absolutely an option, although it is also about what other options they are looking at.

The Chairperson: So what other options —

Mr Luney: We are looking for that coordination.

The Chairperson: Presumably, you have been in discussion with the regulators, North and South, and the Department.

Mr Miller: As well as with the system operator, because that is an element of understanding how much capacity we think could be required. Other elements are the market structure, the reassurance that we give ourselves that we will be able to be remunerated fairly to recover our investment, and the interaction in the market on that exact investment.

Mr Luney: To be clear —

The Chairperson: That is what I am looking for.

Mr Luney: — if the investment metrics are at the higher end, and we cannot get comfortable with investing on our own bat in the merchant market, then we need some facility in the market to offer us a contract to remunerate. At the minute, there is no such contract or commercial arrangement in place. We cannot make that happen. That has to be a decision of the system operator, the regulator and DETI combined. We need that coordination and for a decision to be made as soon as possible so that we can have a clear sense that, yes, we can go merchant, which is tidy for everybody, or, no, we cannot and instead need a contract of some description, and that may take on a life of its own. However, we need that clarity. That is the point, Chair.

The Chairperson: That is grand. Thank you very much for that. Gentlemen, thank you very much for your time. That proved to be very useful.