

ESB Corporate Response to “Consultation on the requirement for enhanced market power mitigation measures within generation licences”

Introduction

ESB welcomes the opportunity to respond to this consultation and provide its views on market power assessment and market power mitigation measures as discussed in the paper (SEM-10-073).

ESB concurs with the Market Monitoring Unit’s assessments to date that the SEM is working effectively. ESB believes that the two main regulatory controls that ensure its continued effectiveness are the Bidding Code of Practice and the continual monitoring of bidding behaviour by the Market Monitoring Unit (MMU). The Bidding Code of Practice (BCOP) has played a key role in containing market price volatility and ensuring that prices reflect generators’ short run marginal costs, as would be expected in a highly competitive market.

The BCOP and MMU ensure that the ability of any market participant to exercise market power is materially mitigated. The Directed Contracts mechanism on the other hand both acts to neutralise the impact of any such power, by removing the incentive to exercise it, rather than preventing it in the first place, and also acts as the mechanism to provide hedging against valid market outcomes.

Market Power Assessment and Market Concentration

The Kilroot and Ballylumford power stations are rarely in merit in the SEM unconstrained schedule. As a result, the HHI by energy assessment as outlined in the consultation paper demonstrates that while there is some impact, caused by the acquisition, on market concentration across the SEM, this impact is small. Furthermore, this assessment also demonstrates that ring-fencing of plant within the AES portfolio will not significantly change market concentration.

The requirement for all Generators to bid their short run marginal cost into the pool, on a per-unit basis, materially mitigates the ability for any generator to leverage any portfolio effects in their bidding strategy. As such, ESB believes that the introduction of any ring-fencing between generation units within the AES Group in SEM will only serve as to increase costs within AES generation business, some of which could eventually be passed to and borne by consumers.

AES does have market power at a local level in Northern Ireland in the constrained schedule (where it is paid its bid price when constrained on). This re-emphasises the need for close monitoring of the application of the BCOP by the MMU and monitoring of availability and forced outage instances in conjunction with the TSO in order to mitigate any of this local market power.

ESB considers that such application and monitoring will be sufficient to mitigate market power across the SEM as a whole and therefore, does not believe that the

introduction of any ring-fencing requirements within the AES Group is necessary or appropriate. In addition, as a single entity, the applicability of ring-fences on AES seems irrelevant.

Market Liquidity and Directed Contracts

The HHI analysis shows that the acquisition will lead to a small increase in SEM market concentration. At present the level of market concentration is referenced during the process to determine the volume of Directed Contracts that ESB must offer to the market.

ESB believes that the market concentration threshold for SEM should be raised to reflect this acquisition and other changes that have happened in SEM since November 2007. However, ESB believes that the volume of directed contracts required of ESB should not be increased in any way to reflect increased concentration brought about by the actions of third parties.

Following this acquisition, there will be a greater number of Generators in SEM with significant generation within their control, whether at a single unit or multi-unit level. ESB suggests that all market participants have a role to play in the contribution to contract liquidity levels in SEM proportionate to their capability whether on a SEM-wide basis or potentially on a local basis as in the case of AES. In furtherance of this goal, ESB suggests that the Regulatory Authorities consider how such a contribution can be brought about, including where necessary the amendment of generator licenses to extend directed contracts requirements across all relevant market participants.

ESB Market Share

Section 2.3 of the consultation paper provides a forecast of market share by generation volume of the largest participants within SEM. This shows the forecasted market share of ESB (combined generation) for years 2010 and 2012 to be 48% and 46% respectively.

ESB considers that such forecasts are significantly over estimated. ESB's own Quarter 3 2010 forecasts show its market share to be 46% for 2010, to be 42% for 2012 and for ESB market share overall to be reducing steadily and to be at 40% by 2013.

ESB does recognise that its own latest SEM market share projection for 2010 is higher than the 43.7% it had forecast at the start of the year. This differential is directly related to the delay to operation of the BGE Whitegate plant and also due to the significantly reduced wind load-factor within SEM. Wind load-factor was expected to be 32% for 2010 but the most recent EirGrid projection for 2010 predicts that this factor may be as low as 22%. As a consequence of these two situations, some of ESB's plant was necessarily operated in SEM at a higher level than forecast in order to make good part of the shortfall from other generation resources. The BGE

Whitegate plant is now operational and as a result ESB believes its market share projections for the coming years are more accurate than those included in the consultation paper.

Specific Comments Requested by SEM Committee

The following section provides ESB's corporate response to the three specific questions posed by the SEM Committee in Section 5 of the consultation.

Ability of AES to Exercise Market Power

The Directed Contracts mechanism both acts to neutralise the impact of any market power held by a Generator, by removing the incentive to exercise it, and also acts as the mechanism to provide hedging for all market participants against valid market outcomes. ESB believes that all market participants have a role to play in the contribution to contract liquidity levels proportionate to their capability.

ESB believes that the acquisition of Ballylumford Power Station by AES will have minimal impact on the ability of AES to exercise market power in SEM. However, at a local level in Northern Ireland, AES will have increased market power behind system constraints in the constrained running regime.

Ring-Fencing Licence Conditions

ESB does not believe that there is a requirement for any ring-fencing of generation businesses within the AES generation portfolio. ESB believes that ring-fencing would introduce additional costs to AES business, some of which over time could end up being passed to consumers. In addition, as a single entity, the applicability of ring-fences on AES seems irrelevant.

Additional Local Power Mitigation Measures

The primary method to minimise local market power of AES is through strict enforcement and monitoring of the application of the Bidding Code of Practice. However should that be deemed insufficient, ESB suggests that there may be a role for the imposition of Directed Contracts as the means for removing any incentive for abusing local market power, in the constrained running regime within the market.