



**Response by Energia to the SEM
Committee Consultation Paper SEM-11-106**

***Consultation Paper on Generator Financial Reporting
in the SEM***

3 February 2012

1. Executive summary

Energia welcomes the opportunity to respond to above consultation SEM-11-106 on generator financial reporting in the SEM. Energia is a member of the National Electricity Association of Ireland (NEAI) and fully endorses its response to this consultation. We also endorse the Irish Wind Energy Association (IWEA) response on this issue. Whilst appreciating the benefits of a transparent and competitive market Energia shares the NEAI and IWEA view that the proposals in SEM-11-106 do not effectively further these objectives in a meaningful, proportionate or constructive way.

It is Energia's considered view that the proposals in SEM-11-106 are:

- (a) Inadequately justified – they are unnecessary in the context of the SEM.
- (b) Disproportionate – they impose an unnecessary administrative burden on generators who already prepare and submit regulatory accounts. Notably the threshold is far too low at 20MW, and wind generation profitability is price taking, generally paid on a fixed PPA price and is impacted by wind yields to a far greater extent than by market prices – we do not see merit in trying to measure notional profitability in this case.
- (c) Misleading and commercially prejudicial – the proposals do not enhance transparency in a meaningful or constructive way, and importantly would result in the disclosure of commercially sensitive information, undermining privacy of contract. Moreover, some of the information required is hypothetical, and potentially misleading.

Energia supports wholesale market monitoring and generator reporting and believes the current market arrangements have delivered an appropriately high degree of transparency. We therefore challenge the basis for the proposals in SEM-11-106 and recommend instead that consideration be given to Regulation (EC) No 1227/2011 (REMIT) as the more appropriate vehicle for enhancing transparency and competition in a consistent way across Europe. We also suggest the SEM Committee should identify where the gaps in transparency are, their implications, and how these translate into matters for the regulatory authorities.

The remainder of this response is structured as follows. Section 2 provides an overview of the key proposals in SEM-11-106. Section 3 details Energia's concerns in relation to these proposals, and Section 4 contains concluding comments.

2. The proposals

It is proposed in SEM-11-106 that:

- (a) Key generator companies (i.e. companies with a combined capacity greater or equal to 20MW) will be required to submit a template described in section 6 of the Consultation Paper, the “Template”) to the RAs annually, in order to provide a ‘brief and clear’ financial reporting template on revenues and profitability.
- (b) Upon receipt of the completed Templates the RAs will publish the results and provide comparisons, where appropriate, with other markets¹.

The stated justification is as follows:

- I. There is genuine interest from stakeholders regarding the financial performance of generators operating in the SEM.
- II. The proposals are in line with practices in other markets such as the GB market where all large generators and suppliers are required to provide information on revenues and profitability and so the proposals will allow better comparisons between SEM and other markets as well as providing additional information to inform policy decisions.
- III. The publication of information on generators’ financial performance, especially with regards to profitability would increase transparency.
- IV. The principal objective of the RAs in the SEM is to protect the interests of consumers by the promotion of competition - increased transparency will assist in the promotion of competition.

Notably there is no reference to Regulation (EU) No 1227/2011 regarding wholesale energy market integrity and transparency (“REMIT”) in the consultation paper.

Respondents are asked to comment on any aspect of the proposals put forward in the consultation paper, and in particular on:

- 1) “...the proposed 20MW threshold and whether it is a suitable level to capture sufficient information while at the same time avoiding creating disproportionate administrative burden for smaller operations” (p. 11).
- 2) “...the appropriateness of publishing all of the [Template] information and in particular the green coloured lines marked with a “*” ...[a detailed breakdown of revenue and operating costs]” (p.13)².

¹ It is not clear what is meant by 'results' in this context, and this needs clarification.

² It is furthermore stated that “[w]hile it is the RAs preference to publish all of the above information, we will give due consideration to the views of respondents in this regard. Therefore it is requested that any stakeholders who have valid reasons why any of the information included in the reporting template should not be published should address this in their response, providing justification for their rationale” (p. 13).

3. Energia's concerns

As outlined in the executive summary it is Energia's considered view that the proposals in SEM-11-106 are:

- (a) Inadequately justified – they are unnecessary in the context of the SEM.
- (b) Disproportionate – they impose an unnecessary administrative burden on generators who already prepare and submit regulatory accounts. Notably the threshold is far too low at 20MW, and wind generation profitability is price taking, generally paid on a fixed PPA price and is impacted by wind yields to a far greater extent than by market prices – we do not see merit in trying to measure notional profitability in this case.
- (c) Misleading and commercially prejudicial – the proposals are inimical to enhancing transparency in a meaningful or constructive way, and importantly, would result in the disclosure of commercially sensitive information, potentially undermining privacy of contract. Moreover, some of the information required is hypothetical, and potentially misleading.

We discuss each of these concerns below.

(a) Justification for the proposals

The consultation paper notes that there is genuine interest from stakeholders regarding the financial performance of generators operating in the SEM. We agree that this is likely to be the case, as it would be in any other market. However, this is not a legitimate justification for the reporting and publication of commercially sensitive cost and revenue information. Reporting and disclosure should be subject to a threshold of reasonableness and proportionate interest bearing in mind the SEM Committee's objectives and a specifically identified transparency gap.

It is asserted that the proposals are in line with practices in other markets such as the GB market where all large generators and suppliers are required to provide information on revenues and profitability and so the proposals will allow better comparisons between SEM and other markets as well as providing additional information to inform policy decisions. We do not consider this legitimate justification for the proposals in SEM-11-106. We note that the information collected in GB, albeit under similar broad headings is collected in an entirely different context. We note for example that:

- i. The requirements in GB are less onerous than those proposed for the SEM (and this therefore invalidates much of the proposed advantages of comparison)

- ii. The GB regime is in response to an identified competition problem in that market and reporting requirements there are directed at large vertically integrated undertakings, with retail market power.
- iii. The determinant of the reporting requirement is the number of customers served (where the threshold is being revised to 250,000 customers), not the capacity of the generation plant.
- iv. Most importantly, the GB requirements are in the context of a significantly less transparent and regulated wholesale market and market monitoring regime. The GB market cannot be compared to SEM which has a single SMP (governed by SRMC bidding principles, a BCoP and the MMU) a single capacity payment, a feed-in-tariff based renewable support mechanism and a market for CfDs which is driven by regulated directed contracts.
- v. The GB market also has a very different infrastructure and generation mix.

The SEM Committee is not comparing like with like, it is misleading to draw conclusions based on such 'comparators'.

In terms of using the information to inform policy decisions, we note the following statement from section 5.2 of the consultation paper:

“The RAs have reviewed the regulated accounts supplied by generators internally in order to have a better understanding of the financial performance of generators operating in the SEM. The analysis covered a range of financial indicators including profitability and liquidity as well as projections of likely future profitability levels. The information provided through this analysis is used by the RAs to better inform their decision making process in matters of policy and with regards to the operation of the SEM.”

We would ask the RAs to clarify this statement, in particular confirming what information has been used to inform decision making to date and in what manner financial information has been used. If any (policy) decisions have been made by the RAs / SEM Committee by reference to a subjective assessment of the level of profitability of individual generators, this would be of particular interest. It is also relevant to have a specific understanding of the use to which information provided under the Templates would be put. We therefore ask the RAs to clarify this in the context of the SEM and also importantly vis-à-vis comparison with other markets.

It is argued that the reporting requirement set out in the consultation paper will promote competition by putting in place the necessary measures to ensure that there is an 'appropriate' level of transparency in the SEM. The consultation paper provides no justification for the basis on which the level of disclosure sought is considered 'appropriate' other than to assert that more information is better. No specific transparency gap is identified. In fact the SEM Committee notes in the consultation paper (and in other publications) that clear market rules and transparency in the SEM have played a part in encouraging investments in new generation capacity over the past few years.

In this regard we note that Article 9(7) of the SEM Order provides that:

"In carrying out any of the functions mentioned in paragraph (1) [the principal function] in accordance with the preceding provisions of this Article, the Department, the Authority and the SEM Committee shall have regard to –

- (a) the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed; (our emphasis)*
- (b) any other principles appearing to it to represent the best regulatory practice".*

Section 9BD of the Electricity Regulation Act 1999 (as amended, inter alia, by the SEM Act 2007, the "**1999 Act**") contains a similar requirement:

"The Minister, the Commission and the SEM Committee shall have regard to the objective that the performance of any of their respective functions in relation to the Single Electricity Market should, to the extent that the person exercising the function believes is practical in the circumstances, be transparent, accountable, proportionate, consistent and targeted only at cases where action is needed" (our emphasis)

We cannot understand how the proposals in the consultation paper can be reconciled with the above requirements to be proportionate and to do no more than is necessary. In order for the measures to be proportionate they should be aimed at achieving a specific objective, and not merely a sweeping requirement to publish more information. Furthermore,

- a) It is not correct that a natural extension of 'transparency' is to provide the information sought in the Templates.
- b) There is no issue of transparency in the SEM (as detailed in the NEAI response) and no action is needed to increase transparency as regards generator profitability.
- c) The requirement to publish commercially sensitive information in a disaggregated manner is entirely disproportionate to the objective of increased 'transparency'.

For the above reasons Energia would strongly suggest that the sweeping proposals in consultation paper SEM-11-106 are unnecessary, inappropriate and unjustified. We would also ask the SEM Committee to specifically clarify the grounds on which they consider information provided in the Templates to be capable of disclosure / publication.

(b) Proportionate regulatory requirements

As already discussed the proposals in SEM-11-106 are inherently disproportionate by not targeting a specifically identified transparency gap. They are also highly disproportionate in their proposed implementation as discussed in further detail below.

The proposals impose an unnecessary and unjustified administrative burden on generators who already prepare and submit regulatory accounts. There is no justification provided for targeting so-called 'key generating companies' (including all affiliates and related undertakings) with a combined installed (renewable and conventional) generation capacity equal to or greater than 20MW. There is no basis for this proposed 20MW threshold. Rather it appears a purely subjective choice by the RAs. This subjectively low threshold is entirely inappropriate, especially when licensed generating units already provide regulatory accounts to the RAs which includes a profit and loss account, balance sheet, and statement of cash flows.

Importantly, if there are individual generating units which do not provide regulatory accounts on an individual basis they should be specifically targeted for this information.

In any event and in the interests of proportionality;

- a) The threshold should be raised such that only generators with an appreciable impact on the market would be caught. We would suggest that the reporting arrangements should not apply to generators of less than 100MW.
- b) Price taking generators should be excluded because they, more than any other generator, earn only what the market will allow them to earn. Their costs are not relevant to market participants as they do not form the basis of their bids, and they do not set market price. Their profitability is driven by variable wind yield as well as market prices, both of which are outside their control.
- c) Generators should be required to report in respect of actual revenues only – hypothetical SEM revenues for non-participating generators should not be required. This would include the contrived and laborious requirement to reconcile the net difference between revenue earned in the pool by third parties and revenues earned by the generator under PPAs. All that is relevant to generator profitability is the revenue actually received. To require more is an unnecessary burden on the generators and third parties concerned. We should also note that regulatory accounts refer only to income received and expenses incurred, consistent with best accounting practice. To report otherwise could be very misleading.
- d) Moreover generators who do not participate in the market will not be capable of providing SEM revenue information. This is true of generators who appoint intermediaries to act on their behalf as well as to below de minimis generators who have no interface with the SEM (other than as negative demand) but who

are caught by the affiliates requirement. We would query the reasonableness of imposing on generators an obligation which they are not capable of complying with. It is essential that privacy of contract between a generator and supplier is not undermined by the proposed reporting requirements. The generator receives a PPA price, generally underpinned by REFIT or supported by ROCs, and is not influenced by market prices.

Apart from the subjectively low thresholds proposed, which differ significantly from GB, and impose an unnecessary administrative burden on the generators concerned, Energia has significant concerns about the granularity of information sought and its proposed publication. These concerns are discussed further below.

(c) Commercial implications

In addition to the substantial and legitimate concerns already expressed it is Energia's considered view that the proposals in SEM-11-106 would be commercially damaging. The proposed Template requires commercially sensitive information, specifically the line items marked with an asterisk, and Energia would have to resist the reporting and publication of these line items. The detailed information sought would also undermine privacy of contract and be irrelevant and contrived for some generators as already explained above.

Apart from significant commercial sensitivities, particularly in relation to PPAs, there is a real danger that the Templates would be misleading in making any comparisons. We have already made this point in relation to making comparisons with other markets, such as GB, but it is worth considering how the information could be misleading and damaging in other respects. The SEMC is, arguably, proposing that generators be asked to publish selective information which would allow market participants (including prospective market participants) to draw conclusions as to profitability, without having considered all variables. For example:

- a) Renewable REFIT supported generators are asked to detail their revenues from the SEM Pool, notwithstanding that they do not earn these revenues and may not have been capable of financing generation units on the basis of these revenues. For such generators, it is the contract price under a power purchase agreement that is relevant. 'Hypothetical' market revenues are misleading.
- b) Details of revenues from CfDs are sought without reference to any of the considerations on which a generator may have agreed a strike price, for example a repayment requirement for a funding arrangement or a long term supply agreement in the case of a vertically integrated utility. CfDs, like any other derivative, are a function of a company's risk strategy and whether or not such a contract is in the money in a given year may not give a realistic picture of whether a generator is 'profitable' in that year. We note that details of other derivatives such as interest rate, foreign exchange or fuel derivatives

- are not sought. Providing the information required in some instances would be clearly misleading to potential investors in the market.
- c) The information proposed provides a snapshot of generator profitability based on a selective breakdown of generator revenues / costs without any context.
 - d) Different accounting policies and financial year ends would make it very difficult to make comparisons on a like-for-like basis, and this could prove misleading.
 - e) Publication of CfD related information is problematic in relation to contracts with third parties in terms of confidentiality. It is essential that privacy of contract between a generator and supplier is not undermined by the proposed reporting requirements. The generator receives a PPA price, generally underpinned by REFIT or supported by ROCs, and is not influenced by market prices
 - f) Publication of CfD related information is also problematic on a generation site basis in terms of application. This is because allocation of CfDs on a generation site basis is inconsistent with the nature of the original hedge, and will not give an accurate reflection of that plant's CfD income - essentially the reporting is required in a way that is not consistent with the original financial contract. Directed Contracts, for example, are allocated on a company, not generation site, basis. Allocations of CfD volumes to units (as proposed) would lead to arbitrary choices being made by the generation business in terms of how such contracts were reported.

In conclusion, we have a real concern that information required in the Templates is inappropriate and commercially damaging. As proposed it would undermine privacy of contract between a generator and supplier. In this instance it should not be required and where information is otherwise commercially sensitive it would be incumbent upon the relevant regulator to ensure that disclosure was avoided or at least was proportionate to the objective to be achieved. We also have a concern that the proposed Templates could be very misleading, as explained above.

4. Concluding comments

Energia supports wholesale market transparency and monitoring and believes that the current market arrangements deliver this. The additional measures proposed in SEM-11-106 are not necessary, nor have they been adequately justified, or targeted where action is needed.

The proposals are disproportionate and impose an unnecessary administrative burden on generators who already prepare and submit regulatory accounts, particularly given the low threshold of 20MW – whilst we do not believe any further reporting is required, we note that price taking generation and generation under 100MW could in no way be seen to be significant in the context of the SEM. It is further argued that the Templates provide little incremental information and, significantly, may result in the disclosure of commercially sensitive information which

would be very damaging commercially – on this note we strongly argue that privacy of contract between suppliers and generators should be respected. Moreover, some of the information required is hypothetical, and potentially misleading. To address any concerns that the SEMC may have, we suggest the SEMC identify specific gaps in transparency, their implications, and how these translate into matters for the regulatory authorities.

We note that some generators may be required to publish information under the REMIT regulation over the coming months/years. This Regulation was specifically drafted and approved to support competitiveness in the European energy markets and in so doing to give confidence to stakeholders in the integrity of the market. We understand however that the obligations imposed by REMIT are unrelated to the information required under SEM-11-106, and we see no obligation in the REMIT Regulation which would justify the furnishing of the information sought by the Templates. REMIT provides an appropriate context to the RAs' objectives of enhancing transparency and competition as it seeks to achieve these objectives across Europe and to create a level playing field for all participants across the different markets. Energia would suggest that this provides a useful platform from which to progress the stated objectives in a proportionate manner.

We should also stress that adherence to best regulatory practice is paramount to investor confidence and this requires regulatory decisions to be justified, proportionate and aimed at achieving clearly identified and specific objectives. A sweeping requirement to provide and publish more information at a very granular level, that is contrived, onerous and commercially damaging, is contrary to the goal of promoting confidence in the market and Energia would urge the RAs to engage further with industry on this matter before taking any decision, especially in light of the REMIT requirements.

As a final point we would note that the consultation paper does not make clear to generators:

- a) the manner in which the information provided will be used;
- b) what level of analysis will be performed on the information provided, and what information will be published;
- c) whether disaggregated generator information will be published

We consider each of these issues to be of fundamental importance and interest to generators, and would query the effectiveness of the consultation where such key information is excluded.