



Generator Financial Reporting in the SEM

SEM/11/106

NEAI Response

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1 Introduction

NEAI represents the electricity industry on the island of Ireland. Its members include all the major electricity generators and suppliers within Northern Ireland and the Republic of Ireland, all of whom operate within the Single Electricity Market (SEM). NEAI is engaged in facilitating the improving operation of the electricity market in order to lower risk, ensure adequate generation for the needs of the island and to maintain electricity prices at competitive levels for the functioning of the economies on the island.

NEAI welcomes the opportunity to respond to the Consultation Paper on Generator Financial Reporting in the SEM (SEM-11-106).

We operate in a market that is recognised as operating well and yielding realistic prices. This has been reflected in a number of reports and these are summarised in the RAs' current consultation on SEM European Market Integration (SEM-12-002). In addition, this market has already attracted new entrants and has nurtured an increasing level of competition.

NEAI fully appreciates the benefits of a transparent and competitive market and the SEM Committee's objectives in this regard. However it is the NEAI's considered view that the proposals in SEM-11-106 do not effectively further these objectives in a meaningful, proportionate or constructive way. Our members are very concerned about the current shape and breadth of the proposed reporting framework, its intended function, its relevance, and adverse consequences. More specifically the NEAI's concerns relate to:

1. The context and justification of the proposed reporting requirements specific to the SEM, and whether they are reasonable and proportionate to the stated objectives;
2. The relevance of the proposals to Regulation (EU) No 1227/2011 regarding market integrity and transparency (REMIT); and
3. The legal imperatives and commercial consequences of the proposals, particularly in respect of publishing commercially sensitive information,;

The remainder of this response will cover each of the above concerns in detail.

2 Context and justification in the SEM

2.1 Transparency

One of the objectives of the SEM Committee is to “ensure transparent pricing in the Single Electricity Market¹”. Short Run Marginal Cost (SRMC) bidding principles and the Bidding Code of Practice (BCoP), overseen by the Market Monitoring Unit (MMU) are the tools in the market that provide assurances to the SEM Committee, market participants, consumers and other stakeholders that the market is working effectively from a price setting perspective.

Importantly the MMU, in its last published report², stated that:

“It is the view of the MMU that the SEM has produced outcomes in the study period that broadly align with expectation, given the suite of regulatory decisions and emergent trends in the input variables (demand, availability, wind, fuel prices and so on).”

A study by CEPA in December 2010³ also referenced the MMU Report of 2009 and the MMU observations with regard to price formation. Notably the report observed that:

“The highest SMP points coincided with highest demand periods during days; The movements of the SMP was in broad alignments with rises and falls in the underlying fuel prices and the carbon price; The SMP has tended to be inversely related to the available capacity margin; and The daily price profiles broadly follow the trends in GB balancing prices.”

In the SEM Committee Annual Report 2009 the SEM Committee commented on the effectiveness of price transparency in encouraging new entry in the wholesale market, as follows:

“A key objective of the SEM was to attract new and efficient generators to the island of Ireland. Because prices have been set transparently, the SEM creates a sound basis for new entry and investment, and the SEM Committee were delighted to see two, major utility companies buy into the all-island market (Scottish & Southern, and Endesa) in the past few years.”

Clearly the SEM Committee has itself confirmed that the mechanisms supporting price formation in the SEM provide sufficient transparency for market entry and continue to be very effective in promoting competition. This combined with the findings of CEPA and the MMU clearly confirm that the SEM Committee’s objectives of transparency in the SEM price formation process, and the effectiveness of these levels of transparency in encouraging greater competition through market entry, are being achieved by the mechanisms underpinning the wholesale market today.

Given the above it is the NEAI’s firm position that the proposals in SEM-11-106 are entirely unnecessary and unjustified. There are no specific transparency gaps identified in SEM-11-106 that could warrant or justify an obligation on so-called ‘key generator companies’ with a

¹ Section 9 of the Electricity Regulation (Amendment) (Single Electricity Market) Act 2007

² SEM 09-039 2009 Market Monitoring Unit Public Report 2009

³ Market Power and Liquidity in the SEM – A report for the CER and the Utility Regulator, 15 December 2010.

combined capacity of 20MW or more to complete the financial reporting template proposed in the consultation paper for analysis and for publication.

The NEAI rejects the use of transparency developments in the BETTA market as an appropriate comparator to SEM and this is expanded upon later in this response.

Additionally, the RAs have stated that stakeholders have a “genuine interest” in greater transparency. This may indeed be correct, but it is not necessarily sufficient reason to proceed with greater transparency. For example, all generators in SEM have a ‘genuine interest’ in the detailed financial performance of their competitors, however disclosures should be subject to a threshold of reasonableness and proportionate interest bearing in mind the SEMC & RAs objective is to promote effective competition.

The RAs have also stated that the financial reporting template they have proposed generator complete and submit for analysis and publication will be used to inform policy. This seems to imply that the RAs will use this information to place a cap on generator profits. NEAI would note that the island of Ireland has moved away from price control for generators, where their profits are capped. As outlined above, the RAs have set out market rules and a BCoP that requires generators to offer their energy into the market at their short-run marginal cost. These rules, monitored by the MMU and enforced by the RAs, are sufficient to ensure that generators are not earning supra-normal profits. NEAI can see no reason to justify providing detailed data on CfD positions or fuel-related operating costs to the RAs, or of completing a financial reporting template for every generating company with a combined capacity of 20MW or more, which invariably includes price takers and de-minimis units.

NEAI members question RA proposals to impose a separate and distinct layer of oversight for the reporting of information, the majority of which is already publicly available, under the conditions of both the generation license and the requirements of company law. The SEMC has a duty when performing its functions to be transparent, accountable, proportionate, consistent and targeted only at cases where action is needed. NEAI does not consider that the request for information meets these criteria. For these reasons, NEAI considers that the request for this information is not proportionate, nor is it targeted “only at cases where action is needed”.

In its own recent proposals, the European Commission has directly addressed the regulatory burden and undertaken to take measures to lighten it. This balanced approach to regulation versus cost is missing from this proposal.

2.2 Promoting competition

It is purported in SEM-11-106 that publication of the proposed financial reporting template on page 12 of the consultation paper for every ‘key generating company’ would help promote competition in the SEM. There is no clear justification or substantiation for this claim and NEAI would strongly argue that a sweeping requirement to publish more information does not necessarily enhance transparency nor does it take into account the significant negative consequences of what is proposed in pursuit of questionable and unfounded incremental benefits. NEAI would refer to the CEPA report already referenced, which in section 3.7 considered the evolution of profitability in the SEM. While the CEPA review of profitability was performed as part of its assessment of market power, it clearly demonstrates that sufficient information is available under existing reporting and publication arrangements in the SEM today (for example through the SEMO published components of wholesale price, spark spreads and price setting plant statistics) and from other sources to determine profitability levels across the market. Therefore, NEAI considers that the granularity of data proposed for reporting and publication by the RAs is unjustified to support major investment decisions by potential new entrants.

In any case NEAI considers that the real barrier to generator market entry in the SEM is the current connection process which elongates the timescale for new entry of any generators that are not already within the process, thereby making the perceived benefit of transparency of financial performance and profitability at a granular level ineffective in terms of new entry or investment decisions throughout the timeframe of Gate 3. NEAI considers that stimulus for new entry in the wholesale market could be best achieved through clarity on the Gate 4 process, a reduction in regulatory uncertainty, for example in terms of a decision on market integration and the accompanying principles of the enduring wholesale market.

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 NEAI would urge the RAs to engage further with industry on this matter before taking any decision.

3 Relevance of REMIT

Regulation (EC) No 1227/2011 (REMIT) was passed by the European Parliament in December 2011. 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 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 Reporting Template in SEM-11-106. In any event it is relevant that the REMIT Regulation specifically provides that National Regulatory Authorities will “ensure the confidentiality, integrity and protection of the information received” in its monitoring activities (Article 9).

4 Legal context and commercial consequences

The information requested in this consultation is of a confidential and commercially-sensitive nature - particularly at the levels of detail sought. Publication of such could create a market distortion due to the potential for significant information asymmetry between licensed generators and ‘unlicensed’ third parties. In the case of publicly-quoted companies, stock market distortion may ensue. Publication of CfD related information is problematic in relation to contracts with third parties in terms of confidentiality and 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. The NEAI notes that Directed Contracts, for example, are allocated on a company, not generation site, basis. Allocations of CfD volumes to units (as proposed) would lead to choices being made by the generation business in terms of how such contracts were reported.

The reference to ‘other revenue’ is ambiguous and, if the RAs continue to seek this information, it needs further clarification. At a minimum, we request that the RAs share their analysis of the benefits of their proposal in terms of further information publication significantly advancing the objective of increased competition versus the projected administrative costs and commercial risks imposed.

The transparency obligations as proposed by the RA have the real potential to result in disclosure of commercially sensitive data in respect of contracts and particular categories of costs or outlays. This could relate to situations where a given generator incurs such cost from one contract or dealings with one other party in the market and this fact or the existence of this contract is known (but the commercial details of same are not) within the market.

Similarly, where a generator incurs costs through contract(s) with third parties who are not part of the market, e.g. fuel suppliers, then publication of the costs by the RAs would compromise the commerciality of these arrangements or follow-on arrangements. Other examples in this regard include PPA contracts and under the heading of non-fuel operating costs could include maintenance contracts, where transparency of these costs could provide information to equipment suppliers etc that would be detrimental to the commercial negotiation strength of the SEM generator in question with these equipment suppliers over time, which would result in higher costs for end-customers.

The risks arising from exposure of commercially sensitive information through publication by the RAs of granular financial performance data are numerous across our members and in addition could have a wider market-impact. NEAI considers the publication of further information in relation to generators' revenue and operating costs, beyond that which exists today or can be derived from information currently published by the RAs, SEMO or other publicly available sources, to be excessive and unjustified. NEAI considers the publication of generator financial performance information to be detrimental to the effective working of the SEM.

Our members are aware of the level of reporting that has been introduced into the GB market as a result of concerns over the lack of transparency of its bilateral market. However, these concerns do not exist in the SEM given its structure and market rules, as referenced earlier in this response. The reforms in BETTA were introduced due to widespread concerns about dominance and market abuse in the market and its impact on prices faced by the customer. The GB market lacks a transparent pool price, regulatory supervision such as the BCoP and the MMU and the recognised effectiveness of the SEM in terms of price setting. The GB market is not an appropriate comparator with respect to publication of financial information and should not inform policy in the SEM in this regard. In addition to the documented views of the SEM Committee with respect to the recognised effectiveness of SEM transparency in furthering competition through market entry, a view with which NEAI completely agrees, NEAI further considers the granularity of the reporting and publication contained in this proposal, which is in excess of those introduced into GB, to be unnecessary and disproportionate. GB financial reporting occurs at a more aggregate level to the disaggregated 'generator site' reporting unit proposed here.

Overall, we believe the proposed reporting and publication requirements are not necessary to encourage competition and attract new entrants into the SEM. In addition, the level of granularity proposed is excessive and likely to be detrimental to commercial arrangements underpinning the success of the SEM to date. The consultation lacks any analysis or comparative evidence outlining the actual benefits that will be garnered from this initiative. From a legal perspective NEAI would note that Article 30 of Directive 2009/72/EC concerning common rules for the internal market in electricity provides a clear message in relation to confidentiality of commercially sensitive information:

Article 30 Right of access to accounts

- 1. 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.*

2. *Member States and 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.*

In addition, Article 63 of the Energy (Northern Ireland) Order 2003 sets out the general restrictions on disclosure of information obtained under the Order and limits the Utility Regulator to only publishing information with the consent of the party, except in a list of exceptional circumstances:

General restrictions on disclosure of information

63.—(1) Information which—

(a) has been obtained under or by virtue of the provisions of this Order, Part II of the Electricity Order [F1, the Electricity (Single Wholesale Market) (Northern Ireland) Order 2007] or Part II of the Gas Order; and

(b) relates to the affairs of any individual or to any particular business, shall not be disclosed during the lifetime of the individual or so long as the business continues to be carried on, except as provided below.

(2) Paragraph (1) does not apply to a disclosure made with the consent of the individual or the person for the time being carrying on the business.

(3) Paragraph (1) does not apply to a disclosure if—

(a) it is made for the purpose of facilitating the performance of any functions of the Department, the Authority, the Council or the Competition Commission under the Electricity Order [F2, the Electricity (Single Wholesale Market) (Northern Ireland) Order 2007], the Gas Order or this Order;

(b) it is required by a notice under Article 31 or 59 of the Electricity Order, Article 30(1) or (2) of the Gas Order or Article 51 or the information has been obtained in pursuance of a notice under Article 30(2) of the Gas Order;

(c) it is made by a licence holder and is required to be made by a condition of his licence; or

(d) it is made by one licence holder to another and is required by that other licence holder for purposes connected with the carrying on of activities which he is authorised by his licence to carry on.

Furthermore, for the sake of consistency in the all island market it is relevant to highlight a disparity in the license condition regarding the provision of information between Northern Ireland and ROI.

Taking account of both the over-arching European context and the legal context in ROI and NI, NEAI believes that the proposals outlined in the latest consultation go over and above the requirements of the Regulatory Authorities and in so doing impede on the commercial interests of the SEM's market participants.

5 Conclusion

The SEM Committee considers the SEM to be working effectively in terms of price formation and has commented publicly on the effectiveness of the existing level of price transparency in encouraging new entry into the wholesale market. NEAI does not share the RA view that further publication of generators' financial performance would lead to increased competition in the SEM.

Our members would greatly appreciate the opportunity to meet with you immediately in order to gain further understanding of the underlying needs and intentions of the proposals and to outline our concerns with respect to the proposals' implications for commercial sensitivity. Recognising the RAs' objective of enhancing transparency and competition in the SEM, the NEAI is firmly of the view that this can be achieved in a more proportionate manner than proposed in the consultation and without impinging on the commercial arrangements in place between parties in the market or between generators and other third parties. Regulation (EC) No 1227/2011 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. The NEAI would suggest that this provides a useful platform from which to progress the stated objectives in a proportionate manner.