Response to

SEM Committee Consultation Paper on Generator Financial Reporting in the SEM

(SEM-11-106)

3 February 2012

Introduction

SSE Renewables strongly opposes the proposal by the SEM RAs to require the reporting and publication of financial performance information on generators at a level that exposes commercially sensitive information and on individual site basis. While we acknowledge the RAs' rights under legislation and as provided for within the current SEM generator licences, to receive financial information for the purposes of assessing the financial capability of licensed entities, we challenge both the levels of detail proposed, as well as the intention to publish such information.

Our contention arises from various issues which in our view renders the proposal entirely unacceptable. No clear policy objective has been articulated for the proposal. The principle of transparency and an associated effect of improving competition are offered in very broad terms as justifications, but there are no particulars on what the proposed regulatory intervention is intended to alleviate. **No specific matter of regulatory concern has been identified, no detrimental effects on the market in general or on specific parts have been delineated, measured and demonstrated and no alternative options for mitigation have been considered. We hold the view that these are all necessary steps to be taken prior to the selection of a measure best thought to mitigate an identified concern**.

Furthermore we view that the proposal in no way addresses the primary duty and constituency of the RAs – that of protection and of consumers. Rather the proposal seeks to satisfy the interests of an undefined grouping of stakeholders who can already obtain sufficient and varied financial information on the performance of generators in the SEM from other sources.

Subsequently we address the reference made to an Ofgem requirement as a comparator for the proposal. A number of issues are highlighted in this section, none the least of which include the structural differences between SEM and BETTA, as well as the clear process of problem identification and assessment employed in reaching the decision to implement the referenced requirement.

Finally we address the complete lack of assessment carried out to identify and weigh the adverse impacts implementing the proposal could have, even to competition and protection of consumers. For example, no consideration has been given to the possibility of the public availability of certain cost information between competitors to lead to inadvertent coordination between them.

Policy Objective

No evidence to how competition is improved

The measure under consultation has been proposed with the policy objective of increasing transparency, which is then automatically assumed to facilitate more effective competition. This establishes a blanket premise; no particulars are identified – the specific issues and concerns that are detrimental to the proper functioning of the SEM that the proposed measure is intended to alleviate.

Proposing disclosure of commercially sensitive information on SEM generators as a basis for promoting competition in the SEM, working backwards, must presuppose that some aspect of competition in the SEM is failing and that the proximate cause for such failing relates to the non-disclosure of the identified financial information. This consultation does not identify any such failings in competition; neither in general nor from financial information non-disclosure. In fact the contrary is the case.

In a recently published regulatory decision paper, the "SEM spot market at present is [described as] quite highly concentrated...[but] the SEM Committee is satisfied that there has been no significant market power exercised in the spot market to date due to the relevant market power mitigation measures in place"[1]. In fact market power concerns arising from legacy structures in the Irish electricity industry constitute the primary competition issues in SEM and to large extent specific measures have been designed and introduced to mitigate each identified areas of concern.

<u>Specific competition mitigation measures and concerns addressed in the SEM</u>

To illustrate, measures that have been introduced in the SEM and the issues of competition they have been intended to address include:

- SRMC basis of bidding and the Bidding Code of Practice to ensure cost reflectivity in generator bidding;
- DCs requirement, with pricing conducted by the RAs, to reduce the overall volumes incumbents can independently price;
- price cap and alternative pricing mechanism for when SMP crosses a threshold of €500/MWh to protect consumers from price spikes;

[1] SEM Committee Decision on SEM Market Power and Liquidity, 1st February 2012, p.3

- the MMU to actively monitor market actions and ensure compliance;
- asset transfer agreement between the Commission and ESB to reduce dominance in capacity, which as well facilitated the market entry of Endesa.

Each of the measures listed above have followed the pattern of identification of an issue of concern, demonstration and measurement of the potential detrimental effects on the market, identification and consideration of various options for mitigation, and finally selection of a measure best thought to mitigate the identified issue. Each one was designed to address generally understood and well-specified concerns. It could (and still can) be demonstrated how the absence of any of the measures would lead to a deterioration in competition within the SEM.

However the same cannot be said of the current proposal. No basis has been advanced to explain how non-disclosure of commercially sensitive information would be damaging to competition and thus the necessity for disclosure. No particulars are discussed of how transparency is lacking in the SEM in the area of financial disclosure, given the various features discussed above that are currently operational, what evidence exists for such lack and how such lack impinges on competition in the SEM.

With the foregoing discussion, it begs the question of **what policy objective is being pursued in requiring publication by generators of commercially sensitive information**.

<u>Further questions on policy objectives</u>

Given the insufficient attention that has been given to the question of policy objective, and in light of the detail of information required, a number of questions arise that need to be addressed. These include:

- With the requirement of information on site-specific level, would regulatory policy now be developed at plant level? For instance would plant dispatch be changed to redistribute market revenue?
- With non-Pool revenue and cost items requested, would SEM design changes be made to utilise the new information?

Principles must be balanced

The RAs have relied on the principle of transparency in informing their proposal. This we believe has been derived from provisions contained within the respective jurisdictional legislation establishing the SEM[2].

Applying the principle of transparency alone is an unbalanced treatment of the legislative provisions and goes against the grain of the other principles that ought to govern the activities of the RAs and the SEM Committee, specifically the principles of *proportionality and targeted action only at cases where action is needed*. It is our view that it incumbent on the RAs to balance the various governing principles in any activity they consider undertaking. In the case of the proposal under consultation this would require an identification of a specific concern or concerns being targeted (beyond increasing transparency, which would be circular reasoning), how the proposal sufficiently address those concerns and equally ensuring that any measure selected would be proportionate in effect – deriving specified benefits to the RAs primary constituency (consumers), but equally to market, as well as to other identified interests that would impacted by such a measure.

[2] NI Article 9(7) of the SEM Order and ROI Section 9BD of the Electricity Regulation Act 1999 (as amended, inter alia, by the SEM Act 2007, the "1999 Act")

Primary Duty and Constituency

No evidence to how protection of consumers is achieved

The consultation points to the RAs primary duty to protect the interest of consumers, principally through promotion of effective competition. Quite, and rightly so. However the consultation refers to an unnamed group of stakeholders with genuine interest regarding financial performance of SEM generators. It is not clear however who these stakeholders are and what duty the RAs owes them.

Stakeholders with genuine interest regarding financial performance of generators operating in the SEM is one thing, but why those stakeholders should be facilitated to such commercially sensitive information as proposed by the RAs is another. We fail to see how the satisfaction of the interests of an unnamed but presumably broad grouping by the RAs relates to the primary duty of protecting consumers.

Much of the requisite financial information on generators in the SEM is readily available from various sources – the CRO (and equivalent NI agency) and SEMO to name two. Stakeholders with interests ought to make their own efforts to gather and aggregate such information themselves. In fact the CRO charges a non-prohibitive fee of €2.50 per full set of financial statements. It is our contention that the financial information publically available from those two sources alone is sufficient to satisfy all legitimate interests in such information.

Hence we fail to see how committing the resources of generators to satisfy the undefined interests of undefined stakeholders, particularly when such stakeholders can procure relevant information from public sources, serves the RAs primary duty of protecting consumers.

If there is indeed a specifically identified informational requirement that is currently not available, and a cogent rationale for why the absence of such an information represents a gap in satisfying the primary duty of the RAs and the SEMC, then the RAs should be consulting on how such a gap can be remedied in a proportionate and balanced manner with due regard to the varied interests of affected stakeholders, including generators. We do not believe that this is the case here and nothing in the consultation alludes to such an informational deficiency.

Specific Regulatory Powers Relate to Ensuring Financial Capability

With regard to relating the financial performance of generators to the primary duty of protecting consumers, quoting from s.9BC2(b) of the Irish Electricity Regulation

(Amendment) (Single Electricity Market) Act 2007, *"...the Commission and the SEM Committee shall carry out their respective functions...in the manner which each considers is best calculated to further the principal objective, having regard to— the need to secure that authorised persons are able to finance the activities which are the subject of conditions or obligations imposed by or under this Act or the Internal Market Regulations or any corresponding provision of the law of Northern Ireland*".

The powers to ensure the financial capability of authorised persons is related to the specific primary duty to protect consumers. That requirement is sufficiently satisfied by the current licence provisions. The measure under consultation, in our view goes beyond seeking to *secure that authorised persons are able to finance the(ir obligated) activities* as a means to *further the principle objective* of protecting consumers, as it seeks for information that has no bearing on SEM competition or prices (for example non-Pool revenue and non-Pool operating costs), information that are arguably non-SEM matters.

Ofgem and the GB Market

Use as comparator misrepresents underlying differences

The consultation makes reference to an Ofgem requirement for large vertically integrated generators to publish information on the level of profits earned. The RAs state that this will enable comparisons of "generator profitability in the SEM with the profits earned by generators in Great Britain". If this is indeed an objective of the measure under consultation, it then is hard to understand the need for the measure under consultation. What Ofgem introduced recently was a requirement for "the Big 6 suppliers to publish **separate regulatory accounts** for their supply and generation businesses"[3].

The requirement to maintain separate (regulatory) accounts for generation businesses has existed in the SEM right from the beginning. Hence the requirement for equivalent information for comparison, presupposing that meaningful conclusions can be drawn from such activity, already exists within the SEM generation licences.

Ofgem Energy Probe – problems of market entry

However since the reference has been made, we will examine in a little more detail the context for the Ofgem requirement. That requirement forms part of a raft of other requirements that Ofgem introduced following its 2008 Energy Supply Probe. The probe was instituted to address "[c]oncerns [that had] been expressed about the operation of Great Britain's gas and electricity retail supply markets for domestic and small business consumers"[4]. The requirement to publish separate accounts stemmed specifically from concerns relating to "*the economics of new entry and the experience of companies trying to enter the energy market"*. The probe then identified specific evidence to support allegations of failings in this area. For example it states that "Of the 14 small suppliers who have entered since market opening, only four remain and none have succeeded in building a scale of business close to that of the Big 6 suppliers."[5] After examining a wide range of issues it concluded that there were a number of failings in the GB market in the area of market entry, stating that:

- "Over the last five years the number of new entrants into GB energy supply markets has decreased substantially;

[3] Ofgem Energy Supply Probe – Initial Findings Report, 6th October 2008, p.14

[4] Ibid p.1

[5] Ibid p.61

- "Of those new entrants that have remained, none have built scale close to that held by the former incumbent suppliers: there is no sizeable "competitive fringe";
- "Amongst a number of significant barriers to entry, the effect of the pricing policies of the Big 6 suppliers and low levels of electricity market liquidity appear to be the most significant."[6]

Only then does it propose the requirement to publish separate accounts as a measure "to improve transparency and make it easier for potential entrants to assess market opportunities at each point along the value chain"[7].

We have argued in preceding sections that in their consultation, the RAs have failed to advance the failings to which the measure they propose addresses. **If we extend the reference to Ofgem's requirement to suggest that the proposed measure is to address market entry, no evidence is in view to suggest that significant new entry has not been achieved in SEM**.

Crucial point of difference between SEM and BETTA – price transparency

The point regarding pricing policy most clearly relates the underlying structural issue leading to the concerns – the fact that the GB market is a bilateral market, with most trades outside of public view and hence with no transparency on pricing. The SEM, with its gross mandatory pool arrangements, has open market access, total transparency and total liquidity regarding (spot) pricing. Furthermore competitive pricing in SEM, as already identified, is ensured by elements such as the SRMC and Bidding Code of Practice requirements, as well as by the functions of the MMU. These are all favourable points regarding the SEM that the RAs have consistently made in discussions on Regional Market Integration.

In light of the discussion thus far, it is with consternation that we view the proposal to require and publish the level of detailed commercially sensitive information on generators in a market that exhibits such high levels of transparency, with already existing requirement for maintenance of separate generation business financial account, with the intention to facilitate comparison with a market without such features.

[6] Ibid p.70

[7] Ibid p.14

Market entry concerns in SEM do not relate to lack of detailed financial information

The primary hindrances to generator market entry in SEM in no way relate to lack of detailed financial information as being proposed. The hindrances arise from the uncertainties around various policies, primarily policies surrounding connections to the grid and dispatch order of plant. The proposed measure would in no way address these more fundamental barriers to entry, if indeed that is the unstated policy objective of the proposed measure.

Regulatory Impact Assessment

No consideration given to full effect of proposal

Finally, there has been no analysis carried out to assess the impact of the proposals. No specific benefits have been identified, nor have costs and other commercial implications, to weigh each category against the other in a bid to determine the full effect of the proposed measure. While we cannot identify any benefits that will arise from the implementation of this measure, we certainly can identify potentially significant damages that are likely to result – to generators, to commercial relationships in and out of the SEM and perhaps even to consumers.

Unravelling of existing contracts

Requiring and releasing such detailed financial information, on a site-specific basis, information which would be of a highly sensitive commercial nature, is likely to lead to breaches of contracts. The information could be used to work-back the commercial details for various contracts – power purchase prices, fuel supply, service and maintenance, land lease options (particularly for wind farms); in each situation such revelation could seriously damage the negotiating abilities of a generator in future dealings. With existing contracts serious damage is likely to be done to commercial relationships where different commercial terms in similar contracts between different parties can be worked-back. Commercial relationships between generators on the one hand and power purchasers, land owners, service providers and fuel suppliers on the other could all be seriously impaired by the proposed measure.

Introduction of confusion

There is also failure to consider the confusion that could be created by underlying differences that may be reflected in the proposed reporting – misalignment of financial reporting periods, different cost structures (for example thermal plants with fuel costs compared with wind farms with virtually no variable input costs).

Detrimental effect on competition and consumer protection

Furthermore no assessment has been done as to how the publication of this detail of financial information could affect competition in general and even undermine the duty to

protect consumers. **The perceived lack of public access to certain information supports an important principle in competition – prevention of coordinated action by market participants**. In order to stay competitive in light of certain information asymmetry, firms can only make educated guesses as to the cost structures and components of their competitors and thus will strive to lower their costs as much as possible. If that information however were to be publicly disclosed, it could perceivably lead to coordination of market actions by competitors, where firms strive only to match or slightly better the costs of their competitors.

Increase in administrative burden, as well as undermining of SEM intermediary provisions

No assessment has been done as to the administrative burden that will be placed on generators, particularly wind farm operators with multiple sites, to comply with the regulation. Neither has the potential unravelling of the intermediary provision in SEM, which not only allows third-party's bid for generators in the SEM, but also collect revenues on their behalf and perhaps remit payments on fixed contract price. In such cases, the intermediary arrangement would have shielded those generators from developing the very detailed books, procedures and staff necessary to disaggregate revenues to the extent being proposed, allowing them maintain simple P/L accounts sufficient for the needs of their financial covenants. The proposed measure could potentially negate some of the value that the intermediary provision enables in the SEM.

Given the foregoing discussion, we would argue that at the very least an impact assessment ought to be conducted to assess the impacts to all stakeholders likely to be affected by the measure being proposed.