



Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

**Interim ESB Electricity Generation Licence
Comments Received and Commission's Response**

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Table of Contents

1.	Background	- 3 -
2.	Respondents	- 4 -
3.	Summary of Comments Received and Commission’s Response.....	- 4 -
3.1	Licensing Process.....	- 4 -
3.2	General Licence Comments	- 4 -
3.3	Part I of Licence – Terms of the Licence	- 5 -
3.4	Condition 1 - Interpretation and Construction.....	- 5 -
3.5	Condition 2 - Separate Accounts for the Generation Business	- 6 -
3.6	Condition 3 - Approval of electricity provision by the Commission..	- 7 -
3.7	Condition 4 - Prohibition of anti-competitive behaviour	- 7 -
3.8	Condition 5 - Prohibition of cross-subsidies.....	- 8 -
3.9	Condition 6 - Separation of Generation Business.....	- 10 -
3.10	Condition 10 - Central Despatch	- 11 -
3.11	Condition 11 - Ancillary Services.....	- 11 -
3.12	Conditions 12 and 13 - Connections to and use of the Licencee’s system	- 11 -
3.13	Condition 19 - Directions etc by the Commission	- 12 -
3.14	Schedule 1 of Licence.....	- 12 -

1. Background

In accordance with Regulation 16(e) of the European Communities (Internal Market in Electricity) Regulations 2005 (“SI 60 of 2005”), on 6th October 2005 the Commission for Energy Regulation (“the Commission”) published for comment its proposed Interim Licence to Generate Electricity to ESB. The proposed ESB Interim Generation Licence covered the generation of electricity from ESB Power Generation’s (PG’s) existing generation stations, and was based on the current generic licence for generators in the Irish electricity market, issued under Section 14 (1)(a) of the Electricity Regulation Act, 1999.¹

The proposed Interim Generation Licence also contained additional conditions appropriate to ESB’s position in the electricity market as a vertically integrated utility. These included:

- Condition 1, which includes a definition of “Business” as follows:

"Business" means any business or activity of the Licensee, or any affiliate, or any related undertaking of the Licensee, other than the Generation Business";

- Condition 3, which requires that ESB only provides or purchases electricity on terms approved by the Commission;
- Condition 4, which prohibits anti-competitive behaviour by ESB;
- Condition 5, which prohibits cross-subsidies and the transfer of commercially sensitive information to/from the Generation Business and any other activity within ESB; and
- Condition 6, which requires ESB to ensure the complete separation of the Generation Business from any other ESB activity, so that it is operationally and managerially independent. This is subject to the approval of the Commission and includes a code of conduct on the transfer of staff between ESB business units.

Comments from interested parties on the proposed Interim Generation Licence were requested by 28th October 2005. This paper summarises the comments received on the proposed Licence and provides the Commission’s response.

Following a review of comments received, the Interim ESB Generation Licence is also published on this date at www.cer.ie, thus completing Stage 1 of the licensing process.

Stage 2 of the licensing process will be implemented in the context of the Single Electricity Market (SEM) operating from July 2007. In this Stage the Commission will undertake a comprehensive review of all Generation Licences,

¹ This generic licence can be viewed on the Commission’s website at: http://www.cer.ie/CERDocs/Generation_Licence.pdf.

including ESB's. This will involve a review of the licence terms and conditions to apply to the ESB Generation Business, followed by the issuing of a final Generation Licence to ESB (superseding the Interim Generation Licence), to ensure compliance with the SEM and all other legal requirements. Stage 2 will commence in advance of the SEM and involve full consultation with all interested parties.

2. Respondents

The following parties commented on the proposed ESB Interim Generation Licence:

- Airtricity;
- Viridian Power and Energy; and
- ESB (also covering ESB PG's response).

3. Summary of Comments Received and Commission's Response

Comments received to the consultation are summarised, categorised and responded to in the following subsections.

3.1 Licensing Process

One respondent stated that Stage 1 of the licensing process does not need to finalise conditions which require a greater understanding of how the SEM will operate, as this could disadvantage ESB Customer Supply (CS) customers compared with Northern Ireland Electricity (NIE) Public Electricity Supply (PES) customers. All parties participating in the SEM need to be treated in an equitable manner and this needs to be borne in mind when finalising the interim licences.

Commission Response

Stage 1 of the licensing process involves the Commission issuing ESB PG with an Interim Generation Licence and therefore does not need to finalise on conditions relating to the SEM. In Stage 2, the Commission will undertake a comprehensive review of all generation licences, including ESB's. This will involve a review of the licence terms and conditions to apply to the ESB Generation Business, followed by the issuing of a final Generation Licence to ESB, to ensure compliance with the SEM.

3.2 General Licence Comments

One party welcomed the draft licence, in particular the introduction of an explicit power for the Commission to publish information provided by ESB PG,

the broad scope of the prohibition on anti-competitive behaviour and the entrenching of business separation between the various business activities of ESB.

Another party also welcomed the draft licence, although it stated that it should apply to each station in ESB's portfolio, such that there can be no cross-subsidy and generators cannot act in concert. It queried:

- (a) Why a general non-discrimination provision in relation to the sale of electricity is not included, when the generic licence contains such a provision for dominant generators?;
- (b) What the Commission can do to enforce this licence, given that termination does not appear practical?; and
- (c) Why the dual fuel requirement applies to independent generators and not ESB?

Commission Response

- a) The general non-discrimination provision is not required in ESB's Interim Generation Licence because Condition 3 of the Licence requires that ESB only provides or purchases electricity on terms and conditions approved by the Commission.*
- b) The Commission may issue a direction or determination to ESB, pursuant to the Electricity Regulation Act, 1999 and SI 60 of 2005, if it is of the opinion that ESB is in contravention of a licence condition. The Commission may terminate ESB's licence to generate from its power stations giving 30 days notice if ESB fails to comply with a direction, determination or order issued.*
- c) The condition requiring dual fuel operation is currently contained within the Authorisation to Construct or Reconstruct a Generating Station, as issued by the Commission, and is applied in respect of gas stations.*

3.3 Part I of Licence – Terms of the Licence

One party queried the lack of additional language in paragraph 3 relating to the determination of the licence in respect of individual stations, as is contained in the generic Licence.

Commission Response

Part I of the generic Generation Licence does refer to a licence determination date, but this is not included in ESB's licence due to its interim nature. It is the Commission's intention that the ESB Interim Generation Licence shall continue in full force and effect until the final Generation Licence supersedes it.

3.4 Condition 1 - Interpretation and Construction

One party queried the following definitions:

- a) “Power Purchase Agreement” and “Trading and Settlement Code” - there is no term in the licence that indicates that it will be revoked and reissued with the start of the SEM. These definitions only apply to pre-SEM conditions;
- b) “Public Electricity Supply Business” - this definition should be amended to capture the PES business, even if it is not yet licensed;
- c) “Transmission System Operator” - this definition does not appear to work as the holder of the TSO Licence is not the person currently performing the TSO function.

Commission Response

These definitions will be reviewed in Stage 2 of the licensing process, which includes issuing ESB with a finalised Generation Licence, taking account of all legal requirements and the SEM.

3.5 Condition 2 - Separate Accounts for the Generation Business

One respondent fully supported the requirement that regulatory accounting information will be made available to the public, stating that it is important that the Commission’s requirement for data is published at a sufficiently detailed level to allow for public scrutiny.

Another respondent noted that the accounting condition does not require the detailed transfer pricing information to be published, nor does it provide for the provision of information on individual generating stations, with the latter running counter to CER’s previous policy (MAE Paper CER/04/189 of May 2004). There is a case that dominant generators should be required to publish bids, marginal fuel costs, other marginal costs, other avoidable costs, total costs and total revenue in respect of each power station.

The respondent also expressed concern that there may be a legal question as to whether accounting information can be published - and other participants would be relying on Commission to act efficiently in their interests.

Commission Response

Subsequent to the issuance of the Interim Generation Licence, the Commission will approve guidelines governing the format and content of the regulatory accounting information to be provided by ESB PG. These guidelines will be published at a sufficiently detailed level, taking account of ESB PG’s position in the electricity market.

The Commission will consider whether to publish ESB PG’s regulatory accounting information, as provided for under Condition 14 of the Interim

Generation Licence, having due regard for the need to protect confidential information.

3.6 Condition 3 - Approval of electricity provision by the Commission

One respondent believes the Commission's power to approve the terms/conditions of electricity provision interferes in normal commercial relationships and is likely to cause delay, inefficiency, and inhibit innovation. However, it is not clear whether the wording of the condition actually gives the Commission the ability to dictate the terms and prices of Contracts for Differences (CfDs).

The party recommended that this condition sets out the minimum criteria which must apply in respect of any contract for the supply of electricity to any other business of the Licensee, including that such obligations be at arms length and transparent, including the types of obligations set out in Condition 3.4 of the standard Generation Licence. It is unclear why an equivalent Condition does not appear to be included in this Licence.

Commission Response

The Commission currently regulates the commercial arrangements for the sale of electricity from ESB PG to ESB PES pursuant to Regulation 3 of SI 60 of 2005. The regulation of generation costs has the objective of, among other things, protecting the interests of final customers and promoting effective competition.

The volume, allocation and pricing of directed contracts in the SEM will be determined by the Commission with the objective of mitigating market power.

Condition 6 of the Interim Licence – Separation of Generation Business – requires that all contracts be entered into on an arms-length basis and on normal commercial terms, unless otherwise approved in advance by the Commission.

3.7 Condition 4 - Prohibition of anti-competitive behaviour

One respondent noted the absence of prohibition of any particular behaviour in the condition and stated that the condition should probably be extended to the market for ancillary services. Another respondent stated that this condition should prohibit the particular aspect of trading where ESB PG can use the availability or bidding strategy of its portfolio of plant to affect the value of energy attributable to other market participants.

In addition, once respondent asked that the Commission confirms that ESB PG is in a dominant position from the date of licence issue, while another respondent also stated that the issue of dominance should be addressed in this condition.

Commission Response

This condition requires that ESB PG does not engage in any activity which prevents, restricts or distorts competition. The Commission may issue a direction or determination to ESB, pursuant to the Electricity Regulation Act 1999 and SI 60 of 2005, if it is of the opinion that ESB is engaging in such activity.

The Commission is comprehensively examining and consulting on the issue of ESB dominance in the context of the SEM. In the meantime, the conditions prohibiting anti-competitive behaviour and cross-subsidies apply to ESB irrespective of whether it is declared dominant.

3.8 Condition 5 - Prohibition of cross-subsidies

Once respondent asked that the Commission issues guidance as to what constitutes a cross-subsidy. It stated that if the licensee does disclose commercially sensitive information to other Businesses of the licensee, this should be published.

The respondent believes that the cross-subsidies prohibition is adequate for a normal business with market power, but does not prevent a cross-subsidy between power stations. The condition should probably also include a reference to the market for ancillary services. The respondent also asked that the Commission confirms that ESB PG is in a dominant position from the date of licence issue.

Commission Response

The Commission reserves the right to determine what constitutes a cross-subsidy. If a cross subsidy does occur, the Commission will take appropriate action, which could include issuing a direction or determination to ESB.

The Commission will examine the issue of cross-subsidies between ESB PG plants, and dominance of ESB PG, in the context of the SEM and Stage 2 of the licensing process. In the meantime, the conditions prohibiting anti-competitive behaviour and cross-subsidies apply to ESB irrespective of whether it is declared dominant.

One respondent stated that while the draft licence provides for information flows “pursuant to arrangements or agreements approved by the Commission” this is still unacceptable for the following reasons:

- Governance of ESB is at the discretion of the Commission. Any provision such as this, which seeks to limit the proper flow of information within the ESB, will impair the ability of the Board of ESB from taking account of the impact of its decisions on individual Business Units and the company as a whole. Therefore, Board Members cannot exercise due diligence in the discharge of their duties and cannot have adequate oversight of the affairs of the company, which is in breach of their legal obligations. They will also be acting in breach of their responsibilities under the Code of Conduct for the Governance of State Bodies. A licence provision which requires Board

members to act in conflict with their duties under company law would itself be in conflict with company law.

- The arrangement is in itself restrictive as ESB would need perfect foresight of the information necessary to ensure proper governance, which in a changing business will not always be possible.
- It creates a situation where ESB PG could determine whether or not ESB Corporate Functions personnel should be either given a particular piece of information or even be made aware of the existence of that information.
- It would make commercial funding of ESB impossible. The lending institutions deal with ESB on the basis of the financial position and performance of all the businesses within the ESB organisation and the “blended risk” that this span of businesses gives them. It would also induce breaches of standard covenants in ESB’s loan documentation requiring the provision of information to the lenders and the certification by ESB of ongoing compliance in its operations. Similar considerations arise in connection with insurance and with the management of personnel and labour relations matters.

In addition, the respondent stated that this condition is unwarranted, unsupported by precedent in other jurisdictions, discriminatory, premature, and disproportionate, as follows.

- There is no provision in legislation which expressly permits the Commission to licence ESB PG in the manner proposed.
- BGE’s Gas Shipping/Supply Licence does not preclude their corporate functions personnel from receiving information from the regulated businesses.
- In addition to the requirement for the Board to comply with the Government’s Code of Practice, the company has in place a strict Code of Business Ethics which deals, *inter alia*, with compliance with the law and licences and the requirement to maintain the confidentiality of information. Breaches of the Code are treated as a disciplinary matter.
- Consultants/advisers should be similarly designated as Corporate Functions personnel when receiving commercially sensitive information. They are made aware of licence provisions regarding the sharing of information when they receive information and must treat the information in their possession accordingly. Severe disruption will be caused (e.g. participation in national energy policy reviews) otherwise.
- The ring-fencing arrangements proposed in the ESB CS and ESB PG licences are unprecedented by comparison with other jurisdictions, in particular when compared to the licensing arrangement of NIE PES.

- This provision is premature as no discussion has taken place on an all-island basis on such ring-fencing issues, contrary to the commitment of both the Commission and NIAER in the Memorandum of Understanding. More importantly, regulations have yet to be established which will set out just how ESB PG and NIE Power Procurement Business (PPB) will trade CfDs with each other, with ESB CS and NIE PES and other third parties.
- This provision is unfairly discriminatory given that no reciprocal arrangements are being pursued in respect of the organisational structure of Viridian in Northern Ireland.
- This provision is unwarranted given ESB's exemplary behaviour in the electricity market to date.

Given that the Commission intends reviewing the licences during Stage 2, the respondent suggested that the restrictions on the transfer of confidential information to Corporate Functions personnel be lifted, while retaining the restrictions which prevent the transfer of information between regulated entities within ESB. This can be most readily achieved by replacing the definition of Business by a definition of Regulated Business, where Regulated Business does not include corporate activities. Alternatively, if the Commission wishes to advance the harmonisation of licences, then it could seek to define Corporate Functions Personnel in a similar manner to that in the NIE licence.

Commission Response

The Commission is keen to ensure that the various licensed ESB activities, such as the Generation Business, operate on a stand-alone basis, to ensure that they do not have an unfair advantage in the energy market. The prohibition of the transfer of commercially sensitive information, as stated in Conditions 5.3 and 5.4, expressly excludes situations where "the Licensee may be entitled to do so by law". Thus the transfer of information required for corporate governance and other reasons could be allowed. However, the Commission accepts that the proposed definition of Business, by including "any business or activity of the Licensee" may result in uncertainty regarding ESB's ability to transfer necessary information between its internal business units.

The term 'Business' is therefore replaced, where relevant, by the term 'Regulated Business' to facilitate the transfer of corporate information between ESB's corporate centre and its various regulated businesses. In order to allow the Commission to monitor the transfer of this information, the Commission requires ESB to draft and submit a protocol which will govern the transfer of this information so as to ensure that only information necessary for the effective management of the ESB Corporate functions is transferred. This implementation of, and compliance with, the provisions of this protocol will be monitored and enforced by the Commission.

3.9 Condition 6 - Separation of Generation Business

One party stated that the separation of business rules do not contain any requirement for the separation of individual power stations. Full separation is perhaps excessive, but there could be a requirement for each station to act in its own commercial interest and not strategically, as was central to Commission's previous strategy on dominance.

Commission Response

This condition requires the separation of the Generation Business from other ESB activities.

3.10 Condition 10 - Central Despatch

One party noted that this condition requires available plant to be offered but does not require best, or even reasonable, efforts to be made to make plant available.

Commission Response

This is a generic licence condition and any extra requirements will be examined and consulted on in accordance with the SEM and Stage 2 of the licensing process.

3.11 Condition 11 - Ancillary Services

One party stated that it is not clear how Condition 11.1 is intended to relate to ESB, as it will not have authorisations in respect of the majority of its stations. It believes this condition should be restricted to situations where there is dominance in the provision of the ancillary service, particularly since this is a condition that is also present in the standard generation licence.

Commission Response

This is a generic licence condition and will be examined and consulted on in the context of the SEM and Stage 2 of the licensing process.

3.12 Conditions 12 and 13 - Connections to and use of the Licencee's system

One respondent queried the inclusion of these Conditions as the Electricity Regulation Act prescribes the third party access regime applicable to the transmission/distribution system and generally prescribes the law in relation to the development of Direct Lines. It is therefore not clear to the respondent what the statutory basis is for the inclusion of this condition on access to a licensee's system.

Commission Response

This is a generic licence condition and will be examined and consulted on in the context of the SEM and Stage 2 of the licensing process.

3.13 Condition 19 - Directions etc by the Commission

One party queried whether Condition 19.2 is enforceable from a constitutional perspective, to the extent that a direction, requirement or determination results in an acquisition of property.

Commission Response

The Commission's statutory powers do not include issuing directions to ESB to acquire land.

3.14 Schedule 1 of Licence

One party noted that the ESB PG Licence does not appear to include a determination date in respect of individual stations as is the case in the standard generation licence. It is not clear why this has not been included in this licence where it may be included in other licences.

Commission Response

The licence determination date is not included in ESB's licence due to its interim nature. It is the Commission's intention that this Interim Generation Licence shall continue in full force and effect until the final licence supersedes it.