

## **VP&E Comments on Draft Interim Electricity Generation Licence granted to ESB**

VPE welcome the issuing of ESB licences for supply and generation for consultation as we consider these documents critical to establishing a level playing field in the market. We note that the Joint Regulatory Authorities have considered that dominance will be treated in licenses issued to participants under the SEM. This approach will require significant further consultation and therefore we have assumed in our response that the licenses here are only of an interim nature and will be fundamentally reviewed and altered when the SEM comes into force.

### **General Comments**

**Application of Conditions to Individual Plant** – The licence should effectively apply to each station in the ESB portfolio individually, such that there can be no cross subsidy and generators cannot act in concert and must prepare separate accounts etc.

**Enforcement** – ESB does not currently hold licences in respect of the majority of its stations and it is not clear what the consequences are of it carrying on its business without a licence. Therefore, despite the fact that the licence contains termination provisions, it is not clear what the Commission for Electricity Regulation (CER) can do to enforce this licence given that termination does not appear practical. In light of the importance of the obligations under this licence and the power which ESB Powergen wields in the market, this is a highly undesirable situation. We strongly recommend that the CER give serious consideration to the manner in which it will enforce the provisions of this licence. At the very least, we strongly recommend that the obligations of the licence should apply independently to every station owned by ESB Powergen and the termination provisions should be exercisable in respect of each individual station.

**Discrimination** – General non-discrimination provisions in relation to the sale of electricity do not appear to be included in the draft licence. Given the market power which ESB Power Generation exercises we are of the view that these should be included.

**Dual Fuel** - there is a requirement on independent generators to be capable of generating electricity on more than one fuel. Why is this obligation not also placed on ESB Power Generation?

### **Part I Terms of the Licence**

The standard generation licence contains additional language in paragraph 3 relating to determination of the licence in respect of individual stations where the licence is granted in respect of multiple stations. It is not clear why this is not included in this Licence.

## **Condition 1 – Interpretation and construction**

“**Power Purchase Agreement**” and “**Trading and Settlement Code**” – There is no term in the licence that indicates that the license will be revoked and reissued with the start of the SEM. These definitions only apply to pre-SEM conditions.

“**Public Electricity Supply Business**” – this definition should be amended so that it captures the public electricity supply business even if it is not yet licensed.

“**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.

## **Condition 2 – Separate Accounts for the Generation Business**

When considered as standard accounting conditions for a business with market power, the separate accounting conditions are fairly well specified. They require details of transactions with affiliates (transfer pricing, apportionment etc.) to be available to the Commission.

However, they do not require the detailed transfer pricing information to be published and they do not provide for the provision of information on individual generating stations.

The latter appears to run counter to CER’s previous policy (CER/04/189). It had previously sought to formulate a strategy to address the issue of ESB dominance in the Irish electricity market under the MAE and one of the guiding principles proposed was that the component parts of ESB (e.g., power plants) should behave as if they were separate participants in the market and act as separate commercial entities. The May 2004 paper (CER/04/189) said, “*The separation of accounts to plant level will increase transparency and ensure that any anti-competitive behaviour aimed at increasing profit across the portfolio of plant as a whole is exposed*”.

If there are not to be special SEM rules for the provision of information by dominant entities, the information will have to be obtained through licence conditions. The CER has general information powers and so could obtain it but there may be a legal question as to whether it could be published and other participants would be relying on CER to act efficiently in their interests. The latter concern is one that recurs as a general theme when considering the licence conditions.

There is a case that dominant generators should be required to publish the bids, marginal fuel costs, other marginal costs, other avoidable costs, total costs and total revenue in respect of each power station. Some might argue that this is excessive but the licence publication requirement seems minimal.

### **Condition 3 – Approval of electricity provision by the Commission**

Both licences give CER the right to specify the terms, presumably including prices, on which electricity is sold and, in the case of generation, purchased. A similar power is given over supply through the economic purchasing condition.

The power seems to me to be sweeping and excessive. If CER sets the terms (as it does now for the details of tariffs) it interferes in normal commercial relationships and is likely to cause delay and inefficiency, and inhibit innovation.

Having said that, it is not clear whether the wording of the condition actually gives CER the ability to dictate the terms and prices of contracts for differences.

We recommend that this Licence Condition sets out 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.

At a minimum this Condition should include the types of obligations set out in Condition 3.4 of the standard Generation Licence. It is not clear why an equivalent Condition does not appear to be included in this Licence.

### **Condition 4 – Prohibition of anti-competitive behaviour**

The anti-competitive behaviour conditions are general. The licensee may not “*prevent, restrict or distort competition to any appreciable extent*” or abuse a dominant position. As in the other conditions where the concept appears, CER is given the final word on whether dominance exists.

Will the CER confirm that ESB Powergen is in a dominant position and so will be bound by Licence Condition 4.2 from the date that the Licence takes effect?

This Condition should probably extend to the market for Ancillary Services and the market for the supply of electricity, as it is able to influence both, as well as the market for generation, transmission and distribution.

What is notably absent from this condition (or the previous one governing the terms of sale or the later one on central despatch) is the banning or prescription of any specific behaviour. The obvious candidates are the ones set out as in VPE’s response on market power – “*restrictions on dominant generators to:*

- *Offer contract terms, including by auction, and not discriminate in doing so;*
- *Make available option contracts that are similar in effect to the present 8% outage top-up provision;*
- *Bid prices into the pool that reflect their avoidable costs;*
- *Use their best endeavours to declare their plant available and flexible;*

- *Earn an overall return that is not excessive.”*

### **Condition 5 – Prohibition of cross-subsidies**

Like the separate accounting condition, the cross-subsidy prohibition is adequate for a normal business with market power but does not prevent cross-subsidy between power stations, for example if there is market power at one part of the load curve and this is used to subsidise predatory pricing at another part.

Like the separate accounting prohibition, this only applies to a dominant business (where dominance is defined by CER) or to one that is vertically integrated with transmission or distribution or as for PES and Powergen.

Notwithstanding that the Licensee is bound by this Condition by virtue of Condition 5.1(a), further to comments on Condition 4, above, will the CER confirm that ESB Powergen is in a dominant position from the date that the Licence takes effect?

Condition 5.1(a) should probably also include a reference to the market for Ancillary Services.

We note that the CER will determine what is a cross subsidy. For the purposes of understanding and providing meaningful comment on Condition 5.2 we would be grateful if the CER could issue guidance as to what constitutes a “cross subsidy”.

If the Licensee discloses commercially sensitive information to another Business of the Licensee under Condition 5.4, this should be published to any competitors of the other Business of the Licensee.

### **Condition 6 – Separation of Generation Business**

The separation of business rules do not contain any requirement for the separation of individual power stations. Full separation is perhaps excessive (because of imposing additional costs) but there could be a requirement for each station to act in its own commercial interest and not strategically. This requirement was central to CER’s previous strategy on dominance.

### **Condition 11 – Ancillary Services**

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.

### **Conditions 12 and 13 – Connections to and use of the Licencee’s system**

VP&E query the inclusion of these Conditions in a generation licence (both this Licence and the standard generation licence). The Electricity Regulation Act 1999

(the “Act”) prescribes the third party access regime applicable to the transmission and distribution system and generally prescribes the law in relation to the development of Direct Lines. It is therefore not clear to us what the statutory basis is for the inclusion of this Licence Condition. Unless this is expressly permitted by statute we do not believe that the CER has the power to implement a third party access regime (which effectively constitutes an acquisition of property) by virtue of a general licensing power. This is particularly true given that the Act requires a third party access regime to be implemented in respect of transmission and distribution but not the “Licensee’s System”.

### **Prohibition of discrimination**

This prohibition has not been applied to the generation business, even when it is dominant. It is difficult to see why, particularly since the standard generation licence does contain such a prohibition for dominant generators. It would often be easier for a discriminated-against supply customer to find an alternative than for a discriminated-against generation customer to do so.

### **Condition 10 Central Despatch**

The central despatch condition requires available plant to be offered but does not require best, or even reasonable, efforts to be made to make plant available.

The ancillary services condition gives CER the right to determine terms in the event of a dispute with the TSO. This seems a more measured power than that conferred on the Commission in Condition 3.1 but 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.

### **Condition 19 – Directions etc by the Commission**

We query 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.

### **Schedule 1**

The ESB Powergen Licence does appear to include a licence 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.

