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28th August 2020

RE: SEM-20-045 Market Power and Liquidity Discussion Paper

Dear Rory and Gary,

I am writing in response to the SEM Committee's Discussion Paper on Market Power and Liquidity (**MP&L**), published on 6 July 2020. This letter sets out the key points of our response, which should be read in conjunction with the Appendix. In the Appendix, we respond to the specific questions posed in the Discussion Paper.

We welcome the Discussion Paper. We strongly agree with the Committee's starting point, which is that, absent the MP&L regulatory measures currently in place consumers in Ireland would face an unacceptable risk of market power being used in a way that harms their interests.

However, there are risks that even with the current MP&L measures in place: (a) the level of forwards liquidity in the SEM is still insufficient to properly protect current and future consumers; and (b) a cause of the insufficiency of forwards liquidity is market power and will be in the future. To illustrate why we believe this:

- ESB and Electric Ireland (**EI**) are unquestionably dominant today. In the future we see ESB retaining and perhaps even enhancing its position of market power in electricity generation with a combination of renewable and flexible technologies, particularly wind and gas-fired peaking plants and batteries.
- The Committee's own and its commissioned analysis also suggests that ESB will become more dominant in future as more wind comes onto the system. From as long ago as 2010[1], CEPA warned of increased market power risks with more wind on the system. Similarly, in 2015, the Committee perceived that "the potential for [ESB] exercising market power at certain times is likely to increase… due to increasing intermittent wind generation, the expected reduction in non-ESB conventional generation capacity and higher demand."[2]
- ESB has a number of advantages in the construction of new flexible capacity such as the ownership of heritage sites by virtue of its earlier monopoly status.
- The award of 10-year contracts to ESB for over 480MW of new capacity in the first T-4 capacity auction in the new SEM for CY2022/23, all based in Dublin, supports our concern that ESB's dominance will increase. The 480MW award also reflects the unmatchable benefit of ownership of heritage sites at advantageous parts of the grid.
- Based on its market share of an assumed 40TWh of total system demand we estimate that EI, after deducting the volume of Directed Contracts (DCs) it is allocated, has at least 12.6TWh of forward exposure. A total of 2TWh across the whole market was traded between July 2019 and July 2020 on the main (Tullett Prebon and MAREX) non-DC platforms. It is not clear to us how and with whom EI is hedging against exposure to prices near to and on the day of delivery.

[1] https://www.semcommittee.com/sites/semcommittee.com/files/media-files/SEM-10-084a%20CEPA%20Market%20Power%20and%20Liquidity%20Consultation%20Paper.pdf
[2] https://www.semcommittee.com/sites/semcommittee.com/files/media-files/SEM-15-094%20I-SEM%20Market%20Power%20Consultation%20Paper.pdf Paragraph 10

To address these risks to consumers in Ireland now and in the future, we request that the Committee takes the following actions:

1. Undertakes to conduct and publish, on an annual basis, a rigorous, transparent and evidence-based assessment of: (a) levels of liquidity in the SEM, particularly in the forwards market; and (b) causes of those levels of liquidity. We believe that the Committee's assessment should ultimately be asking and answering the questions: "even with the current MP&L measures in place, is the level of forwards liquidity in the SEM sufficient to properly protect Irish consumers now and in the future, and why?" If the answer to that first question is "no", then the next step would be for the Committee to consider and consult on appropriate remedies. The assessment would need to consider the future as well as the present to allow the Committee to take preventative action if necessary.
2. Implements immediate reforms to the Directed Contracts (**DC**) regime so that it better: (a) meets its original objective of mitigating market power in the day-ahead market and; (b) mitigates the risk to consumers that there are low levels of forwards liquidity because of market power.
3. Examines the relationships between all generation plant in which ESB has an interest and EI to ensure that the vertical ringfencing provisions are fully and properly applied. In particular, we urge the Committee to examine the relationship between the Coolkeeragh and Synergen power stations and EI. We see no reason why the vertical ringfencing requirements should not apply to all generation plant in which ESB has an interest, particularly given the time that has elapsed since these legacy arrangements were established.

We acknowledge the attention that the Committee has given to MP&L to date and welcome the corresponding actions it has taken to protect consumers. For example, the Committee introduced vertical ringfencing, DCs, bidding principles and set up the Market Monitoring Unit (**MMU**). However, we believe that there are still MP&L risks to consumers and that more needs to be done to mitigate those through the proportionate actions described in 1-3 above. In the rest of this cover letter, we explain why we believe these actions are needed and provide more detail for what we believe is needed for each action.

The Annual Liquidity Assessment

We believe that the Annual Liquidity Assessment (ALA) is needed because the regularity, rigour and transparency of the ALA process will give extra confidence to existing and potential new market entrants that the electricity markets in Ireland are competitive. This extra confidence should better attract new entrants and investment, ultimately protecting consumers. We believe that an ALA should be published every year until the risks that (a) there are inefficient levels of forwards liquidity and (b) that inefficient levels of liquidity are caused by market power, are both materially diminished. We do not expect these risks to be materially diminished anytime soon. For the reasons outlined above, we see the risks increasing in the future.

The ALA would be something new; its role would not be fulfilled by the Committee's current publications. Further to a commitment given in its 2017 Decision to "undertake a review of liquidity in the I-SEM forward market 18 to 24 months of the I-SEM energy market", the Committee has published the current Discussion Paper. The ALA would be qualitatively and quantitatively different to the current Discussion Paper, for example in terms of the evidence provided and the questions asked and answered. Whilst we welcome the Discussion Paper, it is a Call for Evidence and does not provide evidence.

In producing the ALA, the Committee would draw on the information currently held by, and the expertise of, the MMU. Added to this, we recommend that as an input to the ALA, the Committee conducts regular surveys, at least annually, of both suppliers and generators to understand their experiences and perceptions of liquidity in the SEM. There is precedent of such liquidity surveys elsewhere. Ofgem recently started liquidity surveys in the UK following suspension of the Market Making Obligation (MMO) in November 2019[3]. We welcome the MMU's quarterly market monitoring reports, but these would also not be a substitute for the ALA. The MMU's quarterly reports do not ask and answer the same questions as the ALA would, and they focus on the liquidity in the day-ahead market and do not focus on liquidity in the forwards market.

[3] https://www.ofgem.gov.uk/system/files/docs/2020/01/liquidity_policy_review_update_january_2020.pdf

Reforms to the DC regime

- **Problem 1: mitigating market power risks in the day-ahead market**

We support the DC regime and commend the Committee for introducing it. However, we are concerned that the DC regime is not properly mitigating the risk that ESB exercises market power in the day-ahead market because: (a) some DCs are allocated to EI; and; (b) sometimes not all the DCs allocated to suppliers other than EI are bought, and become available to be bought by EI instead. As we see it, there are two leading solutions to (a), either: (i) do not allocate any DCs to EI; or (ii) do not count the portion of DCs allocated EI to the HHI reduction, thereby increasing the volume of DCs available to suppliers other than EI. The solution to (b) is about pricing; we believe that sometimes not all DCs are sold to suppliers other than EI because they are too expensive. We provide a full range of options for solving these problems in response to question (iv) in the Appendix below.

What DCs were intended to achieve – recap

The intent of DCs is that by requiring ESB to sell-ahead some generation volumes via a contract for difference (CfD) with the day-ahead price, DCs disincentivise ESB from increasing its prices in the day-ahead market to a level consistent with the exercise of market power. The volume that ESB is required to sell-ahead is linked to the threshold level of HHI that is deemed acceptable in terms of the ability to exercise market power. With every DC that is sold, ESB's market power in the day-ahead market is reduced until in theory it cannot (or has no incentive to) exploit its dominant position. However, in practice the theory behind the DCs does not work because: (a) some DCs are allocated to EI; and (b) sometimes not all the DCs allocated to suppliers other than EI are bought and become available to be bought by EI instead.

Why (a) – that some DCs are allocated to EI – is a problem.

In theory, with every DC that is sold, ESB's power in the day-ahead market reduces. But this reduction of ESB's market power does not happen when a DC is sold to EI, because EI is part of the same company as ESB. A DC being sold to EI does not contribute to a reduction in ESB's market power because ESB knows that if it increases prices in the day-ahead market (linked to EI's DC), ESB will have to pay out, but only to EI as part of the same company. Similarly, EI as part of the same company is indifferent to the price of DCs; why not take them at any price if it is only paying itself?

When DCs are not sold in the initial (primary) window, they are offered in a supplemental window. Therefore, if DCs are too expensive for suppliers other than EI and are not bought in the first round, EI may buy more of them in the supplemental round. Our analysis in response to question (vi) in the Appendix below suggests that EI is likely to be the main buyer of DCs in primary subscription windows and is likely to buy any remaining unsold volumes in supplemental windows. Since every DC sold to EI does not contribute to a reduction in ESB's market power, EI buying more than its allocated share of DCs is a major issue.

Why (b) – that sometimes not all the DCs allocated to suppliers other than EI are bought and become available to be bought by EI instead – is a problem.

With every DC that is sold to a supplier other than EI, it reduces ESB's market power in the day-ahead market. Therefore, with every DC that is not sold to a supplier other than EI, it does not reduce ESB's market power in the day-ahead market. We believe that the reason DCs are sometimes left unsold to suppliers other than EI is that they are too expensive.

Solutions

We discuss possible solutions to problems (a) and (b) in the Appendix, particularly in response to question (iv). In this cover letter we have said that the leading solutions are to either: (i) not allocate any DCs to EI; or (ii) not count the portion of DCs allocated to EI to the HHI reduction, thereby increasing the volume of DCs available to suppliers other than EI.

We anticipate that EI would object to both of these solutions by arguing that they are discriminatory. Such an argument would misunderstand what discriminatory means. Treating things differently when they are the same is wrong. However, treating things the same when they are different is also wrong. EI is different to all other suppliers in that it is part of the same company as ESB and is therefore indifferent to the price of DCs.

It would therefore not be discriminatory to treat EI differently to other suppliers in the DC regime. Indeed, we believe it is discriminatory to treat EI the same as other suppliers in the DC regime.

- **Problem 2: mitigating the risk that market power causes insufficient (and inefficient) liquidity in the forwards market**

We believe that the DC regime provides an additional but insufficient level of protection to consumers in Ireland that complements but does not substitute vertical ringfencing of ESB and EI. Besides protecting against market power in the day-ahead market, DCs also *partially* mitigate the risk that ESB and EI *tacitly* hedge against one another and therefore do not trade forward contracts as much with any market participant as they would as genuinely separate companies. As part of its research prior to producing the ALA, we believe that the Committee should investigate whether ESB and EI are tacitly hedging.

DCs only partially mitigate the risk of tacit hedging because DCs were designed to protect against market power in the day-ahead market. DCs are limited in volume and are made available to EI as well as all other suppliers by market share. EI is indifferent to the price of DCs because it is part of the same company as ESB. Therefore, it would better mitigate the risk that ESB and EI tacitly hedge by not making DCs available to EI. Not making DCs available to EI is the same as one of the remedies we have already suggested for the problem that DCs are not fully mitigating market power risks in the day-ahead market. By not making DCs available to EI, the SEM Committee would be killing two birds with one stone.

Vertical ringfencing of ESB and EI is essential to protect consumers, but it is not sufficient. The "Non-Discrimination Offer" licence clause, for example, protects against the risk that ESB delivers below-cost contracts to EI and above-cost contracts to other suppliers. Vertical ringfencing also protects against informational advantages. However, what vertical ringfencing does not protect against, and perhaps cannot protect against, is the risk that ESB and EI *tacitly* hedge against one another and therefore do not trade forward contracts as much with any market participant as they would as genuinely separate companies. DCs allocated to suppliers other than EI partially protects against tacit hedging today; DCs could be reformed to better protect against it by not allocating DCs to EI. The fact that some DCs are allocated to EI inadvertently supports vertical integration of ESB and EI.

Ensuring that vertical ringfencing is complete

We understand that there are legacy arrangements which may mean that vertical ringfencing protections do not apply to all supply contracts between generation plant in which ESB has an interest, and EI. In particular, we understand that contracts between the Synergen and Coolkeeragh power stations and EI may not be captured. If power stations such as Synergen and Coolkeeragh are not required to contract on non-discriminatory terms with all suppliers, they may withhold contracts from the wider market and/or price in favour of EI. We request that the Committee examines the relationships between all power stations and wind farms in which ESB has a stake and EI and ensure that the vertical ringfencing arrangements are fully applied.

We hope that our response to the Discussion Paper is useful. We are keen to discuss our views and recommendations with the Regulatory Authorities (RAs). We will be in touch to arrange a meeting. In the meantime, if you have any questions on this response, please contact alun.rees@centrica.com

Yours sincerely,

Joanne Ross

Legal, Regulation and Corporate Affairs Director

Appendix – responses to questions in the Discussion Paper

As well as the responses below, our covering letters also answers questions in the Discussion Paper. The Appendix should be read in conjunction with the covering letter.

Market Power – answers to questions

i. Is the electricity market sufficiently contestable that market participants are free to enter and exit the market?

Market participants being free to enter and exit the market does not mean that the market is "sufficiently contestable". The question would be better phrased as "is the electricity market sufficiently contestable that market participants do not face undue barriers to entry, growth and exit from the market?"

If there are inefficient levels of liquidity in the SEM forwards market, a likely effect is that barriers to entry and/or growth in the SEM for suppliers or generators or both are unduly high. To understand whether barriers to entry and/or growth in the SEM are too high, we would expect the SEM Committee to consider as part of the ALA we are proposing, amongst other things:

- Do suppliers complain about lack of liquidity for forward generation products? Which suppliers?
- Over time and therefore in various market conditions, how successful has market entry and growth/ sustainability been for standalone electricity suppliers compared to electricity suppliers that also generate electricity?

In relation to these questions and the Committee's assessment, Bord Gais Energy's own experience is instructive. We invested in the Whitegate gas fired power station because we believed that it was too risky to compete in the electricity retail market in Ireland without it. Without Whitegate, we would be exposed to unacceptable levels of short-term price fluctuations because of the lack of forward products. We do not believe that most consumers, particularly residential consumers, are willing to accept being exposed to such volatility.

ii. Do you agree with the SEM Committee's intended approach of not further reviewing ESB's current ring-fencing arrangements at this time, and outline rationale for agreeing with the SEM Committee's intended approach? If not, please outline the basis for why ring-fencing arrangements should be reviewed and either partially/ entirely removed.

Yes we agree that ESB's current ring-fencing arrangements should not be reviewed at this time. We do not consider our request for the Committee to investigate and ensure that the vertical ringfencing requirements are fully applied to all power stations and windfarms in which ESB has a stake to be a review. Our request is about ensuring that the current arrangements are working as they should be.

The earliest that the current ring-fencing requirements should be reviewed in a policy sense is after the publication of the first Annual Liquidity Assessment. Our rationale for why we agree with the Committee is provided in the covering letter above. To reiterate:

- Vertical ringfencing of ESB and EI is essential to protect consumers. The "Non-Discrimination Offer" licence clause, for example, protects against the risk that ESB delivers below-cost contracts to EI and above-cost contracts to other suppliers. Vertical ringfencing also protects against informational advantages.
- ESB and EI hold positions of significant market dominance. The risks that vertical ringfencing was designed to mitigate against are still present and may be worsening. Please see the first page of the covering letter to illustrate why we believe this. In addition, the graph in our answer to question (vii) below outlines our analysis of the generation that ESB will hold relative to the rest of the market out to 2030.

ESB's current ring-fencing arrangements should be fully and properly applied, which means that they should be applied to the Synergen and Coolkeeragh power stations as well as the rest of ESB's generation fleet.

We request that the Committee examines the relationships between all generation plant in which ESB has an interest and EI to ensure that the vertical ringfencing provisions are fully and properly applied. In particular, we urge the Committee to examine the relationship between the Coolkeeragh and Synergen power stations and EI. We see no reason why the vertical ringfencing requirements should not apply to all generation plant in which ESB has an interest, particularly given the time that has elapsed since these legacy arrangements were established.

In its 2012 Decision[4] the Committee said that there are legacy contracts between the Synergen and Coolkeeragh plants and ESBIE (now part of Electric Ireland). The 2012 Decision also said that the licence requirements are such that no cross-subsidies between generation and ESBIE apply with respect to this generation output. The 2012 Decision said that EI was as acting as an agent for these plants and the RAs' intent was that they would continue to monitor the impact of these legacy contracts.

We are not clear on what the RAs' monitoring of these contracts has shown. We request transparency on the nature of the current contractual relationship between EI and these two plants' volumes in the context of hedging its retail book. The Committee's 2016 Market Power Decision said that "vertical ring-fencing aims to ensure that selected integrated companies do not provide preferential terms to their affiliates compared to other market participants". We request confirmation that the Non-Discrimination clause is being adhered to by EI for all ESB generation, including Coolkeeragh, Synergen and windfarms.

Given the dominant position of ESB's generation business and the future share of flexible and renewables capacity ESB is expected to hold, we suggest that in the ALA the SEM Committee updates the 2015-2016's highly informative market dominance analysis. Updating the 2015-2016 Committee-led modelling in the ALA would in our review reveal the likelihood of ESB's continued and likely to grow dominant position[5].

As outlined in the covering letter, vertical ringfencing of ESB and EI is essential to protect consumers, but it is not sufficient. What vertical ringfencing does not protect against, and perhaps cannot protect against, is the risk that ESB and EI *tacitly* hedge against one another and therefore do not trade forward contracts as much with any market participant as they would as genuinely separate companies. DCs allocated to suppliers other than EI partially protects against tacit hedging today; DCs could be reformed to better protect against it by not allocating DCs to EI. The fact that some DCs are allocated to EI inadvertently supports vertical integration of ESB and EI.

iii. Should the SEM Committee continue to use Directed Contracts as a mechanism for mitigating the potential use of market power in the SEM? If not, please provide rationale for not applying Directed Contract obligations, and detailed alternative options for mitigating potential market power.

Yes. We strongly believe that the SEM Committee should continue to use Directed Contracts as a mechanism for mitigating potential use of market power in the SEM.

However, as outlined in the covering letter, we are concerned that the DC regime is not properly mitigating the risk that ESB exercises market power in the day-ahead market because: (a) some DCs are allocated to EI; and; (b) sometimes not all the DCs allocated to suppliers other than EI are bought by them, and become available to be bought by EI instead. As we see it, there are two leading solutions to (a), either: (i) do not allocate any DCs to EI; or (ii) do not count the portion of DCs bought by EI to the HHI reduction, thereby increasing the volume of DCs available to suppliers other than EI. The solution to (b) is about pricing; we believe that sometimes not all DCs are sold to suppliers other than EI because they are too expensive. We provide a full range of options for solving these problems in response to question (iv) below.

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[4] SEM-12-002 https://www.semcommittee.com/sites/semcommittee.com/files/media-files/SEM-12-002%20Market%20Power%20and%20%20Liquidity%20Final%20Decision.pdf (p.19) and the related consultation that preceded it, SEM-11-089 (p. 32)

[5] We urge the Committee to exercise caution when receiving views from ESB and/or EI on "evidence" they might allude to, to support any relaxation in market power mitigation measures. We agree with the Committee that "past behaviour is not a guarantee of future behaviour, and it is the ability and incentive to exercise market power that needs to be mitigated." No evidence has been publicly presently to warrant any consideration of relaxing these measures. The earliest that vertical ringfencing should be reviewed is after the publication of the first ALA.

As also outlined in the covering letter, we believe that the DC regime provides an additional but insufficient level of protection to consumers in Ireland that complements but does not substitute vertical ringfencing of ESB and EI. Besides protecting against market power in the day-ahead market, DCs also partially mitigate the risk that ESB and EI *tacitly* hedge against one another and therefore do not trade forward contracts as much with any market participant as they would as genuinely separate companies. DCs only partially mitigate the risk of tacit hedging because DCs were designed to protect against market power in the day-ahead market. DCs are limited in volume and are made available to EI as well as all other suppliers by market share. EI is indifferent to the price of DCs because it is part of the same company as ESB. Therefore, it would better mitigate the risk that ESB and EI tacitly hedge by not making DCs available to EI.

As part of its research prior to producing the ALA, we believe that the Committee should investigate whether ESB and EI are tacitly hedging.

In response to the last major DCs consultation in 2017[6] a number of respondents expressed concerns around the volumes of DCs allocated to EI. The Committee's response at the time was that any changes to the eligibility model "would be more appropriately considered in the future consultation on contracting along with other potential changes to the DCs."[7] We believe that now is the time for this consideration. We elaborate on our view on how to address the DC volumes issue in our answer (iv) below.

iv. Assuming the SEM Committee's continuation with Directed Contracts, would you be in favour of the Directed Contracts price being determined by a competitive auction? If yes, how should the auction be designed (i.e. what should auctions be trying to achieve/avoid in the proposed design for Directed Contracts)? If not, please provide detailed alternative options (e.g. should the RAs amend the DC pricing formulae?).

We could not possibly support DC prices being determined by a competitive auction if EI were allowed to compete in the auction, unless extra protections were put in place to ensure that DCs still mitigate market power risks. For the reasons we have explained in the cover letter to this response, DCs do not meet their objective of mitigating ESB's power in the day-ahead market when they are bought by EI.

If EI was permitted to buy DCs in a possible DC auction it would have the incentive to bid up the price with a view to foreclosing competitors from accessing forwards hedging products at reasonable prices. This in turn would expose non-EI suppliers to unacceptable spot market price risk. Furthermore, as discussed under our answer to ring-fencing above, EI would be indifferent to how high or not the auction price is. In its SEM-16-030 consultation on liquidity, the Committee questioned whether, if an auction were to be introduced for DCs, EI should be allowed to participate. The Committee asking this question appears to recognise the source of concern that EI and ESB are part of the same financial group.

The Regulatory Pricing Formula which underpins the pricing of the contracts is not sufficiently responsive to react to changes in market dynamics, which has led to the increasing trend of DC prices being inflated and volumes not being sold. There may be scope for the RAs to examine how the formula could better react to market changes, for example by calculating closer to DC Rounds.

To address the problem that DCs are not meeting their objective of mitigating market power in the day-ahead market, we suggest the following solutions for consideration:

a. EI is excluded from DC allocations
b. To the extent that DCs continue to be allocated to EI, EI's DC volumes do not count towards the HHI reduction with the result that additional volumes would be offered to non-EI suppliers;
c. When EI buys its allocation in the primary DC auction window, it is excluded from purchasing any of the power in the second (supplementary) window. A major drawback of this solution is that it would not help address the pricing problem.
d. Where every non-EI supplier does not take up its full allocation in the primary window, reduce the price of DCs to a level more commensurate with what market participants are willing to pay.

Of these options, only (a) would mitigate against the risk that ESB and EI tacitly hedge. Therefore, we support EI being excluded from DC allocations.

[6] SEM-17-064, the decision on which was SEM-17-081
[7] SEM-17-081, p.14

v. **Assuming the SEM Committee's continuation with Directed Contracts, do you agree that the Market Concentration Model (as described in SEM-17-064) is an appropriate mechanism for determining Directed Contracts volumes? If not, what amendments/alternative approaches should be taken by the RAs to determining DC volumes?**

Our views on the options for determining DC volumes are set out in the covering letter and in response to question iv above. Under our favoured option, EI would be excluded from DC allocations but the same volume of DCs would be allocated as today in order to reduce ESB's dominance in the day-ahead market to a level consistent with acceptable levels of market power.

vi. **Are there any specific reasons for which a market participant has not taken up their allocated Directed Contracts eligibility for a given period? (e.g. The DC price did not reflect your expectations/ already had a hedging strategy for the period in question, have access to alternative hedging products, etc.).**

We believe that the reason DCs are sometimes left unsold is that they are too expensive. There are different ways of addressing this problem, such as adjusting the methodology used to set the prices.

There has been a trend of considerable lack of take-up of DCs in the primary subscription window. The primary subscription window is more instructive for understanding lack of takeup than the supplementary subscription window because before an entity can buy in the supplementary window for a DC round, they must first have bought volumes in the primary window.

The examples below of what happened with DC allocations demonstrate that there is a lack of takeup in the primary subscription window, which is then followed by 100% takeup in the secondary window. These examples support our hypothesis that DCs are too expensive for many suppliers other than EI, and that EI is buying more than its allocated share of DCs:

Example 1:

Q3 2019	RD 3	RD 4	RD 5	RD 6
Initial Volumes - BL	60%	60%	83%	82%
Final Volumes - BL	100%	100%	100%	100%

- "Q3 2019" means that these % subscriptions are for delivery of baseload volumes in Quarter 3 2019.
- "RD 3" refers to the DC Round 3, and so on for "RD 4", "RD 5", "RD 6".
- "Initial Volumes – BL" refers to the baseload volumes sold in the primary subscription window for the relevant DC Round for Q3 2019 hedges.
- "Final Volumes – BL" refers to the baseload volumes sold in the supplementary subscription window for the relevant DC Round for Q3 2019 hedges.

In the example of baseload volumes offered for DC hedges for Q3 2019:

a. BGE did not subscribe for any Q3 2019 delivery volumes in any of the four DC Rounds 3-6 as prices were consistently significantly above BGE's view of fair value and were also above comparable forward prices in the NDC market.
b. BGE contends that when DC volumes are not fully subscribed in the primary window, as occurred for all related Q3 2019 DC Rounds, then when remaining volumes are bought up in the relevant supplementary windows at least some if not all of them are being purchased by EI. In the case of Q3 2019 volumes and DC Rounds this means that as a sole purchaser of supplemental volumes in Rounds 3 and 4 for example, EI may have bought up to 75% of total DC volumes (on the assumption that they have c.35% market share).

In this example 1, for Rounds 3 and 4, 75% of DC volumes are not achieving their intended effect of mitigating market power in the day ahead market. They are also not mitigating the risk that ESB and EI tacitly hedge. We request that the Committee assesses EI's purchasing of DCs and rationale for it.

Example 2:

Q4 2020	RD 8	RD 9	RD 10	RD 11
Initial Volumes - BL	33%	100%	48%	91%
Final Volumes - BL	100%	100%	100%	100%

- "Q4 2020" means that these % subscriptions are for delivery of baseload volumes in Quarter 4 2020
- "RD 8" refers to the DC Round 8, and so on for "RD 9", "RD 10", "RD 11".
- "Initial Volumes – BL" refers to the baseload Q4 2020 volumes sold in the primary subscription window for the relevant DC Round for Q4 2020 hedges.
- "Final Volumes – BL" refers to the baseload volumes sold in the supplementary subscription window for the relevant DC Round for Q4 2020 hedges.

In the example of baseload volumes offered for DC hedges for Q4 2020:

a. The large inconsistency in the subscription levels above reflects a lack of consistency in DC pricing.
b. The volumes sold in the primary window in Round 8 (33%) appear to be very close to what it might be assumed EI's market share at the time was. If so then it points to a hypothesis that in Round 8 EI as the only purchaser in the primary window would have been the only entity entitled to purchase in the supplementary window ("Final Volumes -BL") leading to the conclusion that EI obtained 100% DC volumes in DC Round 8 for delivery in Q4 2020.

It is very rare (BGE has only one example) that volumes not bought in the primary and supplementary windows go forward for sale in the next DC Round. The reason for this in our view is that EI will always buy all supplementary volumes of DCs, with the effect that they are not made available for any non-EI supplier in future.

Alternative hedging strategies for suppliers are currently quite limited. Forwards volumes will be reduced following the expiration of the PSO contracts-for-difference in 2019, which reinforces the need for more action to be taken to address this reduction. We consider that it would be unduly risky for suppliers to abstain from forwards market hedging and be exposed to volatile spot prices on a sustained basis. Neither do we believe that consumers would want to be exposed to such volatility, particularly domestic consumers. The scope for interconnector volumes is also currently limited and costly and is not helped by the uncertainty surrounding future interconnector trading post-Brexit.

Forward Contracting & Liquidity – answers to questions

vii. In the event of no regulatory interventions regarding forward contracting in SEM, how do market participants envisage the forwards market for SEM evolving in the short, medium and long term?

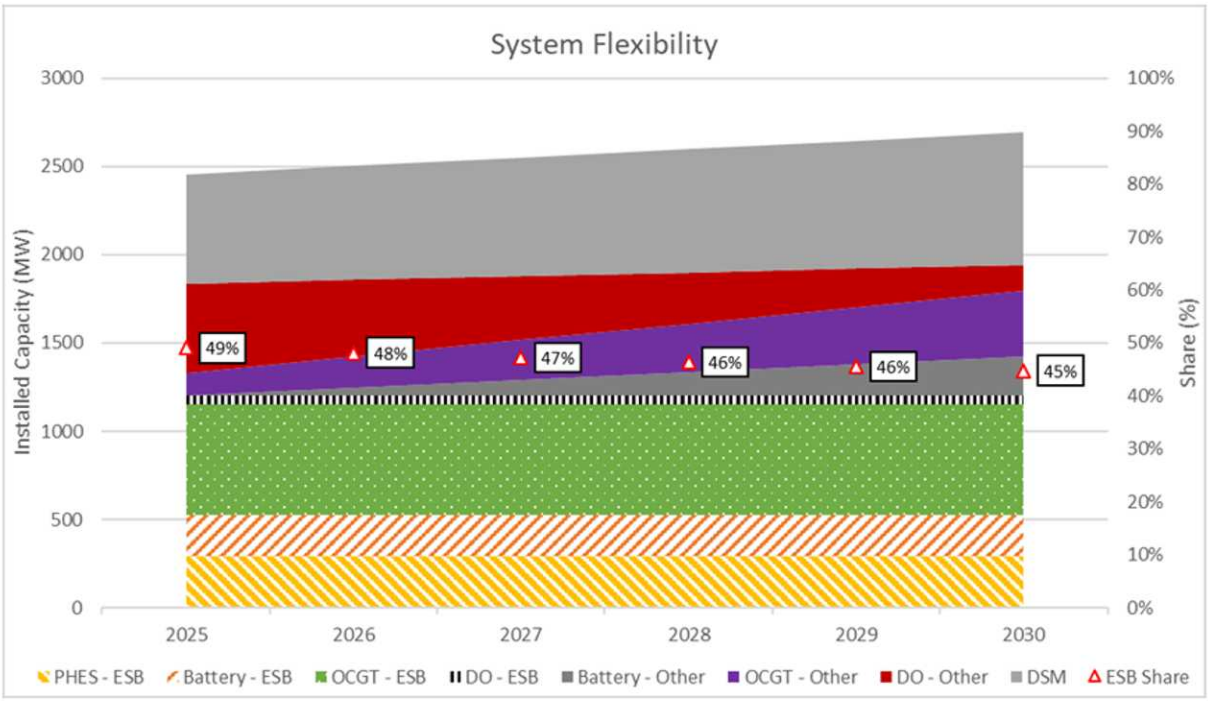
Absent regulatory interventions beyond what already exists today, we believe that the following risks will not change materially and may even get worse in the short, medium and long term:

a) That the level of forwards liquidity in the SEM is still insufficient to properly protect consumers on the island of Ireland; and
b) That a cause of the insufficiency of forwards liquidity is market power.

We see ESB retaining and even enhancing its position of market power in electricity generation with a combination of renewable and flexible technologies, particularly wind and gas-fired peaking plants and batteries. ESB has a number of advantages in the construction of new flexible capacity such as the ownership of heritage sites by virtue of its earlier monopoly status.

The graph below outlines our analysis of the generation that ESB will hold relative to the rest of the market out to 2030. Whilst ESB's market share might appear to be declining in aggregate terms, we would remind the Committee of its own perception which we agree with that "the potential for [ESB] exercising market power at certain times is likely to increase… due to increasing intermittent wind generation, the expected reduction in non-ESB conventional generation capacity and higher demand."[8]

[8] https://www.semcommittee.com/sites/semcommittee.com/files/media-files/SEM-15-094%20I-SEM%20Market%20Power%20Consultation%20Paper.pdf Paragraph 10



viii. What actions could be taken by market participants to create greater forward contracting opportunities? Is there scope for natural growth or innovation in the forwards market, and if so, how can this be progressed? Can renewable supported generators offer hedges?

Whilst we welcome the Committee seeking to understand how the market may evolve, there is nothing to suggest that the Committee could safely consider relaxing the vertical ringfencing requirements on ESB and EI or the DC obligations on ESB. Indeed, as we have demonstrated in this response, vertical ringfencing and DCs currently provide insufficient protection to consumers against the risk that ESB exercises market power in the day-ahead market and that ESB and EI tacitly hedge. Reforms are needed to better protect Irish consumers.

ix. On what public interest grounds should the SEM Committee decide to intervene in the forwards market in the future? In the event that the SEM Committee decide to intervene in the future, what impacts should be considered prior to intervening in the market?

The Committee should intervene in the forwards market in future if it is found that the level of liquidity in the forwards market in the SEM is insufficient to properly protect consumers. The Committee should discover whether the level of liquidity in the forwards market is sufficient to properly protect consumers using the ALA we are proposing.

The nature of intervention would depend on *why* the level of liquidity in the forwards market is insufficient. If liquidity is insufficient because of market power, then action will be needed to prevent such market power in future.

Prior to intervening in future, the Committee should undertake a comprehensive impact assessment, as it should for any intervention. The impact assessment should set out:

- The rationale for intervention (i.e. the problem that needs to be solved)
- Options considered, including the "do nothing" counterfactual
- Impact of different options, including on consumers and competition
- Evidence to support all of the above