



# Submission by the Competition Authority to the Consultation on Market Power and Liquidity in the SEM

S-11-003

February 2011



## **1. INTRODUCTION**

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- 1.1 The Competition Authority welcomes the opportunity to make a submission to the consultation on market power and liquidity issues in the SEM. A competitive wholesale electricity market is an essential prerequisite for retail consumers to reap the benefits from competition between rival electricity suppliers. This submission, while focusing on issues relating to the wholesale market, builds on the views contained in the Authority's submission to the CER's 2010 consultation on a *Roadmap to Deregulation of the Retail Electricity Market*.
- 1.2 Competition among electricity companies is now a reality in Ireland. Consumer reaction to the entry of Bord Gáis and Airtricity into the retail electricity market, as demonstrated by the level of switching, has been very positive. However unlocking the potential for competition at retail level requires a wholesale electricity market where all suppliers can:
- purchase electricity at prices that reflect the cost of generation, and
  - manage market risk by entering into contracts for hedging purposes.

### **Structural solutions work better than curbing behaviour**

- 1.3 The Competition Authority reiterates its support for a structural, rather than a regulatory, approach to addressing market power issues. A regulatory approach, based on curbing the behaviour of market participants, necessarily imposes a second-best solution on the market. Structural remedies on the other hand, provide long term solutions in circumstances where market concentration and the potential for exploitation of market power, is of primary concern.
- 1.4 Structural remedies such as splitting up the ESB's generation assets come at a financial cost in the short term. However, this should be balanced against the considerable, albeit less easily quantifiable, benefits of increased competitive rivalry and entry which we have seen since the SEM was established.

### **SEM market power mitigation strategy**

- 1.5 The market power mitigation strategy formulated by the regulators, the CER and NIAUR (the "RAs"), prior to the establishment of the SEM is primarily a reflection of their concern at the time that concentration in generation ownership posed a potential threat to the development of a truly competitive wholesale market. In the *Market Power Mitigation in the SEM Decision Paper* of 2006, the RAs state;

*"In proposing a market power mitigation strategy for the SEM, the RAs acknowledge that there is a problem with generation ownership concentration in the market. The RAs see a reduction in ownership concentration through a divestment of certain generation assets as the*

*preferred approach for tackling this problem rather than a regulatory scheme to prevent market power abuse.”<sup>1</sup>*

- 1.6 Given that the option of divestment was not available to the RAs at the time of the establishment of the SEM, the market power mitigation strategy has had to rely on behavioural *ex-ante* regulatory measures to mitigate the threat of market power abuse. These measures are:
- the *Bidding Code of Practice* which stipulate that bids must reflect Short Run Marginal Cost;
  - ongoing market monitoring;
  - directed contracts;
  - ring-fencing of each of the generation and retail businesses of ESB and Viridian; and
  - local market power mitigation measures.
- 1.7 While the CEPA consultation paper *Market Power and Liquidity in the SEM* and the *State of the Nation* review published by the SEM’s Market Monitoring Unit have concluded that the market mitigation strategy appears to be working well, it is also clear that market power mitigation instruments have been employed as a second-best option in addressing the issue of concentration and vertical integration.
- 1.8 Behavioural remedies prescribe conduct, without seeking to affect the underlying incentives of the company involved. Structural remedies in contrast, attempt to remove the underlying incentive of the firm to engage in anti-competitive conduct.
- 1.9 The main problem with behavioural remedies is one of effectiveness. Behavioural remedies attempt to make the undertaking act contrary to its own interests. The risk is that the regulatory authorities must keep all market participants on a tight leash which removes the incentives for innovation and investment that are characteristic of competitive markets.

### **Market power is not just a SEM issue**

- 1.10 Market power issues in electricity are not confined to the workings of the SEM as they also relate to the ownership and future development of the electricity transmission and distribution networks, collectively known as the “grid”. The issue of ownership of the electricity transmission network has been the subject of considerable discussion and a decision on this matter is expected soon. Access to the grid is an essential prerequisite for both generation and supply companies. Therefore full separation of the transmission network from the contestable stages of generation and retail supply would be the cleanest means of ensuring that competing electricity companies have equal access to grid.

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<sup>1</sup> Market Power Mitigation in the SEM Decision Paper AIP/SEM/31/06 7 April 2006

## **Now is not the time for re-integration**

- 1.11 A re-integration of the ESB's ringfenced businesses, be it a horizontal integration of its two key generation assets ESB Power Generation (ESB PG) and ESB Independent Generation (ESB IG) or vertical reintegration of its generation and retail supply business ESB Customer Supply (ESB CS) would give rise to competition concerns. Therefore any proposal for re-integration should be assessed on the basis of the effect this would have on competition at each stage of the electricity production process.
- 1.12 Horizontal reintegration of the ESB's generation portfolio should be carefully assessed to ascertain how an increase in ownership concentration would affect what is still nascent competition in the SEM.
- 1.13 Similarly, any proposals for vertical reintegration of the ESB's generation and supply businesses would have to be closely examined as such an arrangement has the potential to create a barrier to entry to likely competitors.
- 1.14 Without prejudicing any detailed plan for re-integration that the ESB might propose, it is likely that any such proposal would affect competition at the contestable stages of generation and retail supply.

## **Grid ownership exacerbates competition concerns**

- 1.15 It is also likely that the effect of horizontal or vertical re-integration would be exacerbated if the ESB was to retain its ownership of the electricity transmission network.

## **Next steps**

- 1.16 There are a number of developments taking place in the Irish electricity sector which will have a significant effect on how competition between electricity companies evolves in the coming years. These developments include:
  - further interconnection with the UK and possibly with mainland Europe;
  - the removal of regulated tariffs for domestic electricity customers; and
  - possible sale of State assets.
- 1.17 The developments listed above have the potential to either enhance or diminish competition depending on how they are addressed. Each of these developments are intertwined and require careful planning and analysis of the issues involved before a final policy decision can be made. As there is considerable uncertainty relating to the future ownership of the State's energy infrastructure, it is important these issues are resolved before any re-integration of ESB should be considered.

## RESPONSE TO CONSULTATION QUESTIONS

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### 1. Do the objectives and criteria for the Market Power Mitigation Strategy remain appropriate today and for the foreseeable future?

1.18 Wholesale electricity markets are characterised by particular economic and physical features which give rise to ongoing concerns about the potential abuse of market power. These characteristics are:

#### *Physical characteristics*

- Electricity is perfectly homogenous (irrespective of what fuel and technology is used to generate electricity);
- Electricity cannot be stored on a large scale;
- Electricity is transported via a transmission network and a distribution network.

#### *Economic characteristics*

- Market structure tends to be highly concentrated;
- Bidding in electricity markets is organised on a temporal basis;
- Prices are determined by frequent repetition of bidding (a repeated game);
- High barriers to entry: long lead times to develop new production facilities, high capital costs and a complex planning process;
- Demand for electricity is price-inelastic: electricity is a non substitutable product; consumption often cannot be postponed;
- The supply curve is convex with a steep end due to diversity in production technologies, power plants can have very different marginal and fixed costs; and
- Market participants have extensive knowledge of market conditions (fuels costs, available capacity, demand and spot and forward prices).

1.19 A firm has "market power" if it can increase its own profit by raising the market price above the competitive level. In order to raise the market price an electricity generator must reduce its supply or withhold electricity from the market. There are two types of withholding:

- Physical withholding occurs when a generator does not offer its economically available capacity to the market or does so at a price which results in the capacity not being taken up.
- Economic withholding occurs when a generator offers its economically available capacity to the market at a price higher than marginal cost but the capacity is nevertheless taken up. (Such behaviour can also be considered as equivalent to excessive pricing.)

- 1.20 The incentive to withdraw capacity exists if the loss of revenues on the withdrawn (most likely, mid-merit) generation capacity is compensated by the additional profits made on the company's base-load capacity. This means that market power can be exercised only by generators that are large relative to the market and diversified enough to be able to significantly raise the market price by reducing their own output by a relatively small amount.
- 1.21 In theory, there are also situations where "small" generators can exercise market power to such an extent that average electricity prices over longer periods are affected. This may be the case if a generator controls a significant part of the peaking capacity. A generator with a significant share of peaking capacity does not have to be big in terms of the total market but by frequently being the only generator that is able to increase output enough to satisfy demand, i.e. by being "pivotal", it has considerable market power.
- 1.22 Generators with a large market share may often be pivotal but the fact that small generators can also be "pivotal" means that the analysis of market power should not be limited to the measurement of firm size and concentration.
- 1.23 It would appear that the *Bidding Code of Practice*, which sets out the principles according to which generators are required to base their bid on their Short Run Marginal Cost (SRMC), together with the requirement that generators must submit their bids a day ahead of the market price being set, have been reasonably effective in mitigating the potential for a single generator to independently raise prices above their competitive levels.
- 1.24 Nevertheless, the large market share of a single generation company with a diversified portfolio, the repetitive nature of the bidding process and the volume of market data available to all participants means that the potential for anti-competitive behaviour will remain notwithstanding any changes to market conditions that may occur in the foreseeable future.

### **Market power and the transmission network**

- 1.25 CEPA's analysis of the SEM deal largely with issues of market power within the SEM itself. However competition in the SEM can also be undermined by conditions upstream and downstream of the wholesale market.
- 1.26 For example, transmission network congestion provides a number of potential opportunities for the exercise of market power. It is therefore important that congestion is monitored and taken into account in monitoring market power.
- 1.27 In the course of the Authority's assessment of ESB's acquisition of Northern Ireland Electricity plc (NIE)<sup>2</sup>, the Authority was concerned that, post acquisition, ESB would be in a position to acquire and use "commercially sensitive information" gained from its ownership of NIE's

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<sup>2</sup> M/10/026 - ESB / Northern Ireland Electricity plc available to download from the Competition Authority's website: <http://www.tca.ie>.

transmission and distribution businesses and ESB's other businesses post-merger.<sup>3</sup>

- 1.28 Following discussions between ESB and the Authority, ESB submitted a finalised proposal in the form of undertakings relating to commercially sensitive information which were acceptable to the Authority. The Proposal formed part of the basis of the Authority's Determination to clear the merger.
- 1.29 Eirgrid, as Transmission System Operator (TSO), clearly has a central role to play in the dispatch of the network and planning its future growth. The role of TSOs will become increasingly important in light of plans for further interconnection with the UK and possibly with other EU Member States in the future. Given the large implications of small changes of available transmission capacity on local prices and the exercise of market power, a credible and transparent process must guide these decisions. To assist in this process, the full independence of Eirgrid must be ensured.

### **Structural remedies are the preferred option**

- 1.30 It is clear that a range of measures are required to mitigate the market power of any single participant but the threat of market power could be more effectively addressed by the implementation of structural measures.
- 1.31 For example, separating the transmission network from generation by transferring the network's assets to Eirgrid, which is already responsible for the operation of the network, would ensure full independence of the natural monopoly element of the electricity system from the contestable stages of generation and retail supply. This approach of unbundling permanently removes the potential for a generator to leverage any commercially sensitive information relating to the network to raise wholesale prices.
- 1.32 Rather than relying on a package of largely behavioural remedies to address what is in essence an asymmetry in market power between the ESB and its competitors, further consideration should be given to:
- rebalancing the distribution of market power in the SEM through the divestment of some of ESB's generation assets; and
  - full legal and ownership separation of the ESB's generation and transmission assets.
- 1.33 A structural solution involving further divestment of plants within the ESB group's generation portfolio has two main benefits to the SEM. Firstly, a divestment programme in which plants of varying sizes could be sold as a bundle would reduce the ESB's market share of installed capacity and also remove the ability of any generation company to be the predominant price setter for the market. Secondly, as competition improves as a result of plant divestments, this provides room for the *Bidding Code of Practice* to be relaxed as normal competitive restraints

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<sup>3</sup> Commercially sensitive information means information held/and or obtained by NIE or any of its affiliates or related undertakings in the discharge of NIE's functions in terms of planning, developing and maintaining the electricity transmission and distribution systems in Northern Ireland.

lessen the need for direct regulatory intervention, which inevitably circumscribes how market participants manage their costs and formulate their bids.

**2. Will the new interconnector facilitate more competition from Great Britain? If so, what will be the impact on the appropriate market power mitigation strategy?**

- 1.34 Further interconnection with Great Britain should improve competition in the SEM provided the current uncertainty about how imported capacity is treated in a mandatory pooled market is clarified ahead of the interconnector going live.
- 1.35 The available economic analysis of the likely effect of interconnection most notably the work done by the ESRI<sup>4</sup> and Eirgrid<sup>5</sup> suggest that Irish consumers will benefit from further interconnection with the UK and at some time in the future, an EU-wide transmission network.
- 1.36 The ESRI's analysis suggests that further interconnection with the larger UK market via the East West Interconnector (EWIC), should reduce the differential between Irish and UK electricity prices with the benefit accruing to Irish customers, in the short term at least. Similarly, in its business case for construction of an interconnector, EirGrid argued that the EWIC would significantly increase the competitiveness of the SEM as the addition of 500 MW of imported capacity would reduce the market power of participants, putting downward pressure on market prices.
- 1.37 However, both reports stress that the full competitive benefits of interconnection will only be fully realised if an appropriate mechanism for the efficient allocation of interconnection capacity is put in place first. As the EWIC is on schedule for completion by the end of 2012, it is crucial that there is regulatory certainty regarding the allocation of capacity on the interconnector.
- 1.38 The economic benefits of interconnection are difficult to quantify *ex-ante* due to the differences in the market arrangements and fuel mixes between the SEM and its UK equivalent, BETTA. However the addition of a further 500 MW of capacity that the EWIC will provide to the SEM is the equivalent to that of a medium sized Combined Cycle Gas Turbine (CCGT) and should therefore provide greater downward pressure on prices and provide more liquidity.<sup>6</sup>
- 1.39 However there are significant differences between the SEM and BETTA which must be addressed before if the additional capacity of the EWIC can be used efficiently. SEM is an *ex-post* mandatory pooled market where bids are submitted one day ahead of the market dispatch schedule but prices and supply quantities are settled four days after physical delivery of power. BETTA is a self-dispatch, balancing market where prices are set one hour before the physical delivery of power.

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<sup>4</sup> Malaguzzi Valeri, L. (2009), Welfare and competition effects of electricity interconnection between Ireland and Great Britain.

<sup>5</sup> EirGrid (2008) business Case. The development of an East West Electricity Interconnector.

<sup>6</sup> Increasing reliance on wind energy on a small island requires interconnection. Large volumes of wind may have to be curtailed to maintain the reliability of the electricity transmission system meaning that the large capital costs incurred in investing in wind generation cannot be offset by lower fuel costs unless this power can be exported.



- 1.40 One of the consequences of the relatively long timeline between bidding and settlement in the SEM is that the potential users of interconnectors in the SEM have no indication of the SEM's System Market Price ("SMP") versus the price in BETTA. This acts as a significant impediment to trading between the neighbouring markets.
- 1.41 As the wholesale price differential between the SEM and BETTA is expected to fall over time due to the increased level of interconnection, the economic viability of the EWIC will require that all of its 500 MW capacity be utilised.
- 1.42 The CER is considering a number of options for the allocation of this capacity. While the final decision on the best option is a matter for the regulatory authorities, the decision that is taken should ensure the interconnector capacity is allocated on a fair and transparent basis to those units who are best able to use it.<sup>7</sup>
- 1.43 The construction of the EWIC is a welcome development but it should be seen as a first step in a much larger project to connect the Irish electricity system with the wider European electricity market. Deeper interconnection with a large interconnected system with a diverse fuel mix (wind, nuclear hydro) is the best means of ensuring Ireland achieves can access a secure source of energy at competitively prices.

**4. In what way could DCs be reformed in order to promote contract liquidity while also mitigating market power? Do you see merits in replacing the HHI with the RSI in determining DC volumes?**

- 1.44 The availability of a liquid contracting market is essential for electricity suppliers so that they can match supply with customer demand. There appear to be merits in using RSI in determining directed contracts as it appear to be a more effective indicator of when market power is a problem to market participants than the HHI.

**The role of Directed Contracts**

- 1.45 The RAs have consistently stated that the primary purpose of Directed Contracts (DCs) is to mitigate the market power of the larger generators in the SEM while the additional benefits they provide to the market in terms of liquidity and hedging opportunities are secondary.<sup>8</sup>
- 1.46 The rationale for DCs is that they mitigate market power by reducing the incentive for those incumbent generators (ESB PG and NIE Energy PPB) who are subject to DC contracts, to submit commercial bids into the SEM at above competitive levels, or otherwise withhold capacity, in order to influence spot prices or future contract prices.
- 1.47 However as outlined earlier, market power in electricity is often more resilient than in most other sectors as the relationship between concentration and market power is not straightforward. The technology, fuel mix and variation in plant size within a generator's portfolio may be as determinative of market power as its market share. This implies that incumbent generators may retain the ability to

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<sup>7</sup> SEM Regional Integration: A Consultation Paper, SEM-09-096, 10 September 2009.

<sup>8</sup> Market Power Mitigation in the SEM Directed Contract Implementation Report SEM-09-015 11 February 2009

sustain high prices despite the imposition of DCs based on market share alone.

### **HHI or RSI**

- 1.48 The limitations of the HHI as a measure of market power in the context of electricity markets are by now widely accepted and highlighted again in the CEPA consultation paper. The HHI is a useful indicator of concentration but it is considered only as a first screening device in any competition assessment. In competition cases, the HHI is limited in so far as it does not take into account the level of spare capacity nor can it predict the strategic behaviour of competitors
- 1.49 The continuous scale of the Residual Supply Index (RSI) has the advantage of indicating the growing threat from a generator to exercise market power even at times when it is nearly, but not quite pivotal.
- 1.50 In addition, the RSI has been shown to be an effective means of detecting market abuse in other wholesale electricity markets and distinguishing instances of price spikes from instances of anti-competitive behaviour.
- 1.51 The RSI in conjunction with an analysis of price cost margins, takes account of the fact that while market power thresholds may be exceeded at certain times, this does not necessarily mean that market power abuse has occurred. Price spikes that are attributable to market conditions such as tight capacity margin, act a signal for investment than an abuse of market power.
- 1.52 The RSI, which is based on a continuous scale to identify "pivotalness", would appear to be a better indicator of the type and duration of contracts that would be most required by suppliers. It should, in theory, provide a market signal for the need for short-duration contracts to cover periods of peak demand.
- 1.53 However there remain a number of issues which should be addressed before a switch to the RSI is considered. The main concern with a switch to the RSI relates to how an intermittent source such as wind energy is accounted for in the calculation of the available capacity of other generators. There is a concern that in a system with high wind penetration that the RSI may overestimate the ability of other generators to meet peak demand.

### **6. Do you consider that the planned forthcoming removal of the EPO for domestic customers in Ireland will have an adverse effect on competition and liquidity in the SEM spot or contracts market? If so, what replacement would you recommend for the SEM?**

- 1.54 The Third Energy Package places requirements on regulators to perform ongoing monitoring of the market to ensure that customers are benefiting from competition, and to take action where that is not the case. Any exercise should not be confined to changes in market shares but also include monitoring of patterns of consumer behaviour. The Competition Authority would be pleased to advise the CER on its assessment at this stage.

**7. What if any, implications for competition/ end customer do you see arising from ESB's proposed reintegration:**

**a) Horizontally,**

**b) Vertically,**

**c) Horizontally & Vertically.**

- 1.55 A re-integration of the ESB's ringfenced businesses, be it a horizontal integration of its two key generation assets ESB Power Generation (ESB PG) and ESB Independent Generation (ESB IG) or vertical reintegration of its generation and retail supply business ESB Customer Supply (ESB CS) would give rise to competition concerns. Any re-integration of the ESB's ringfenced units, while not a notifiable merger under the Competition Act 2002, should nevertheless be assessed by the regulatory authorities for its impact on competition.
- 1.56 Re-integration of the ESB's ringfenced businesses is a matter for the regulatory authorities but the Competition Authority, as the public body with responsibility for merger assessment in the State has extensive experience and expertise in the area of mergers and joint ventures.
- 1.57 The main provisions concerning mergers and acquisitions are set out in Part 3 of the Competition Act 2002. In addition, the Competition Authority has published a number of Guidance documents on the interpretation of certain terms used in Part 3 of the Competition Act 2002 and various aspects of the merger review process.<sup>9</sup>
- 1.58 The Authority applies a Substantially Lessening of Competition (SLC) test in its assessment of all mergers. The SLC test is interpreted in terms of consumer welfare. Consumer welfare depends on a range of variables including price, output, quality, variety and innovation. In most cases, the effect on consumer welfare is measured by whether the price in the market will rise. The conclusion that an SLC will result from a merger is thus based on whether the price to buyers is expected to rise (or output to fall). Where price is not the appropriate variable, welfare is measured by the changes in the relevant variables
- 1.59 In its 2003 report "A Powerful Competition Policy", the Nordic competition authorities suggested that given the particular characteristics of wholesale electricity markets, horizontal mergers between generators required careful consideration.<sup>10</sup>
- 1.60 There have been several mergers involving some of the large players in the Nordic markets since 2003. In Elsam/NESA the Danish Competition Authority cleared the acquisition subject to the sale of 600MW capacity through a VPP and the divestment of the merged entity's holding in the transmission network.<sup>11</sup> In DONG /Elsam/E2, the

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<sup>9</sup> <http://www.tca.ie/EN/Mergers--Acquisitions/Legislation--Guidance/Guidance-on-Mergers.aspx>

<sup>10</sup> *A Powerful Competition Policy*, joint report by the Nordic Competition Authorities, (2003).

<http://www.konkurransetilsynet.no/>

<sup>11</sup> Available to download from the Danish Competition Authority website:

<http://www.konkurrencestyrelsen.dk>

EU Commission cleared the merger subject to a number of asset swap agreements with other energy companies.<sup>12</sup>

- 1.61 There have been a number of recent mergers and/or joint ventures in the EU energy sector where divestments have been required by the Commission: EDF's acquisition of British Energy<sup>13</sup>, Vattenfall's acquisition of Nuon Energy<sup>14</sup>, RWE's purchase of Essent<sup>15</sup> and the acquisition of Segebel by EDF<sup>16</sup>. In all these cases, the merger was cleared subject to structural remedies: the parties proposed to divest certain business to third independent operators.
- 1.62 From an examination of these mergers, concerns are likely where an already diversified generator buys further price-setting capacity from a smaller competitor. This can have significantly greater effect on prices than one where additional baseload capacity is purchased instead.

**What, if any, new measures would you recommend be put in place for each of the above forms of integration?**

- 1.63 Given the considerable structural changes that have already taken place in the Irish electricity in recent years and the conclusion of CEPA that the SEM is working well, there does not seem to be a strong case for reintegration at this time.
- 1.64 It is not clear what the consumer benefits of re-integration would be. Separation of the contestable stages of the electricity production process (generation and retail supply) from the natural monopoly element (transmission and distribution) is a key feature of the electricity market liberalisation process. Achieving this separation is the purpose of the "unbundling" provisions in the EU's Third Energy Package ("TPE").
- 1.65 The TPE follows the sector inquiry published by the EU Directorate for Competition ("DG Comp") in early 2007 (the "Sector Inquiry"). This inquiry concluded that reform of the European energy sector is developing too slowly largely on account of the market power enjoyed by vertically integrated incumbent energy suppliers.
- 1.66 When a vertically integrated supply company owns a network, competitors will necessarily need access to this network in order to compete on the markets served by it. The vertically integrated firm has an incentive to use its network to distort competition in its favour.
- 1.67 This can be achieved not merely by refusing to grant access to the network but also by giving access on less favourable conditions than those applied to internal transfers, or in the case of a price squeeze, on conditions that do not allow an equally efficient competitor to remain on the market.

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<sup>12</sup> Case No COMP/M.3868-DONG/Elsam/Energi E2.

<sup>13</sup> Case No COMP/M.5224 - EDF / British Energy.

<sup>14</sup> Case COMP/M.5496 Vattenfall / Nuon.

<sup>15</sup> Case COMP/M.5467 — RWE/Essent.

<sup>16</sup> Case No COMP/M.5549 - EDF/ Segebel.

## **8. Would further divestment by ESB encourage deeper competition in the wholesale market?**

- 1.68 Yes, further divestment by ESB would have competition benefits provided that asset sales are designed to address the imbalances of market power between ESB and its competitors. This is best achieved through the sale of generation plants as portfolios rather than as standalone entities - as this would give market participants the opportunity to develop the shape of their supply. The issue of market power in the SEM stems largely from the scale and scope of ESB's generation portfolio, further divestment of power plants should be considered to encourage competition in the wholesale market.
- 1.69 It is appreciated that any divestiture aimed at mitigating market power can be a complex process involving detailed market modelling of the price-setting ability of individual plants at certain times. However published reports by the Market Monitoring Unit have shown that the price-setting plant can be detected with a fair degree of certainty - although further work may be required in this area.<sup>17</sup>
- 1.70 As discussed earlier, the source of ESB's market power in the SEM is derived primarily from its ownership of a diverse range of power generation plants rather than its overall share of installed capacity. Therefore a piecemeal approach of selling individual plants is unlikely to be effective in reducing the underlying source of market power. Instead an asset divestment programme should be structured in a way that allows the sale of generation assets in bundles comprising both mid merit and peak plants.

## **11. Do you agree with the CEPA analysis of the ability of structural remedies to address the competition problems presented by the hypothetical structural scenarios outlined in section 6 of the accompanying paper?**

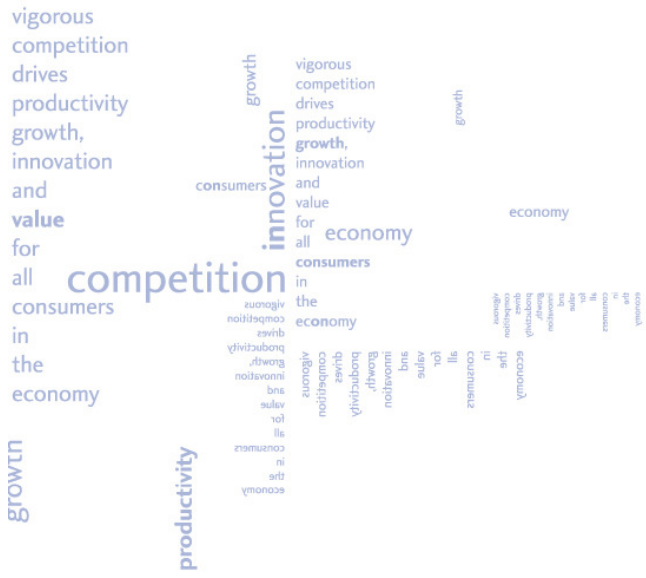
- 1.71 The best solution to mitigating market power is to get the market structure right, namely the allocation of generation capacity among a sufficient number of market participants.
- 1.72 Failing that, directed contracts or any other form of regulatory intervention will require considerable commitment of resources and specialised skill to get right and will require ongoing costly monitoring of the behaviour of market participants.
- 1.73 It would be inappropriate for the Competition Authority to comment on the specific scenarios outlined by CEPA in Section 6 of the consultation paper as some of these scenarios would require the Competition Authority to conduct a merger assessment under the procedures set out in the Competition Act 2002.
- 1.74 Notwithstanding our statutory responsibilities in relation to merger assessment, the thrust of CEPA'S analysis in Section 6 indicates that the regulatory authorities should consider remedies that address the structure of the SEM rather than further regulatory intervention.
- 1.75 While the costs of horizontal separation of the ESB's generation businesses may be considerable, these costs should be balanced

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<sup>17</sup> Single Electricity Market Monitoring Unit Public Report 2009 pp45-47.

against the considerable but less quantifiable benefits of entry by other generators that has taken place since the SEM was established.

- 1.76 The entry of Endesa and Bord Gáis and the emergence of AES as competitors to the ESB companies in the SEM have brought a new dynamic to competition which cannot be quantified as easily as the costs relating to the separation of ESB.



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