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James Grigor
Economist, Energy Economics
Ofgem, 9 Millbank
London
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23 April 20, 2010

Dear James,

Liquidity proposals for the GB wholesale electricity market – ESBI response

ESB International (ESBI) welcomes the opportunity to comment on Ofgem's proposals for improving liquidity in the wholesale electricity market. As an independent generator of electricity, the ability to compete effectively in the wholesale market is a key requirement. The current low level of liquidity is a concern and we therefore welcome Ofgem's review of the issue.

ESB International

ESBI has been a developer of independent Combined Cycle Gas Turbine (CCGT) generation projects in the GB market for over fifteen years. We currently have interests in the 350MW Corby power station and in the 850MW development at Marchwood, which commissioned in late last year. We also recently announced our latest 860MW development at Carrington which is planned to commission in 2013. We are also developing other large CCGT developments at various locations across GB. It is ESBI's intention to build 3GW of thermal generation in Great Britain in the next decade.

In addition to building up our conventional generation fleet, we are also seeking to expand our GB portfolio of renewable generation sites, having recently announced the acquisitions of Fullabrook Down and West Durham windfarms. All these developments are set within the context of a wide-ranging programme announced by the ESB group to facilitate the transition to a low carbon economy.

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Summary of ESBI views

At the highest level, we welcome Ofgem's review of liquidity in the electricity wholesale market. Further, we agree with its conclusion that there is a fundamental lack of liquidity which is detrimentally affecting competition, particularly for independent electricity generation and supply. As a consequence, customers may be paying higher prices than necessary.

However, there are aspects of Ofgem's conclusions that concern us: firstly, that there should be further review of impacts and arrangements for liquidity involving independent generation; and then as to the timing of possible market intervention. We would seek for these to be addressed at the earliest opportunity.

The wholesale market is dominated by the large integrated energy companies. Ofgem's investigation into market liquidity focused on the impacts this dominance has on smaller independent supply companies and how liquidity could be improved to the benefit of suppliers. Whilst liquidity to support independent suppliers would certainly bring benefits to customers, we are strongly of the view that Ofgem should also look more closely at how liquidity could be improved in relation to the operation of independent generators. We feel that there has been insufficient consideration of the benefits that could be seen, should trading liquidity be improved between independent generators and large suppliers.

Wholesale energy costs account for a significant proportion of customers' bills¹. Generation costs make up a large proportion of the wholesale energy cost and as such we would strongly advocate the benefits that could result, were liquidity and competition to be improved in the generation market. Although most of the proposals raised by Ofgem are focused primarily at developing liquidity for independent suppliers, we are of the view that they could be introduced, with minimal additional change, to also benefit independent generators.

We recognise that there is adequate liquidity in the spot and day-ahead markets but, as Ofgem identified, the lack of liquidity is particularly pronounced further along the forward price curve. A lack of long-term liquidity prevents clear investment signals being seen for new generation and as such could have impacts

¹ Indeed, Ofgem's last Electricity and Gas Supply Market Report states that, historically, wholesale costs account for approximately 60% of retail bills, whilst currently this is 44%.

for future security of supply.

Ofgem's conclusion was that it has identified deficiencies in current arrangements which are contributing to the low levels of liquidity presently being seen in the market. Further, it proposes a number of possible remedies that could be introduced to stimulate liquidity. In terms of process, some of these are relatively small incremental changes, such as limitations on self-supply whilst some are more fundamental, such as mandatory auctions. However, Ofgem has decided to delay introducing any change in order to provide an opportunity for a number of market initiatives to deliver improved liquidity. Ofgem indicates that it will monitor the situation over the forthcoming year and will take a decision late in 2010 or early in 2011 as to whether additional measures are required. In this case a relatively small incremental change could deliver significant market benefits and better facilitate the principles upon which liberalised markets are predicated. As such we would urge Ofgem to look again at whether action is required immediately to address the deficiencies it has identified rather than waiting until a point further in the future.

Conclusion

ESBI is a strong advocate of the role that liberalised markets play in delivering energy policy. However, we are also of the view that the current market arrangements and associated lack of liquidity are working to the detriment of market participants, generation investment signals and, ultimately, consumers. There are relatively small incremental changes that Ofgem could introduce quickly, that would significantly improve the amount of liquidity in the electricity wholesale market. We are strongly of the view that these should be implemented at the earliest opportunity rather than further delaying in anticipation of possible improvements in liquidity.

Should you wish to discuss any of the issues raised in this response further, please do not hesitate to contact me.

Yours sincerely,

Michael Dodd

GB Regulation Manager

ESBI Investments

By e-mail