

Supplier & Generator Suspension Delay Periods – AIP/SEM/07/427

Response by Airtricity

Summary

Whilst Supplier default in SEM is likely to be extremely rare, the Supplier concerned will be aware of its impending occurrence for some time prior to the event actually occurring and can be assumed to have been making efforts to recover remaining business value prior to the default event itself. On the other hand, provision of credit cover is an ongoing burden on market Participants and carries a cost related to business size and variability of generation available to provide settlement re-allocation. In setting the Supplier Suspension Delay Period, it is important to balance the benefit of affording an individual Supplier additional time to seek business rescue, against the resultant facilitation of a greater level of market default coupled with the ongoing cost burden of continuing Participants providing additional security cover.

On balance we believe that the asymmetry of financial information between defaulting Supplier and the relevant Regulator means that a Supplier will not be disadvantaged by a short suspension delay period, whereas all Participants will derive ongoing benefit from minimising their obligation to provide security cover. A short delay period will also reduce default risk to the market, as less energy/capacity forecasting will be required and (aside from legal issues in NI) posted security cover will be a closer match to outturn liability.

Effect on Credit Cover

Credit cover is a key concern of participants. Issues with extending the suspension delay period include the cost of providing the cover and variability in the level of requirement; accuracy of statistically-derived values when these are being used to take fundamental decisions affecting a Supplier's business viability; increasing Participants' costs for providing security cover without a corresponding reduction in market risk exposure.

cost burden and variability

Provision of security cover is an ongoing burden for all market Participants; commercial convenience of a single Supplier potentially facing expulsion from the market must be a secondary concern. There is a costs associated with this provision that varies depending to the scale and resources of each Participant. For Participants with no generation resources from which to obtain value through settlement reallocation, or for those whose ability to reallocate is weather-dependent, the burden of the value magnitude and management effort required to maintain credit cover will be an ongoing issue.

accuracy of statistically-derived values

As the Undefined Potential Exposure is statistically derived, it is virtually certain that the calculation will result in a credit cover requirement that does not match a Participant's outturn liability. Taking fundamental decisions on the commercial future of a Participant, on the basis of a statistically-estimated estimated liability that suggests there is a 50% chance of making a wrong decision, must be regarded as potentially flawed. Calculated liabilities must overwhelmingly predominate in determination of security cover requirements.

loss of market risk mitigation

The consultation suggests that a likely credit cover requirement is €12m, per day of undefined exposure period, across the market. Given the inherently variable impact of security cover provision across Participants, the further impact of each additional day's cover resulting from extending the suspension delay period and the uncertain correlation of market risk with calculated undefined potential exposure, we strongly believe it is essential that the undefined potential exposure period is minimised.

For reasons of minimising the burden of security cover on Participants, as well as maintaining alignment of calculated liability estimates against outturn, we do not support the RAs' proposal that a further 7 days be added to the basic suspension delay period to allow for further business recovery attempts.

SoLR Process

The Consultation highlights an omission in the NI Licence revision process whereby the time for revocation has remained at 3 days; failing to take account of experience in GB, where a number of Supplier failures has led to the notice period being reduced to 24 hours. We would support this timescale being included in the NI Supply Licence as a means of reducing market exposure arising from the discrepancy between the suspension delay period and duration of the legal process. We would also support (in the medium/longer term) a review of Electricity Regulations (Northern Ireland) 2007 and/or the Insolvency (Northern Ireland) Order 1989, to permit the SoLR process to be triggered in line with TSC requirements and independently of Insolvency proceedings.

Supplier Suspension Delay Period

The Consultation suggests that three distinct time periods must be allowed to determine whether or not to invoke the Suspension Order;

- time for the RAs to determine the underlying driver of the default,
- time for the RAs to decide the appropriate course of action, and
- time for the defaulting Participant to address its financial problems.

However we do not accept that the activities need run consecutively. We believe that any Participant approaching default will be very aware of the situation and the causes of its dilemma and will have been seeking a solution on an ongoing basis; another few days is unlikely to deliver a materially better outcome.

In terms of addressing the default, we agree that the RAs need to understand the basis of the problem and reach a decision on appropriate action. The former can rapidly be accomplished through discussion with the Participant (and potentially the MO), so the 7-day period suggested for identification of the driver(s) underlying the default could also provide adequate time for decision on implementation of the Suspension Order.

Because any default event will not be a surprise to the defaulting Participant, who will already have explored and taken action on potential business rescue strategies, we do not believe it is necessary to provide additional time in the suspension delay period to allow for non-regulatory concerns. We therefore support the period of 7 days following Supplier default as being a sufficiently long Supplier Suspension Delay Period. A further period of 7 days to address Supplier business rescue issues will unduly increase the ongoing burden of security cover on Participants and related issues, as described above.

In the first paragraph on page 11, the Consultation states that €180m of credit cover would be "unlikely to exceed €10m pa which is less than 1/2% of the total market turnover", as though this amount were trivial. We suggest that the author should consider "1/2%" as a proportion of the PES allowed net supply margin before trivialising this amount. The further implicit assumption, that the cost of credit cover is the same for all Participants, is invalid since startup Supplier businesses will almost certainly pay a higher fee for their security cover than more established Participants. We are aware that the range of charges could result in a cost of €10m for an individual Participant. The availability of revenue for settlement reallocation will also vary between suppliers and across generation technologies.

A 7-day Supplier Suspension Delay Period balances the need for intermittent delivery of orderly market exit by a single Participant against the ongoing burden of security cover provision by all Participants. It also reduces the potential discrepancy between the Undefined Potential and Actual Outturn exposure of the market to Participants.

NI Licence withdrawal issue

With regard to the NI-specific issue of Insolvency law and Supplier Licence termination, we agree that the MO should issue the statutory demand as soon as the default occurs, but we believe there is also scope for mitigation by a change in the TSC. This would prohibit a defaulting NI supplier from acquiring customers and imposing an obligation on the supplier to obtain its energy from the SoLR. Without further payment from the supplier (payment would be unlikely if the supplier were already in default) the SoLR would then acquire the ongoing debt and would be able to recover this via the defined SoLR cost recovery process.

Once the law/licence changes could be brought into effect, the additional SoLR exposure to the extended NI insolvency process would be reduced to be equivalent to that in RoI.

Generator Suspension Delay Period

We support the proposal for the Generator Suspension Delay Period to be set at 7 days.

Insurance

We agree that it would be difficult to obtain reasonable insurance cover for an undefined liability. However it might be possible to obtain a competitive quote for a defined liability of (say) €20m. This could allow the market exposure to an individual defaulting Participant to be limited for a Supplier Suspension Delay Period of up to the proposed 14 days, without imposing an additional undue security cover burden on surviving Participants.

While it is clear that an insurance option is infeasible for 1 November, the RAs should investigate the cost of insurance once the market is operational and underwriters have access to the data needed to evaluate the risk of Participant default.

Summary

We agree that the Generator Suspension Delay Period should be set to 7 days. We do not agree that it is necessary for the Supplier Suspension Delay Period to be longer than this and propose that the two should be the same. We believe that the insurance option should not be ruled out on the basis of an untested assumption as to its cost, but should be investigated for future implementation.