

SEMC Consultation  
SEM-23-024 -  
Compensation  
Arrangements for Net  
Transfer Capacity  
Reductions  
Mutual Energy response

Date: 5<sup>th</sup> May 2023



A Northern Ireland company  
**working for consumers**

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## Executive Summary

We welcome the opportunity that this consultation presents to provide an interconnector owner (“ICO”) perspective on compensation arrangements in the case of reductions in net transfer capacity (“NTC”).

Cross border interconnector capacity brings significant benefits to consumers, including;

- Enabling energy market integration and more competitive energy pricing;
- Avoiding significant costs of building new peak generation capacity;
- Increased security of supply associated with a more diversified energy mix; and
- Enabling higher levels of renewables.

Uncompensated (and therefore uncosted) NTC restrictions would lead to under-utilised assets with significant socio-economic welfare costs across the connected jurisdictions. We therefore believe that cost-reflective and fair compensation arrangements are required to ensure that the optimal capacity is always made available to the market.

It is Moyle’s position that the compensation arrangements in the Interim Cross Zonal TSO Arrangements (“ICZAs”) are very clear and help to reach such an outcome. Whilst the SEM regulatory authorities may wish to direct that aspects of the ICZAs be updated, there is no clear reason or mandate to change the previously agreed and still applicable compensation provisions for the intraday and balancing timeframes.

As is evident from the consultation paper, and as we make clear here, there is a substantial body of evidence to demonstrate that the parties to the ICZAs have previously accepted that NTC reductions should ultimately be compensated based on the principle of ‘causer pays’ and that the compensation value should be at the loss adjusted market spread. There is further clear precedent in GB for the implementation of such an arrangement.

We note the statement in the consultation paper that SONI and EirGrid (“SEM TSOs”) <sup>1</sup> maintain that the compensation arrangements in the ICZAs are unclear. This is not the case, and it would not be unreasonable to infer that the SEM TSOs have been relying on the ICZAs to reduce NTCs since September 2021, simply without addressing the requirement to pay compensation to the ICOs.

A clear gap in the ICZAs is that they have insufficient detail on the circumstances in which NTC restrictions can be applied and there is a pressing need to put controls in place which define the circumstances in which SEM TSOs can take these actions and what tools they are required to exhaust before doing so. There is a resultant lack of transparency around NTC restrictions, and we believe that there is an urgent need to establish transparent and auditable criteria for their use by the SEM TSOs. The compensation cost of NTC restrictions should be both an input to decision making on their use and an indicator of their efficiency. Not fully compensating such restrictions would ultimately lead to incorrect decisions, lack of transparency and scrutiny of the impact of these actions, and a likely increase in costs to consumers.

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<sup>1</sup> SEM TSOs here refers to SONI and EirGrid, notwithstanding that Moyle Interconnector Ltd is also a certified TSO.

## About Mutual Energy

Mutual Energy Limited (“MEL”) owns and operates large-scale, strategic energy assets in the long-term interest of Northern Ireland (“NI”) energy consumers, including critical energy infrastructure linking the NI energy system to Great Britain (“GB”); the 500 MW HVDC electrical Moyle Interconnector and the Scotland to Northern Ireland Pipeline for gas. Both assets are essential to maintaining security of energy supply in NI. As well as these subsea assets, MEL owns and operates large sections of the onshore NI gas transmission network (the Belfast Gas Transmission Pipeline and the West Transmission Pipeline). MEL have also established a joint venture with GNI (UK) (the other gas Transmission System Operator (“TSO”) in NI) to provide a market operator function via the Gas Market Operator for Northern Ireland (“GMO NI”), to facilitate the efficient transportation of gas across the NI gas network.

As a mutual company, MEL has no shareholders, and our corporate purpose is to own and operate energy infrastructure in the long-term interest of NI energy consumers. Our licence structures and regulatory stability allow us to raise debt-finance at a low cost of capital, and therefore the mutual model reduces the cost to Northern Ireland consumers of mutualised assets and has the potential to reduce the cost to NI consumers of new, capital intensive strategic energy infrastructure required to enable the energy transition.

As stated in the consultation paper, the SEM TSOs have restricted the export capacity of the Moyle Interconnector in over 25% of trading periods since September 2021, thereby preventing the interconnector from generating its primary revenue stream. It is in that context in which we respond to this consultation on behalf of the Moyle Interconnector Ltd (“Moyle”) business.

## Commentary on background provided in consultation paper.

To support our answers to the consultation questions, we wish to provide additional background information and correct a number of inaccuracies in the consultation paper. For ease of reference, we provide this commentary under the headings used in the consultation paper.

### Section 1.1.1

#### Interim Cross Zonal Arrangements

This refers to the Interim Cross Zonal Arrangements (“ICZAs”), their ongoing relevance and their applicability to Greenlink and future SEM-GB interconnectors. It is important to remember, as the consultation paper notes, that the ICZAs were a common arrangement developed by the TSOs and endorsed by regulators. The arrangements in the ICZAs were agreed as a package and the compensation provisions which form part of that package are of fundamental importance to Moyle and its financiers and other stakeholders. We would assume they are of equal importance to future SEM-GB interconnectors, such as Greenlink. It is therefore essential that any SEMC decision preserves the balance of these arrangements (i.e. if onshore TSOs restrict interconnector capacity they must compensate ICOs for forgone congestion income) and we do not see how any SEMC decision which does not do so can be effected without the agreement of the affected ICOs.;

Whilst Financial Transmission Rights (“FTRs”) are currently not sold on the SEM-GB interconnectors, the compensation provisions which were agreed by the TSOs (and reviewed and endorsed by the SEM RAs and Ofgem) when they adopted the ICZAs in September 2017) explicitly address the intraday market timeframes in which interconnector capacity has been allocated following the UK’s exit from the EU. The consultation paper states that the SEM TSOs consider it to be unclear how the provisions of Article 3 (20, 21 and 22) should be applied going forward. Moyle’s view is that there is no lack of clarity in the provisions, as they explicitly address the intraday market timeframes in which interconnector capacity is currently allocated. The intraday timeframe compensation arrangements in Article 3 remain in full force and effect in accordance with their terms and continue to have a fundamental role in protecting the ICOs against revenue losses arising from the actions of another TSO which reduces an interconnector’s NTC below the level previously determined in accordance with the established procedures.

This section also states, *“In this [FTR] context, interconnector owners (ICOs) would earn revenue from FTR auction receipts; in turn, ICOs would pay the congestion rent earned from the (loss-adjusted) market spread between the two bidding zones to FTR option holders, when the market spread was positive in the direction of the FTR”*. We recognise that we are clarifying an apparent minor point of accuracy in this text, but, in the FTR context ICOs would earn revenue from FTR auction receipts, collect congestion rent from day ahead and intraday implicit allocation and make FTR pay-outs to FTR holders which were calculated based on positive (loss-adjusted) day ahead market spreads i.e. there were two sources of ‘congestion income’, one associated payment obligation (all of different values) and the resulting ICO revenue would be the net of these. The compensation amount payable by a restricting TSO under the ICZAs equates to the forgone congestion rent from day ahead and intraday implicit allocations and the issuance (or not) of FTRs is irrelevant. We demonstrate this point in Table I below.

Table I illustrates the effect of the application (or not) of the ICZAs on an interconnector's revenues from capacity allocation under both 'pre-Brexit' market arrangements, when FTRs were issued, and in the current market arrangements where all capacity is allocated in the intraday auctions. For simplicity we assign each income stream and cost a value of one<sup>2</sup> and a +1 sign is used to illustrate income and a –1 sign to illustrate a cost. We show the outcome (i) where there is no NTC restriction; (ii) where the NTC restriction is applied before the primary implicit auction (DAM pre-Brexit and IDAI post-Brexit); and (iii) where the NTC restriction is applied after the primary implicit auction. Again, for simplicity, we assume the NTC restriction reduces the NTC to zero.

Table I.

	FTR auction receipts	Congestion income	FTR payouts	Imbalance	Compensation from TSO under Interim Arrangements	Net result
<b>Pre-Brexit</b>						
No NTC restriction	+1	+1	-1	0	0	+1
NTC restriction before DAM	+1	0	-1	0	+1	+1
NTC restriction after DAM	+1	+1	-1	-1	+1	+1
<b>Post-Brexit</b>						
No NTC restriction	0	+1	0	0	0	+1
NTC restriction before IDAI	0	0	0	0	+1	+1
NTC restriction after IDAI	0	+1	0	-1	+1	+1

As can be seen, the net result for the interconnector owner is the same across all scenarios, both pre and post Brexit and with or without the allocation of FTRs – in each case the application of the ICZAs keeps the interconnector 'whole' from the impact of an onshore TSO initiated NTC reduction. There is no lack of clarity in the compensation mechanism which applies under Article 3(20) where the NTC is restricted before or after IDAI. The mechanism operates separately from the compensation mechanisms for other timeframes in Article 3(20) and is not in any sense impaired if the interconnector does not currently participate in these other timeframes. It is important that this mechanism be preserved. The allocation of FTRs is therefore not relevant to the issue of TSO compensation for NTC reductions as, when FTRs were allocated, the ICO was the impacted party and had to pay FTR holders,

<sup>2</sup> In reality FTR auction receipts will reflect market participants' forecast of market spreads and FTR payouts, so may be higher or lower than the congestion income or FTR payouts. Due to the impact of ramping constraints, ex ante congestion income would be slightly less than the associated FTR payouts.

irrespective of whether the ICO received compensation from the TSO. The only difference between the application (or not) of the ICZAs with or without FTR allocation is how the net result is calculated, with the net result being effectively the same in either case.

The scenario that has ensued since September 2021 is shown in red in Table 1. If Moyle were not compensated in this particular scenario, the net result would be that Moyle would receive zero revenue from capacity allocation when its NTC is restricted, a clear unwarranted outlier in comparison to all other scenarios shown.

### Transparency and principles of use

The paper goes on to state: *“The TSOs have outlined that they are taking these actions in order to avoid system alerts, along with the associated need to carry out SO-SO countertrades, at potentially very high prices or at the risk of not being able to carry out such a countertrade, where exports have been scheduled in the ex-ante markets” and “The RAs note that, going forward, there may be a need to further optimise TSOs’ obligations in terms of demonstrating or codifying need, reporting or transparency when they reduce NTC between GB and SEM”.*

In Moyle’s view, there is an urgent need for transparency around the use of NTC reductions, to set parameters for the circumstances in which TSOs can reduce NTCs and to incentivise SONI and EirGrid to use alternative tools and develop new tools to avoid such regressive actions. For example, the TSOs state they are reducing NTCs to avoid carrying out SO-SO trades at potentially very high prices. Whilst this might be considered a plausible reason for reducing NTCs, if the affected ICO is compensated, no specificity or detail is provided around what constitutes ‘very high prices’ and we are not aware of any ex-post mechanism that has been used to determine whether the SEM TSOs’ actions were economically efficient and justifiable. If TSOs are able to avoid paying compensation for NTC reductions, they will clearly take that action before another action for which there is an explicit cost, ignoring the indirect impact of their actions such as lost congestion income, trading opportunities for market participants, future interconnector capacity market revenues and impacts on the neighbouring market. The requirement to pay compensation is therefore essential to prevent TSOs from using NTC reduction as a ‘free’ option and additional controls on its use are required to reflect the wider impacts and further incentivise the development of alternative tools. We note that NGESO is required to seek a derogation<sup>3</sup> from Ofgem for the application of NTC reductions on GB interconnectors and a time limited derogation<sup>3</sup> has recently been granted with clear expectations set on further work required to justify the use of NTC reductions by NGESO.

We are aware that one reason SEM TSOs have stated for using NTC reductions ahead of the ex-ante markets is that, in the event exports from SEM are scheduled, opportunities to trade with parties in GB to reduce the export flow may not be available. The TSOs also do not currently have arrangements in place to agree trades ahead of the market schedule being determined. We believe that the absence of such arrangements is attributable to the fact that the SEM TSOs lack an incentive to improve the cross-zonal trading opportunities available to them. Clearly if an export flow to GB is scheduled this increases the system margin available in GB (compared to the scenario where no export is scheduled) which means that, unless GB is operating on extremely fine margins, it is difficult to comprehend why trades are likely to be refused so the trading issue seems eminently solvable.

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<sup>3</sup>Source: [Derogation from SLC C28 for NTC](#)

From analysis of publicly available information from NGENSO<sup>4</sup> we can see that on days when Moyle's capacity has been reduced, the margin in GB has been ten times (4GW) Moyle's maximum export NTC of 400MW on almost 90% of occasions. If we only consider the surplus margin in GB (i.e. the remaining surplus after meeting the margin requirements of NGENSO's operational planning), we can see that there was 4GW of surplus on almost 60% of occasions.

Further assurance that trades would be available in GB (and that reciprocal actions were unlikely to be used) can be taken from NGENSO's published statements ahead of this winter<sup>5</sup>:

- *"We will make every effort possible to provide assistance to neighbouring TSOs provided it does not require disconnection of GB consumers".*
- *"On an occasional and exceptional basis we will use the Winter Contingency Coal units and the Demand Flexibility Service to support exports to the continent if a neighbouring TSO is at risk of demand control and the ESO is unable to assist under either market trades or emergency assistance. This option would not be available if the ESO had identified a potential need to run the coal plant for the benefit of GB customers i.e., to avoid demand disconnection".*  
(The winter contingency coal units were procured by NGENSO out of market to support security of supply in GB over winter 2022/23. The demand flexibility service was similarly developed to provide consumer demand respond at times of tight margins).
- *"In extreme scenarios (ESEC) the restriction of interconnector capabilities will be considered in liaison with affected TSOs to avoid disconnection of GB consumers".*  
(ESEC is the Electricity Supply Emergency Code which describes steps which the UK Government could take to deal with an electricity supply emergency of the kind envisaged in section 3(1)(b) of the Energy Act 1976 - "there exists or is imminent in the United Kingdom an actual or threatened emergency affecting fuel or electricity supplies which makes it necessary in Her Majesty's opinion that the government should temporarily have at its disposal exceptional powers for controlling the sources and availability of energy". In contrast to the SEM TSOs' approach of pre-emptively restricting NTCs, this demonstrates the priority that is given to allowing the market to determine interconnector flows in GB.

### ***Section 2.1 NTC reduction compensation as set out in the ICZAs***

It is clear (as described above) that the compensation arrangements in the ICZAs continue to have a vital role in protecting ICOs from loss of revenue caused by TSO enacted NTC restrictions, with a key component of the compensation mechanism being the 'causer pays' principle in Article 3(19).

We note that the SEM TSOs have expressed uncertainty about how the ICZAs should be interpreted in the light of Brexit and FTRs currently not being sold. Moyle does not share that uncertainty. Article 3(20) of the ICZAs comprises four mutually exclusive bullet points, each dealing with reductions in NTC and the payment of associated compensation in specified timeframes, each of which operates independently.

The first bullet of Article 3(20) makes reference to curtailment of long-term transmission rights ("LTTRs", of which FTRs are one variety) and the day ahead market spread, both of which are no longer

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<sup>4</sup>Source:

[https://data.nationalgrideso.com/generation/dailyopmr/r/daily\\_operational\\_planning\\_margin\\_requirement](https://data.nationalgrideso.com/generation/dailyopmr/r/daily_operational_planning_margin_requirement)

<sup>5</sup> Source: <https://www.nationalgrideso.com/document/270586/download>



applicable for SEM-GB interconnectors. That bullet addresses the point in time before the ‘day ahead firmness deadline’, after which cross-zonal capacity for the day-ahead allocation becomes firm and FTRs could not be curtailed (other than for force majeure or in an emergency situation) under the EU frameworks i.e., a consequence of a reduction in NTC in this timeframe (and effectively only in this timeframe) is that FTRs would be curtailed. Later reductions of NTC for operational security reasons would not result in any curtailment of FTRs.

The fourth and final bullet of Article 3(20) makes reference to an “IDM3 auction”. This is not currently applicable to SEM-GB interconnectors as interconnector capacity has never been allocated in this auction.

The second and third bullets in Article 3(20) are self-explanatory and clear, stating that NTC reductions ahead of an auction will be compensated at the loss adjusted market spread of that auction.

Article 3(21) is a statement of fact because, under the “EU Harmonised allocation rules for long-term transmission rights”, FTR holders were (and are) still entitled to receive the full day-ahead market spread as curtailment compensation when FTRs are curtailed ahead of the day-ahead firmness deadline. The effect of FTR curtailment was to apply a cap to the curtailment compensation payments made to holders of curtailed FTRs, such that payments to FTR holders could not exceed the total congestion income collected by the ICO<sup>6</sup>. As stated above, FTR holders were entitled to receive the hourly loss adjusted day ahead market spread multiplied by their FTR holding in MW. In the ordinary course of business, the payments made to SEM-GB FTR holders were typically greater than and not directly linked to the day-ahead congestion income collected by the ICO due to ramping constraints, and it is the ICO which has the obligation to make the FTR payments. We find it extremely difficult to conceive a scenario where FTR holders would have been negatively financially affected by any NTC reduction under the ICZAs.

Consistent with the previous articles which ensure that the ICOs do not suffer as a result of TSO actions, Article 3(22) ensures that ICOs are not exposed to imbalance costs. Again, imbalance costs are not relevant to FTR holders, so the interpretation of this article is also unaffected by Brexit and the non-issuance of FTRs.

## 2.2 Existing arrangements in Great Britain

Notwithstanding that the transparency and controls around NTC reductions initiated by NGENSO could be improved, the compensation arrangements in Great Britain as described in the consultation paper are in fact consistent with and confer equivalent protection on all GB interconnectors as the equivalent articles in the ICZAs.

We note that the description in the consultation paper of this compensation methodology for implicit intraday coupling, such as on Moyle and EWIC, is not correct. The paper states:

*“The methodology regarding the commercial arrangements for implicit intraday coupling (Moyle and EWIC) is as follows:*

- *When allocated capacity is restricted (including FTRs), compensation equals the “net imbalance charge from both markets”.*

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<sup>6</sup> Refer to Article 59, Harmonised allocation rules for long-term transmission rights. The cap was based on monthly totals for DC interconnectors.

• *When unallocated capacity is restricted, compensation equals, “where practicable, the difference in congestion rent from a re-run of the coupling algorithm without restriction OR, the loss adjusted, market spread adjusted for increased scarcity by ‘correction factor’”.*

The first bullet in fact does not relate to FTRs as this methodology was developed in the post-Brexit context. The scenario addressed here is where capacity has been allocated in one of the intraday auctions and is then restricted, which would result in the interconnector being in an imbalance position in both markets. In that scenario, without compensation, the ICO would be exposed to imbalance costs, so the ICO is being kept whole, or cost neutral. This is equivalent to Article 3(22) of the ICZAs.

With reference to the second bullet, Moyle understands that NGENSO has not developed the capability to re-run the coupling algorithm, nor are we aware of a ‘correction factor’ being determined for the SEM-GB border or any other interconnector connected to GB. This means that, in the event of an NTC restriction by NGENSO, the compensation would be based on the intraday market spread. This again is entirely consistent with the applicable provisions of Article 3(20) of the ICZAs.

## 2.3 EU regulatory framework

### 2.3.1, 2.3.2, 2.3.3.

As noted in the consultation paper, the cited EU regulations no longer apply to SEM-GB interconnector trade so are of somewhat limited relevance.

When quoting these regulations, it is important to remember that they are written in the predominant continental European context where interconnections between bidding zones are typically part of the national/onshore TSOs regulated asset base. In the UK (and shortly in Ireland) the model is different, with the interconnector TSO effectively being a connecting ‘customer’ of the onshore/national TSO. The onshore/national TSO is therefore a further step removed from the allocation of interconnector capacity as the TSO do not own the cross-zonal capacity or have primary responsibility for its allocation but can impact it in the course of managing its system. To that end the EU regulation is not a particularly useful reference point in the current context, but it does make clear that where there are downstream consequences of an onshore/national TSO decision to restrict capacity that compensation is payable to the affected party – in the EU framework the affected parties are market participants (because the TSO allocates capacity to market participants) but in the UK the party to be compensated is the ICO. As can be seen in the regional capacity calculation methodologies referenced below, which were required under the CACM and FCA guidelines, it was necessary to account for these regional specificities at the Capacity Calculation Region level since they were not addressed in the prevailing regulation.

### 2.3.4 Implementation of Capacity Calculation Methodology (CCM) for SEM-GB cross-zonal arrangements

#### Day-ahead and intraday timeframes

With reference to the IU TSOs’ proposal for a capacity calculation methodology for the day-ahead and intraday market timeframe (‘day-ahead and intraday CCM’), we note that the consultation paper draws out the key point that it *‘assumes but does not consider the details of, compensation that would be payable to an interconnector in the event that its capacity is restricted’* and that this compensation *‘shall reflect the value of interconnector capacity to the market’*. It is important to note that detail around compensation was not included in this proposal as the necessary detail was not agreed between the

ICOs and onshore TSOs, which risked delaying the regulatory submission and approval process. We note that Ofgem has recently opined on the current arrangements in GB and the market value of restricted interconnector capacity as follows<sup>7</sup>: *“We note that the NTC commercial compensation methodology attempts to recreate the market value of any restricted capacity, and we agree that this is a good principle as it uses a proxy for market value on the restricted capacity, and intends to prevent ICs from losing or gaining through NTC application”*. It seems reasonable to conclude that the current arrangements in GB provide a strong indication of what would have been acceptable compensation arrangements arising from the day-ahead and intraday CCM.

The consultation paper also draws out that Article 11(2)(b) in the day-ahead and intraday CCM states that *“the compensation cost of interconnector capacity reduction shall be determined relative to the firm capacity value stated in the relevant connection agreements”*. To add further context to this statement, at the time this methodology was developed Moyle’s bilateral connection agreement (“BCA”) with National Grid specifically provided Moyle with two types of ‘transmission entry capacity’ (“TEC”) onto the GB transmission system. A proportion of Moyle’s TEC was to be available at all times (subject to typical outage planning conditions) while the remainder (termed ‘subject to interim restrictions on availability’) would be made available, subject to a daily capacity calculation performed by National Grid<sup>8</sup>. The effect of the reference to firm capacity was therefore to clarify that National Grid was not obliged to compensate Moyle when TEC subject to interim restrictions on availability was not available, as had been contractually agreed between Moyle and National Grid. Since Moyle’s TEC is no longer subject to interim restrictions on availability, this reference to ‘firm capacity’ would not be relevant if this methodology applied today.

For the purposes of the current consultation, it is also relevant to note that this methodology links compensation of an ICO to the interconnector’s capacity and does not make any link between compensation and the sale of long-term transmission rights, either financial or physical, to third parties.

### **Forwards timeframe**

We note that the consultation paper summarises the operation of the IU TSOs’ proposal of a common capacity calculation methodology (“Forward CCM”) in accordance with the forwards capacity allocation guideline. The compensation provisions in that methodology are concerned with already allocated capacity in the forwards timeframe and, as the consultation paper highlights, Article 27(3) of the methodology states that no compensation will arise if there is a reduction in cross-zonal capacity where cross-zonal capacity has not been allocated. It is important to understand how these provisions would have operated in conjunction with connection agreements and the day ahead and intraday CCM in order to avoid the misleading impression which might be created if the statement in Article 27(3) were read in isolation.

The Forward CCM operates in the Y-I timeframe with initial, mid-year and final capacity calculations acting to release increasing volumes of capacity for forwards allocation broadly in line with the timing of established outage planning procedures that pre-date the Forward CCM. Under these historic procedures, and subject to the terms of individual connection agreements, in some cases TSOs would have the right to restrict an interconnector’s capacity (or require it to be on outage) if specific transmission circuits are out of service, without any requirement to compensate the interconnector owner (“allowed outages”). There would therefore be a potential commercial exposure to ICOs if they allocated forwards capacity and an allowed outage then reduced the interconnector availability during

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<sup>7</sup>Source: [Derogation from SLC C28 for NTC](#)

<sup>8</sup> This capacity calculation ceased from 1<sup>st</sup> April 2022 as Moyle’s TEC was not subject to interim restrictions on availability from that point.

the product period of that forward capacity i.e. if FTRs had been allocated, the interconnector owner would be obliged to pay the market spread to FTR holders but would not be collecting congestion income from the market coupling process.

What the Forward CCM therefore does in practice is provide the ICOs with the comfort they need to allocate forwards capacity in line with that released by the forwards capacity calculations. If the TSOs subsequently updated their outage planning to require an interconnector outage or capacity reduction after LTTRs have been allocated, then the interconnector owner would be compensated accordingly irrespective of whether this was an allowed outage under the historic framework. The ICOs therefore do not require compensation in the forwards timeframe if no forwards capacity has been allocated as no loss will arise in that timeframe and that point is clarified by Article 27(3). Any loss of congestion income would then arise and be dealt with under the day-ahead and intraday compensation provisions.

## 2.4 Trade and Cooperation Agreement

The relevant provisions of the TCA are reproduced in the consultation paper without comment, so we have little to add here. The TCA is between the UK and EU, does not directly confer obligations on TSOs and requires significant work to implement it which is underway. That said, it is noteworthy that the current unilateral restrictions placed on SEM-GB flows fall well short of the ambitions of Article 311.

## Response to Consultation Questions

PLEASE NOTE THE RESPONSES TO THESE SPECIFIC QUESTIONS SHOULD BE READ IN CONJUNCTION WITH THE REST OF THIS REPOSE WHICH SETS OUT THE RATIONALE FOR THESE VIEWS.

**Q1.** Please set out your view on the appropriate arrangements for NTC reduction compensation going forward in the SEM, given the current arrangements for crossborder trading. Would this be impacted if cross-border forward hedging instruments were introduced in advance of MRLVC and, if so, in what way?

As described in the preceding commentary, we believe that the existing intraday compensation arrangements set out in the ICZAs continue to be in full force and effect in accordance with their terms in relation to the timeframes in which the interconnectors now participate i.e., ICOs are compensated at the outturn loss-adjusted positive market spread of the auction that the restricted capacity would otherwise have been made available in. These arrangements continue to be appropriate in the context of the current arrangements for cross border trading.

If cross-border forward hedging arrangements were put in place (and we assume this means interconnector PTRs or FTRs being issued to and held by market participants as capacity holders) there may be a need to align the compensation payable by the TSOs for NTC reductions impacting holders of FTRs/PTRs with the ICO's exposures to those parties under interconnector access rules. Since the compensation due to capacity holders in the case of capacity restrictions will be described in detail within the interconnector access rules, adopting this principle would provide futureproofing against future product or access rule developments.

If cross-border forward hedging instruments were introduced in advance of MRLVC we would also expect that curtailment of FTRs or PTRs would only be permitted in limited extenuating circumstances, as is the case under the existing European framework. For example, Article 16(2) of Regulation (EU) 2019/943 states: "Transaction curtailment procedures shall only be used in emergency situations where the transmission system operator must act in an expeditious manner and re-dispatching or countertrading is not possible", and we would expect similar principles to be adopted.

**Q2.** This paper references various principles that underpin different approaches to compensation arrangements for NTC reduction (i.e. 'causer pays', 'cost neutrality', 'different compensation arrangements for allocated and unallocated capacity'). In your view, what principles should underpin compensation arrangements for NTC reduction going forward in the SEM?

As stated throughout this response, the existing intraday compensation arrangements reflect the principles that should underpin compensation arrangements for NTC reduction in the SEM. With reference to the specific principles referred to in this question:

- Causer pays is a key principle.

- Cost neutrality – the ICO should not lose (or ideally not gain but please refer to the answer to question 3) as a result of a TSO decision to reduce NTC. To deliver cost neutrality, both allocated and unallocated capacity should be compensated:
  - o Capacity allocated in the forwards timeframe and restricted/curtailed should be compensated in line with the applicable interconnector access rules governing the sale of such forwards capacity.
  - o Capacity allocated in the day-ahead or intraday market and curtailed by a TSO decision to reduce the NTC should be compensated at the net imbalance cost to the ICO.
  - o Unallocated capacity which is the subject of a TSO decision to reduce the NTC should be compensated at the applicable positive loss adjusted ex ante market spread.
- Compensation in relation to TSO decisions to reduce NTCs should be payable by the TSO to ICO and include a link to interconnector access rules addressing circumstances where FTRs or PTRs are curtailed.
- Interconnector access rules should govern the compensation due from ICOs to holders of FTRs or PTRs in the event of their curtailment.

**Q3.** Are there any other factors, not covered in this paper, which should be considered by the RAs ahead of a decision? If providing, please explain relevance.

- It is vitally important that any decision which is made by the SEM Committee following this consultation does not impair the entitlement of Moyle, as an affected TSO, to compensation under the ICZAs. It is not realistic to suppose that Moyle would have agreed the arrangements in the ICZAs had they not conferred protection on it for the financial consequences of decisions made by a TSO to restrict the capacity of the Moyle Interconnector.

Any decision of the SEM Committee which seeks to undermine that protection would not only be manifestly unfair and lacking in rationality, but would also deprive Moyle of a valuable right which was written into the ICZAs with the agreement of all the Ireland-UK TSOs - and indeed (as is expressly stated in the Covering Letter to the ICZAs) with the endorsement of the Utility Regulator, the CER (now CRU) and Ofgem.

- We note that the paper does not refer to the impact of arrangements for NTC reduction compensation on future investment in interconnectors. Whilst interconnector investment between SEM and GB has recently been the subject of regulatory underpinning via a 'cap and floor' regime, uncompensated NTC reductions would make it near impossible for investors to forecast potential interconnector revenues. In these circumstances we cannot see how equity investment would be attracted to such investments, even with the protection of a cap and floor, as investors do not invest with an expectation of earning floor level returns.
- In a similar vein, uncompensated NTC reductions would make it near impossible for existing ICOs to forecast their future revenues. As the Utility Regulator will be aware, Moyle's financing arrangements enable it to use surplus revenues for the benefit of electricity consumers in Northern Ireland. However, revenues will not be considered as surplus if future revenues cannot be forecast and historic revenues are required to be retained support the interconnector business.

- With reference any consideration being given to not compensating NTC reductions at the applicable market spread, there are detailed complications to be considered beyond the issues already raised in this response and the consultation paper.
  - o Whilst it may be the case that restricting an NTC increases the market spreads and compensation due to an interconnector, it could be argued that those increased market spreads are closer to representing the true value of the restricted capacity, than the market spreads when the capacity is available. It is notable that when an interconnector is not available, other than in rarely seen circumstances, previously applicable EU regulations and interconnector access rules required that the outturn market spread was paid to PTR or FTR holders in order to keep them 'whole'. We do not see that a different approach should be used to compensate ICOs when a TSO decides to reduce an NTC.
  - o There will shortly be three interconnectors on the SEM-GB border. As demonstrated in the consultation paper, NTC reductions have not been applied equally to the two existing interconnectors – without compensation at the actual market spread, this raises the inequitable issue of a less restricted interconnector earning increased market spreads due to another interconnector being more heavily restricted. This potential issue will become more complex as more interconnector capacity is developed.
  - o The point above illustrates that the SEM ex ante markets appear to be unconstrained for all market participants except interconnectors, since transmission constraints are clearly being considered in the course of determining NTC reductions ahead of the ex-ante market runs.
  - o NTC reductions have the potential to cause a SEM-GB ICO not to meet its delivery obligations in the capacity market in GB. The UK Government is in the process of considering strengthening the penalty regime for non-delivery in that market so there is a real risk of material loss to an ICO if the SEM TSOs reduce its NTC at a time of system stress in GB. This potential loss in a few hours of system stress would vastly exceed the compensation payable under the ICZAs and should be considered by the SEMC in the course of making any decision on compensation for NTC reductions.