



Integrated Single Electricity Market (I-SEM)

Response to discussion paper on Forwards and Liquidity

SEM-15-010

A submission by EirGrid plc.

27 March 2015

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INTRODUCTION

EirGrid Group welcomes the publication of the Forwards and Liquidity Discussion Paper and the opportunity to respond to the proposals contained within it.

EirGrid holds licences as independent electricity Transmission System Operator (TSO) and Market Operator (MO) in the wholesale trading system in Ireland, and is the owner of the System Operator Northern Ireland (SONI Ltd), the licensed TSO and market operator in Northern Ireland. The Single Electricity Market Operator (SEMO) is part of the EirGrid Group, and operates the Single Electricity Market on the island of Ireland.

Both EirGrid, and its subsidiary SONI, have been certified by the European Commission as independent TSOs, and are licenced as the transmission system and market operators, for Ireland and Northern Ireland respectively. EirGrid also owns and operates the East West Interconnector, while SONI acts as Interconnector Administrator for both of the interconnectors that connect the island of Ireland and GB.

EirGrid and SONI, both as TSOs and MOs, have roles defined within the draft EU regulations that the I-SEM is required to comply with. We are committed to delivering high quality services to all customers, including generators, suppliers and consumers across the high voltage electricity system and via the efficient operation of the wholesale power market. EirGrid and SONI therefore have a keen interest in ensuring that the market design is workable, will facilitate security of supply and compliance with the duties mandated to us and will help to provide the optimum outcome for customers.

This response is submitted on behalf of all EirGrid Licensees.

STRUCTURE OF THE RESPONSE

This response is provided in three key sections. Firstly, we provide some general comments on the Forwards and Liquidity workstream and how it interacts with other aspects of the I-SEM development and also the development of the wider European framework. Secondly, we provide some observations on the detail contained within the paper. We conclude with our answers to the specific questions that are relevant to the EirGrid Group.

GENERAL OBSERVATIONS

The Forwards and Liquidity Workstream is developing in parallel with other I-SEM workstreams and also the development of Network Codes at a pan-European level. It is important that the workstream is aligned with both of these.

This discussion paper contains assumptions about the outcomes of other I-SEM workstreams, which are either currently being consulted upon or are due for consultation in the coming months. For example, the Market Power workstream will be considering the need for bidding principles in the I-SEM, however on page 11, it is stated that these will be relaxed. To avoid confusion, a distinction should be made between assumed outcomes from related workstreams and those that have already been determined. We are also concerned by a potential overlap with system services procurement, where in paragraph 2.4.17, it is stated that directed contracts could extend to specific locations and/or flexible generation. The purpose of the Forwards and Liquidity workstream is to develop forward financial trading, in accordance with the I-SEM HLD, and this appears to move outside that scope.

It is important the forward trading arrangements align with the emerging requirements across Europe. In particular, the Harmonised Allocation Rules (HAR) provide specific requirements for cross zonal forward trading, setting out detailed rules that we will need to adhere to. The arrangements for forward trading and possible interactions between them – CfDs, Reliability Options, FTRS etc will need careful consideration.

There are a number of references in the discussion paper to approvals being required from Ofgem as part of this process. This appears to assume an outcome from the current discussions at a European level around the scope of each Capacity Calculation Region. This is currently being consulted upon by ACER and there still remains a possibility that the I-SEM could be included in a larger Capacity Calculation Region. Many of the requirements provided for in the FCA Network Code that will form a substantive part of the forward trading arrangements in the I-SEM need to be determined in cooperation and coordination with neighbouring TSOs and NRAs. The larger the Capacity Calculation Region, the larger the number of TSOs and NRAs involved in the approval of the cross zonal financial instruments.

Overall, it is critical that this workstream works in parallel with developments in both the related I-SEM workstreams and the EU Network Codes. This coordinated approach will ensure that the deliverables from the workstream are aligned and consistent with deliverables in other workstreams to achieve the objectives of the I-SEM and to ensure compliance with EU requirements. It should also identify where the workstream has flexibility to determine outcomes specific to the I-SEM and where it does not i.e. where the outcome is determined in Europe.

DETAILED COMMENTS

In this section we look to address specific comments in the discussion paper and provide our views.

WITHIN ZONE FORWARD AND SPOT MARKET LIQUIDITY

We have some comments on specific areas of the within zone forward and spot market liquidity section of the discussion paper, which we hope will be of benefit to the workstream.

There appears to be a divergence from the ETA workstream with respect to balance responsibility. While this paper states that “their notifications of generation or demand best reflect their actual expectations”, this does not appear to be consistent with the ETA workstream where notifications can be “de-linked” from contracted volumes and participants can manage their balance responsibility through spilling if the imbalance price is attractive. Currently the ETA discussions do not include notifications from demand participants.

While it is essential that the Forwards and Liquidity workstream considers the interactions between any Directed Contracts and forward trading, it also needs to consider the impact of Directed Contracts on the physical markets. Trends in the scope of products offered by European Power Exchanges should also be considered, with a significant focus now on spot markets.

CROSS BORDER FINANCIAL INSTRUMENTS

We have also reviewed the cross border financial instruments section of the discussion paper, and provide our observations below.

It would be useful if more clarity was provided to the industry around the role of the relevant National Regulatory Authorities (NRAs) in this process. The paper alludes to the need for discussions and agreement with Ofgem without explaining why this is required. The applicable Capacity Calculation Region (CCR) for the I-SEM still needs to be determined. While the current working assumption is that the CCR for the I-SEM is the SEM-GB border, this has still to be determined by the NRAs. If the relevant CCR is not SEM-GB but the wider FUIN¹ region then the RAs will need to discuss and get agreement with all NRAs within FUIN and not just those with an interest in the SEM-GB border. In this regard, we note that the current proposal from the NRAs and TSOs of the FUIN region for two Capacity Calculation Regions (SEM-GB & GB-Continent) does not appear to be fully in line with a recent ACER proposal that envisaged one of the following three scenarios:

1. All FUIN members join the Central West Europe region;
2. GB-Continent joins CWE region and SEM-GB operates as its own CCR region;
3. All FUIN members form their own CCR region.

In terms of the method of allocation of FTRs, this has already largely been dealt with within the European context through the Harmonised Allocation Rules and the requirement for a Single Allocation Platform provided for in the draft FCA Network Code. In addition, the reference price for the FTR will be determined in the final FCA Network Code and associated HAR and the current drafts specify that they will be struck against the day-ahead market spread. The FTRs associated with the I-SEM will be required to comply with these rules. Any specific I-SEM design requirements will need to be included in a regional annex to the Harmonised Allocation Rules. The TSOs and Interconnector Owners have already been involved in the drafting of the HAR

¹ FUIN refers to a region comprising France, UK, Ireland, and Netherlands.

rules for PTRs and FTR Options. The I-SEM regional annex is included in the draft HAR recently issued for consultation by ENTSO-E.

When considering the advantages and disadvantages of Options and Obligations as possible FTR variants it is important to consider not just the advantages and disadvantages as identified in the literature but also:

- the applicability of these advantages and disadvantages in the context of the I-SEM;
- the interactions of these FTR variants with other aspects of the I-SEM market design;
- the suitability of these FTR variants based on considerations such as the type of products being offered on other HVDC interconnectors to Great Britain, and those in the rest of Europe;
- the development of pan-European Harmonised Allocation Rules; and
- the likely timelines for implementation of the different FTR variants.

As part of this workstream, the implications of the financial regulations need to be properly understood. Other TSOs, NRAs and Market Participants in Europe are facing the same issues and are also trying to assess the implications.

The discussion paper oversimplifies the ENTSO-E position on the sharing of risk between interconnector users and owners. The ENTSO-E position is based on the risks being borne by the party best placed to manage the risk. This does not mean that “the risk should be with Interconnector users”, rather it is looking to share the risk among the relevant parties with Interconnector operators and users, both taking on some risk rather than allocating all risk to a single party. With respect to firmness, interconnector users can manage this risk by trading out positions. The differences in risk profile between AC and DC interconnectors should also be carefully considered.

When considering the possible interaction of FTRs with CfDs, Reliability Options and Renewable Certificates, it is important to be cognisant of the fact that trading in FTRs will be determined largely by pan-European rules underpinned by European regulations, in particular the FCA Network Code. There is more discretion to adopt an I-SEM specific approach for CfDs and Reliability Options. Any interaction between FTRs and I-SEM specific products must ensure that

we remain able to comply with European legislation. It is also important to consider any potential differences between the two jurisdictions to ensure a non-discriminatory approach is taken. Consideration of the impact of design decisions on the neighbouring market and vice-versa is also necessary.

RESPONSES TO THE QUESTIONS POSED IN THE DISCUSSION PAPER

We have considered the questions posed in the discussion paper, and have included responses to those that are relevant to the EirGrid Licensees.

WITHIN ZONE FORWARD AND SPOT MARKET LIQUIDITY

What are the priority issues to address under I-SEM and what possible solutions should be considered?

The need to consider the interaction between all regulated contracts in the forward timeframe is essential to ensuring that they are internally consistent and comply with the relevant European legislation. In particular, the interaction between existing forwards products (ROCS and REFIT), new forwards products that are specific to I-SEM (Renewable Obligations and Directed Contracts), and new forward products that are not I-SEM specific (FTRs and FIT CfDs) need to be assessed carefully and a roadmap produced as to how these contracts sit in the new I-SEM arrangements.

The need to reduce the overhead placed on market participants when posting credit cover should be considered, where this does not increase the risk to counterparties including customers who underwrite risks that are socialised. It is therefore important that this work is undertaken in close cooperation with the other workstreams, in particular in the areas of Market Power mitigation and Capacity Remuneration.

What forward products are expected to be needed under I-SEM?

Previous consultations undertaken by the Interconnector Administrator with Interconnector Users (during the development of an online Auction Platform) proved to be highly beneficial as users were able to voice their opinions on the suitability of products. Should a similar consultation process be adopted for the I-SEM, then this would allow future market participants to signal which products they consider to be most useful for risk management – for example, whether products are based on calendar period (monthly, seasonal, quarterly etc.) or time period (baseload, mid-merit etc.).

Should development of appropriate products be left to the market or is specification from the RAs required?

It is probably more appropriate for the market itself to determine the nature of the products to be offered, as these will need to complement the risk management strategies adopted by the market participants.

CROSS BORDER FINANCIAL INSTRUMENTS

What are the advantages and disadvantages of FTR Options or FTR Obligations? What is your preferred approach?

The FCA Network Code provides for both FTR Options and FTR Obligations, and does not necessarily rule out the implementation of both products on the same border.

The main advantage of FTR Obligations over FTR Options often noted is that it provides for netting, thereby promoting liquidity. One of the principle disadvantages is that it introduces an additional level of counterparty risk to the TSO/Interconnector Owner as the FTR holder would be obliged to pay if the market spread was negative (a risk for market participants) and could potentially default. FTR Options do not have the benefit of netting but limit the downside risk for both FTR holders (by constraining negative values to zero) and TSO/Interconnector Owners.

It is clear that FTR Options and Obligations both work and are employed in a wide number of electricity markets around the world. When assessing the advantages and disadvantages of FTR Options and Obligations for the I-SEM it will be important to ensure that these are assessed against the specific requirements of the I-SEM (e.g. relatively isolated system with DC interconnectors to GB, rather than being part of a heavily-meshed AC network as is the case in continental Europe) to determine to what extent these advantages and disadvantages would materialise in reality.

Other important considerations include the timeline for implementation of FTR Options and/or Obligations and the extent to which this is harmonised with products adopted elsewhere in Europe, in particular those that will be in the same Capacity Calculation Region. While it must be emphasised that the FCA Network Code requires the development of harmonised rules for both FTR Options and Obligations and the provision of these products on a Single Allocation Platform, currently the focus in Europe has been on PTRs and FTR Options in order to adopt an early implementation of the requirements of the FCA Network Code. Harmonised Allocation Rules are currently being consulted on for PTRs and FTR Options. There is no plan in place to develop rules for FTR Obligations, although this will need to be done at some point. Given current developments in Europe it should be possible to implement an FTR Option solution in advance of I-SEM go-live in Q4 2017. There is greater uncertainty as to the feasibility of an FTR Obligations solution within the timescale, namely due to the following – dependency on other TSOs/NRAs in Europe and their commitment to work on a solution that none of them are

implementing for their own cross-border markets, ability to leverage existing rules and platforms already in situ today.

What measures need to be implemented to comply with financial regulation requirements?

We are currently seeking legal advice around the implications of the financial regulations and any potential exemptions that may apply.

We are also participating in a working group that has recently been established in ENTSO-E that is tasked with determining the implications of the financial regulations on TSOs.

How should transmission losses be factored into FTR design?

The treatment of losses in the allocation of congestion income is included in the HAR and the FCA Network Code. The loss factors to be applied are being consulted on in the I-SEM Energy Trading Arrangements Workstream. Our understanding is that the settlement of day ahead congestion income with FTR Rights holders will be loss adjusted, as will any market spread compensation to ensure revenue adequacy. Consideration should also be given to the other technical characteristics of HVDC interconnectors, such as ramping.

What are the I-SEM specific issues that need to be considered in development of Single Allocation Platform?

The Single Allocation Platform must be able to accommodate both HVDC and HVAC interconnectors. EWIC and Moyle have provided a draft regional annex in the HAR currently being consulted on in Europe, that sets out the I-SEM specific issues that would need to be included such as the regional specificities for HVDC and Capacity Shortage (insufficient physical capacity for reasons other than Force Majeure, an Emergency Situation, or System Security); Ramping and Revenue Adequacy; and potentially an I-SEM Day Ahead Fallback solution.

I-SEM design should be cognisant of the evolving functional responsibilities the FCA Network Code places with the Single Allocation Platform including:

- Single point of registration for market participants which will be separate from the I-SEM registration;
- Single credit cover requirement per market participant for all interconnectors represented by the Single Allocation Platform;
- Single settlement arrangements;
- Single invoicing arrangements (which may require additional software systems procurement) where customers will be invoiced for all interconnector activity they have engaged in directly by the Single Allocation Platform administrator;
- Address any revenue adequacy shortfall.

Should development of allocation arrangements be left to the market or is specification from the RAs required?

I-SEM will need to adhere to the pan-European Harmonised Allocation Rules and Single Allocation Platform provided for under the FCA Network Code.

What are the I-SEM specific issues that need to be considered in consideration of firmness?

Under the HAR and FCA Network Code, FTR rights are firm from the Day Ahead Firmness Deadline. Although it is possible to introduce a Long Term Firmness Deadline there is no explicit requirement to do so. The issue of firmness is an important one to consider as it will impact on parties differently, depending on the regime. The RAs will need to weigh up the potential benefits of increased firmness for market participants against the magnitude of costs that would be borne by end-consumers on the island when the interconnector or associated on-shore infrastructure is unavailable. It is widely accepted that the firmness risk for DC cables is significantly higher than for AC lines and that a monthly cap on the market spread would be an appropriate mechanism to ensure an equitable sharing of the risk between all parties.

Should treatment of firmness issues be left to the market or is input from the RAs required?

The precise details on the firmness regime are still being discussed in Europe and are subject to change via the FCA Network Code and associated HAR.

What are the issues relating to revenue adequacy, which need to be considered?

The two main issues relate to losses and ramping. The FCA Network Code currently includes provision for losses, but no such provision is in place for ramping.

What potential market power issues are linked to FTRs? How can they be dealt with?

At a European level, it is likely that these issues will be addressed through legislation such as REMIT, Transparency and Financial regulations. Indeed, it is possible that FTRs would be subject to both energy and financial legislation in Europe, increasing the level of regulatory scrutiny and mitigating the potential risk of market power. A balance therefore needs to be struck in the I-SEM between claiming exemptions from financial legislation and obtaining the benefits that are provided by it. The market power issues in relation to FTRs should be considered with the other components of the I-SEM under the market power workstream.

What interactions with other CfDs need to be considered in development of FTRs? What potential implications does FTR design have on these areas of interaction?

Any design for these items impacting on FTRs should be cognisant of the FCA Network Code requirements regarding Regional Platforms that may apply, in particular these:

... shall not hamper the improvement and harmonisation process of harmonised Allocation Rules

... shall not have an adverse impact on the liquidity of Long Term Transmission Rights on Bidding Zone Border(s).

The timing of the auctions for FTRs should be considered in conjunction with the arrangements for any CfDs and Directed Contracts.

How should transition to FTRs be managed? What requirements are there during the transition phase?

The current platform solution will be required to continue until the SEM arrangements conclude and I-SEM goes live. To ensure that market participants can secure their positions in line with their risk management policies, the new arrangements would need to operate in parallel with the current processes to facilitate auctioning of FTRs in advance. The new systems will need to be in place by the end 2016/early 2017.

CONCLUSIONS

In this response, we have identified some of the primary considerations that will need to be taken into account by the RAs as work progresses in the Forwards and Liquidity Workstream.

Strong coordination with the other workstreams is required to ensure a consistent approach. It is imperative that all workstreams are working in unison and are well informed of developments in each so that decisions taken are based on informed discussions across the workstreams and are not determined in isolation, without properly identifying potential implications for other workstreams.

The involvement of other NRAs is dependent on the final decision on the Capacity Calculation Regions in October 2015. The determination of the Capacity Calculation Region will have a key bearing on which NRAs we will need to involve in discussions on cross zonal financial instruments, and the current assumption that Ofgem is the only other NRA involved may be premature.

When examining the relative advantages and disadvantages of FTR Options and Obligations, it must be determined to what extent the advantages and disadvantages identified in other markets in the US, New Zealand and Europe actually translate to the I-SEM. Other important considerations include the timeline for delivery of FTR specific rules and platform in time for I-SEM go-live and the level of harmonisation with neighbouring markets within the Capacity Calculation Region and indeed wider in Europe.

It is likely that FTRs will be considered as financial instruments and subject to the relevant European financial regulations. It is less clear what this means in terms of possible exemptions from these financial regulations and potential overlaps with energy legislation such as REMIT. Work is currently on-going both in EirGrid and indeed in ENTSO-E to identify what the implications are.

The firmness regime for the I-SEM should provide for an equitable sharing of the risks involved between all parties to appropriately protect end-consumers and should reflect the characteristics of the technology used for cross border trading. There are I-SEM specific issues with regard to losses and ramping that need to be addressed in revenue adequacy to ensure that end-consumers are not unduly impacted.

The possible interaction of FTRs with CfDs, Reliability Options and Renewable Certificates will need careful consideration and clearly delineate the differences between what products are required under EU legislation and therefore limited in terms of what we can do, and products that are specific to the I-SEM where we have more flexibility on the approach taken.

We look forward to working closely with the RAs to progress this work and to ensure that the objectives are achieved.