Electric Ireland Response:

Integrated Single Electricity Market (I-SEM)

Financial Transmission Rights Consultation Paper SEM-15-061

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1. RESPONDENTS DETAILS

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2. GENERAL COMMENTS

Electric Ireland welcomes the opportunity to respond to this Financial Transmission Rights (FTRs) Consultation. Consistent with our response to the Markets Consultation, Electric Ireland views these consultation proposals from the perspective of a standalone supplier and as a representative of the customer. We are keen that the proposed I-SEM design including that relating to cross-border trading should operate effectively. Should this be the case then Northern Irish and Irish customers would have access to cheaper sources of electricity from other European markets and this would support one of the main objectives of the I-SEM and EU Target Model objectives.

In addition we expect that FTRs will play an integral role in risk management as part of the overall I-SEM Forwards and Liquidity solution.

In our response we focus on those areas that particularly impact costs and outcomes for supplier businesses and customers.

Electric Ireland believes that both Options and Obligations offer benefits and that, subject to implementation considerations, both should be offered.

Timely availability of forward hedging instruments are of the greatest importance to enable suppliers to forward hedge their customers' demand in a normal commercial fashion. Electric Ireland requests that the Regulatory Authorities include in their project plan updates of realistic and feasible dates for the availability of FTRs and I-SEM Contracts for Differences (CfDs) and report on progress in relation to regulatory engagement with OFGEM, development of draft and final Harmonised Allocation Rules, and auction platform developments or any other critical dependencies for delivery of FTRs and I-SEM CfDs.

Electric Ireland are aware that Ofgem published an approved revised set or access rules and charging methodologies for Moyle and EWIC on Thursday (15/10/2015). This paper allows for losses, ramping constraints and curtailment to be reflected within Financial Transmission Rights payouts. Electric Ireland is concerned as it does not support reflecting interconnector losses or ramping constraints as it would not be an appropriate allocation of risk and also the exclusion of these increase the value of the FTR to the holder. However Electric Ireland support reflecting curtailment provisions but are concerned about the widening definition of capacity shortage. Electric Ireland have not reviewed Ofgems publication in its entirety and in terms of regulator process, its not ideal to release this volume of material a few days before a consultation deadline, we therefore suggest that a more mindful approach to publication should be considered in the future and that Electric Ireland would also reserve the right to follow up on any additional comments that maybe necessary in light of the Ofgem publication.

Electric Ireland believes that greater efforts should be made to overcome the difficulties of offering a single 'border' FTR instrument as this would support the overall objectives of promoting liquidity and competition.

Electric Ireland requests that the RAs seek to achieve an early implementation of FTR auctions to enable effective supplier forward hedging but encourage pragmatic decisions on either a European or regional initiatives to avoid stranded implementation costs.

Electric Ireland note that the financial regulations requirements of FTR's has not be covered. The form and method of reporting obligations should be established in a timely manner to allow participants to put in place any required internal processes. The feasibility of centralised reporting, by TSOs or by the NEMO, should be investigated.

3. RESPONSE TO QUESTIONS

3.1 FTR Type – Options versus Obligations

3.1.1 Which offers the greater benefit to the I-SEM/GB market: FTR Options or FTR Obligations?

Electric Ireland believes that both instruments offer potential benefits and that the Forward Capacity Allocation network code requires provision for both FTR Options and Obligations (as well as Physical Transmission Rights – PTRs) and therefore has no strong objections to either instrument being used for the I-SEM / BETTA border.

FTR Options:

- provide an effective hedge against downside risks including for typical demand profiles where fewer FTRs per MW of peak demand may be required to the extent that there is a correlation of demand and price spread;
- offer an upside potential where the price differential is negative (in the sense of the instrument);
- ongoing collateral requirements are zero lowering the cost of participation, although higher collateral requirements for the auctions themselves due to the higher expected value of Options;
- potentially more attractive to asset-less traders (protection against price shocks) which may improve liquidity and price discovery.

FTR Obligations:

- offer a perfect hedge similar to familiar contracts for differences (CfDs);
- potentially offer greater liquidity through the ability of the Interconnector Owners (IOs) to simultaneously offer obligations in both directions while netting the associated transactions and so the overall volume of Obligations offered may exceed the physical interconnector capacity - however this requires differing views about price differentials between markets (i.e. not a consensus view) for this benefit to materialise, could be procured at a lower cost than for Options and so may be more frequently able to support cross-border trading in the gap between wholesale sell aspirations and retail buy aspirations in neighbouring markets;
- require a more straightforward modelling activity to support valuation than for Options.
- Suffer from higher collateral requirements and uncapped price shock risks (which may deter asset-less traders).

- When implementation considerations are taken into account it appears that FTR Obligation could be implemented but that significant additional work needs to be done (e.g. in terms of formulation of Harmonised Allocation Rules and developing practical credit management arrangements) in order to implement FTR Obligations in time for I-SEM Go-Live.

Electric Ireland believes that there may be benefits in exploring limited time-of-day FTR instruments. Any fragmentation may dilute liquidity and the chance of efficient prices (including offering both Options and Obligations) so that it is not likely to be feasible to offer e.g. six 4-hour time of day instruments. However separate day & night products might be considered to enable the possibility of trading in different directions at different times of day as occurs on some European interconnectors. This might also allow combinations of e.g. baseload + day to approximate more closely to typical demand profiles. Such fragmentation may be particularly beneficial where FTR Obligations are offered.

Finally, there is the possibility that OFGEM takes a different view on the most appropriate instrument(s) to support cross-border trading. Electric Ireland appreciates that the Regulatory Authorities (RAs) are keeping an ongoing dialogue with OFGEM on the progress of this Consultation, including at the recent DECC / OFGEM Stakeholder Meeting and that final decisions may not be taken until the deadlines required by the FCA network code. Electric Ireland believes that it would be helpful for the RAs to report (e.g. as part of the quarterly I-SEM Project Plan Updates) progress on achieving a consensus position with OFGEM on this matter and any steps taken to ensure that any differences in views arising can be managed without incurring unnecessary implementation costs.

3.2 FTRs per Interconnector or per Border

3.2.1 What arrangements would be preferred: one FTR between the I-SEM and GB or one FTR per interconnector?

Electric Ireland believes that there may be benefits in further investigating the possibility of single FTR instruments being offered for the I-SEM / BETTA border. A single FTR instrument would appear to concentrate liquidity in the auctions, improve price efficiency and price discovery, and promote the RAs' primary objectives of facilitating competition and liquidity. The opportunity to go to the market at different times (to spread price risk) may be adequately provided by regular auctions for different product terms in accordance with the provisions of the FCA network code.

The Consultation paper stated the pre-requisite for a single 'border' FTR to be that no losses or ramping could be reflected within the FTR instrument. However a previous paper discussed the possibility of an average loss factor being used for a single 'border' instrument and the relevant arguments were not reprised in the paper.

The main stumbling block for implementing a single 'border' FTR appears to be the difficulty of achieving a revenue sharing agreement between the two IOs and we understand in agreeing the appropriate treatment of curtailment events.

Electric Ireland requests that the RAs facilitate negotiations between the IOs with the aim of achieving an appropriate revenue sharing agreement. Only if irreconcilable differences emerge should the prize of greater liquidity of FTRs be foregone. The RAs should include within their Decision, the results of such efforts including an assessment of the potential benefits and of the costs and / or barriers to implementation of a single 'border' FTR instrument.

3.3 FTR Product Definition

3.3.1 Should any of the following be discounted from the FTR product payouts?

Interconnector transmission losses;

Electric Ireland are against reflecting interconnector transmission losses within FTR payouts for the following reasons:

- FTRs remain principally as a financial instruments (apart from curtailment arrangements imposed by the draft HAR and ultimately the final FCA network code);
- FTRs would be straightforward and transparent and easier to value (no need to assess to what extent the losses 'deadband' impacts on hedge effectiveness) which would promote liquidity and attract asset-less trader participation;
- a hurdle in the way of a single 'border' FTR instrument is removed which should promote liquidity and competition.

Note: If Interconnector losses are reflected within FTR payouts, the losses should be fixed for the duration of the FTR term and declared before the auction to avoid participants taking the risk of the actual loss variation.

Ramping constraints;

Electric Ireland believes that ramping constraints should not be reflected within FTR payouts.

These are not technical limits associated with the interconnector capability but rather limitations of the ability of the adjoining systems to deliver changes in output (largely due to governor droop settings of 5%). The DS3 programme aims to improve generator and demand side responses to enable the system to be operated effectively in the context of increasingly greater wind penetration. Consequently it is reasonable to expect that the system response, and so the ramping limit, will improve over time. So current ramping constraints may not be a robust basis for decisions about the future.

Irrespective of the ramping constraint level, it is very difficult to see how any participant could make a rational evaluation of the extent of the impact of biting ramping constraints on interconnector flows and hence FTR payouts (should they be reflected in these). Hence it would be wholly inappropriate to allocate the ramping risk to participants in this way.

The exclusion of ramping increase the value of the FTR to the holder and the potential efficiency of the FTR as a hedging instrument.

It may not be particularly appropriate that the ramping risk be allocated to IOs either since it is TSOs who are perhaps best placed to manage this risk. However the DS3 incentives, as described above, may act to reduce the impact of ramping for IOs over time and it may be possible for the interconnector ramping parameter used in the EUPHEMIA algorithm to be set at a higher level by TSOs (thereby enabling larger swings in interconnector flows between consecutive periods).

Curtailment risks

Electric Ireland believes that the I-SEM FTR instruments need to comply with the Approved HAR published on Thursday (15/10/2016) provisions on curtailment. However, Electric Ireland is concerned that curtailment is not definitely defined and as result the scope of curtailment could be extended to include events that should not fall under curtailment, such as black starts. Therefore further definition of “capacity shortage” is required to prevent this.

3.4 Auction Platform

3.4.1 What are the important issues to be considered in deciding on the development of an auction platform?

Electric Ireland believes that speed of delivery and implementation costs are the most important criteria.

Early implementation of FTR instrument auctions is important to enable suppliers to forward hedge their customer’s demand in a normal commercial fashion. Electric Ireland requests that the RAs pursue early implementation options which will enable FTRs for the I-SEM / BETTA border to be auctioned well before the ‘latest required’ date currently scheduled within the I-SEM Project Plan.

Electric Ireland wants to avoid the costs of multiple implementations as far as is possible. This is difficult in the context of implementations which are required before the FCA network code is finalised and comes in to force. It was stated at the Dundalk Industry Forum that the Joint Allocation Office (JAO) initiative aims to offer 2016 interconnector capacity (presumably PTRs) by the end of 2015 and that the France-UK-Ireland-Netherlands (FUIN) group of IOs were entering exploratory talks with the JAO initiative. This sounds encouraging and offers the hope that perhaps FTR Options might be capable of being offered in advance of the date scheduled in the RAs plan, and if JAO is feasible within the timelines, this is Electric Irelands preferred option. Electric Ireland therefore requests that relevant developments from these initiatives be incorporated within the RAs Project Plan Updates.

However if JAO is not possible within the timelines, Electric Ireland would encourage full participation within a regional FUIN platform which may provide a solution with an adequate shelf life. Electric Ireland is not in favour of a local I-SEM / BETTA platform and believes this solution is likely to be replaced quickly and lead to unnecessary stranded costs. .

The timeliness of the availability of instruments is of the greatest importance. There are significant concerns that neither I-SEM CfD nor FTR instruments will be ready in sufficient time to enable suppliers to forward hedge their customers' demand in a normal fashion. The RAs' current project plan schedules the first FTR auctions for April 2017 (it is understood that this is a "latest required" date calculated by working backwards from the first CRM auction). There is no equivalent date for first availability of I-SEM CfDs and it is not clear whether the RAs Forwards workstream includes the establishment of a master trading agreement or a power exchange or clearing house, both of which could add significant time before first availability. Electric Ireland requests that the RAs bring clarity to both these timelines and reports on intermediate but yet significant milestones (as part of its Project Plan Updates or otherwise) to enable industry participants to assess when appropriate hedging instruments might become available.

3.4.2 What is the preferred approach in relation to the establishment of the I-SEM FTR auctioning platform?

Electric Ireland believes that the RAs should proactively engage with the FUIN group and the JAO initiative with the aim of encouraging the least cost option and the early implementation of FTRs for the I-SEM / BETTA border, whether that is a JAO or FUIN platform. We would support pragmatic decisions to achieve this aim including, given our support for both FTR Options and FTR Obligations, implementing FTR Options first and FTR Obligations at a later stage as per the requirement by the FCA.

We request that the RAs keep market participants informed on progress regarding relevant developments and dependencies.