



Gaelectric Holdings Plc.

Response Paper to:

**SEM Committee Consultation on
Financial Transmission Rights**

Gaelectric Holdings Plc. Response

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Public

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1 INTRODUCTION

Executive Summary

Gaelectric Holdings Plc. (“Gaelectric”) welcomes the opportunity to respond to the SEMC consultation paper on Financial Transmission Rights in the upcoming I-SEM. We commend the SEMC for engaging with market participants through this consultation and the public workshop, both of which we believe have been mutually beneficial.

Gaelectric is an independent wind, energy storage, solar and biomass developer operating within the Republic of Ireland, Northern Ireland, United Kingdom and North America. To date Gaelectric holds 150MW of generating assets across 6 projects in Northern Ireland and the Republic of Ireland, and a further 40MW of ‘shovel ready’ projects with grid connections and full planning approvals in place.

Gaelectric’s near term pipeline on the island of Ireland is circa 320MW with the expectation that the company will have 400MW of projects generating power by the end of 2017.

Through developing our portfolio of wind assets through early stage planning into construction and operation phases, we have become one of the largest independent developers and operators of wind energy on the island. In addition to our extensive wind portfolio and development of Project CAES NI, which has an agreed connection offer in place with SONI, Gaelectric and Tesla have announced the purchase and planned deployment of Tesla Energy’s first battery power utility-scale project in Ireland. Tesla and Gaelectric will work together to develop a pipeline of battery projects. Gaelectric are further assessing opportunities in the UK market.

We believe the forward market is an integral requirement of a well-functioning energy market, and Gaelectric place particular emphasis on the ability to manage risk in what will be a far more complex market place than that in existence at present.

We urge the SEM Committee to ensure that the products available to participants are designed to manage risk across the long and short term with emphasis on creating liquidity in all markets by ensuring the barrier to entry is not unnecessarily raised.

Below is a summary of the view expressed by Gaelectric in this consultation response. Some of these points are equally applicable to either FTR obligations or FTR options, regardless of which are implemented.

- While long term auctions are necessary, Gaelectric strongly believe that adequate FTR volumes must be preserved and auctioned close to real time.
- The classification of products auctioned must provide sufficient granularity to allow market participants to manage their risk exposure in the new I-SEM
- A secondary market for FTR’s is inevitable therefore the authorities must decide whether they wish to establish a centralised platform or allow a decentralised OTC market to evolve. The rules and regulations of this market can also significantly aid market flexibility.
- Gaelectric are of the view that FTR obligations would be of greater benefit to market participants in GB and Ireland as they allow a perfect hedge to market participants and will

boost market liquidity, particularly in longer term auctions, due to IC owners' ability to net off trades.

- Cross collateralisation of obligations should be allowed where appropriate.
- Gaelectric agree with the view expressed by the SEMC that ramping losses should not be discounted from market participant pay-outs.
- Gaelectric have no strong position on which party absorbs transmission losses.
- Gaelectric favour an auction platform that would be easiest to integrate into the wider European market.
- Gaelectric would also impress upon the regulatory authorities the importance of securing the approval from Ofgem for this FTR scheme and to notify market participants once this has been secured.

2 CONSULTATION QUESTIONS

Notwithstanding our preference for FTR obligations in the I-SEM, regardless of whether the SEM Committee choose to implement an FTR obligation or option, there are certain characteristics that should be included in either design.

With regard to allocation timescales, Gaelectric agree that it is appropriate and common practice across other markets to begin FTR allocation over a year out from real time with subsequent auctions of residual capacity taking place closer to real time. Gaelectric believe that the methodology of how the volumes are divided across these auctions is of the upmost importance for the efficient functioning of the market. It is important to ensure that an adequate portion of FTR's are preserved and allocated close to real time to allow market participants to effectively manage their risk. Gaelectric feel a hybrid between the current future contracts available on the EEX derivative exchange and the PTR's offered on the CASC capacity allocation platform would be the most suitable allocation and trading structure. We therefore propose the following structure;

- Current future contracts automatically cascade from yearly products into quarterly and monthly products as they progress closer towards delivery. We feel this should also be the case for FTR's with even shorter time granularity (daily, peak, off-peak and hourly).
- Currently PTR holders are able to either re-sell their transmission rights to the interconnector owners or transfer to another market participant. Applying these to FTR trading this through either a centralised or de-centralised trading platform will be essential to an efficient market.

Gaelectric contend that a combination of the abovementioned features will serve to increase liquidity in the market and ultimately benefit market participants and the broader energy consumer in both the I-SEM and GB markets.

The type of product that can be auctioned can vary significantly. The PJM offers yearly, monthly, off peak and on peak products¹ while markets across Europe offer a similar mix of peak, off-peak, monthly and annual products². We believe that these product types are too broad considering the trading window timeframes decided for the new I-SEM. The day-ahead market will consist of hourly traded windows so therefore the granularity of the FTR products should reflect this: they should be offered

¹ <https://www.pjm.com/~media/markets-ops/ptr/eftr-user-guide-annual-ftr-auction.ashx>

² http://www.casc.eu/media/Rules%20for%20Capacity%20Allocation_V2_0.pdf

as daily, peak, off-peak and hourly products. This would allow market participants to appropriately manage their risk exposure. This could also be accommodated through the presence of a secondary market where products can be spilt up either by volume or timeframe.

Gaelectric believe that a secondary market for FTR's is inevitable and the SEM Committee must take the lead in developing a centralised platform for this market. Gaelectric are of the opinion that a centralised platform would be an effective outlet for liquidity to pool and is something which should be committed to early in this process. Currently in Europe the CASC and CAO platforms offer secondary market services for the CWE and CSE regions and their respective border transmission arrangements, predominantly PTR's with a use-it-or-sell-it clause³. The PJM market in the USA operates a centrally managed secondary market for bi-lateral trading of both FTR obligations and options. This operates on the same eFTR system on which the annual and monthly auctions take place and allows the authorities to monitor and change the position of market participants after trades have taken place. Market participants are allowed to break up FTR's into different MW amounts with different start and end dates on this platform. Both FTR Options and Obligations are traded on this platform with trading limited to PJM register members⁴⁵.

The facility to disaggregate FTR volumes and timespans for secondary market trading purposes would greatly increase the flexibility and allows market participants an effective means to manage their exposure. This could also make up for the broader timespans and volumes of the FTR's being auctioned. Gaelectric would support such a centralised secondary trading platform.

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

Currently Gaelectric believes the introduction of FTR obligations will provide greater benefits to the I-SEM and GB Markets. FTR Obligations allow market participants to perfectly hedge their position across markets provided they have assets operating in each. We believe this is the most effective way to manage the risks associated with cross border trading. We also believe that introducing obligations will increase market liquidity in comparison to FTR options due to the ability of interconnector owners to net off obligations in opposite directions. This will be particularly pronounced over the longer term FTR obligation auctions where there is more uncertainty about the price spreads. The practical experience from US markets is that obligations are the main instrument for hedging congestion costs and FTR options can sometimes be offered as a complementary instrument⁶.

There are certain obstacles that need to be overcome for the effective implementation of an FTR obligation scheme. Obligations will require increased credit cover for market participants which can become cumbersome and inefficient without the possibility of cross collateralisation of these products. For this reason we believe that, where possible, cross collateralisation of products should be allowed. This would reduce the barrier to entry for market participants.

Furthermore the methodology for calculating collateral should be adequately consulted

³ http://www.casc.eu/media/Rules%20for%20Capacity%20Allocation_V2_0.pdf

⁴ <http://www.pjm.com/~media/documents/manuals/m06-redline.ashx>

⁵ <https://www.pjm.com/~media/markets-ops/ftreftre-user-guide-annual-ftreftre-auction.ashx>

⁶ https://ec.europa.eu/energy/sites/ener/files/documents/2012_transmission.pdf

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

Gaelectric believe that a “per border” product would reduce barriers to entry for market participants and more easily facilitate FTR trading. We recognise the complexities associated with developing a per border product however many of these seem to centre on discounting transmission losses from the pay-out. For this reason we feel it is appropriate for transmission losses not to be discounted from the pay-out. The net position of each participant would not change as the treatment of the transmission losses will be reflected in the bid price while the benefits of a per border product could be significant in increasing the efficiency optimising the trade between market while reducing barriers to entry. This would also overcome potential problems around staggering the auctions between interconnectors.

Our support for a per border product is contingent on transmission losses not being discounted from the FTR pay-out. If the SEM Committee decide to include transmission losses in the FTR pay-out then Gaelectric believe a per interconnector product would be more suitable as the complexities of devising an aggregated FTR including the characteristics of each interconnector for auction would outweigh the benefits of this approach.

Under a per interconnector structure, consideration must be made on whether to stagger the auctions on each interconnector.

Ramping Constraints and Curtailment

While we acknowledge the final decision on losses and ramping is subject to the final FCA publication, Gaelectric agrees with the view expressed by the regulatory authorities that ramping costs should not be discounted from the FTR pay-outs. Ramping constraints cannot be controlled or predicted by market participants. Therefore we believe that the risk of ramping constraints should not sit with the FTR holder. It is more appropriate that the interconnector owner manages the cost of this risk, and liaise with the TSO on mitigating that risk.

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

Gaelectric supports an allocation platform design which is compatible to other regions and minimises the changes required in the future once the Joint Allocation Office Platform is developed. While a platform specifically tailored to the I-SEM may work well initially, amendments to this will be required to integrate this into a centralised European platform. This may cause further complexities into the future and reduce large scale cross border participation. While the FUIN is an option, the Joint Allocation Office Platform currently being developed by ENTSOE-E may be a more appropriate as it encompasses a greater number of energy markets.

Currently no other borders in Europe operate a FTR obligation scheme so the SEM Committee must do their utmost to ensure there are no issues integrating this into the JAO. The FCA guidance document released in August explicitly stated that should the national regulators choose to implement FTR Obligations, appropriate harmonised allocation rules will be implemented⁷. It currently seems that there will be difficulties in accommodating the trading of FTR Obligations on the JAO by I-SEM go live

⁷ https://www.entsoe.eu/Documents/Network%20codes%20documents/NC%20FCA/150821_HAR_final.pdf

in 2017. This is something the SEM Committee must address and transitional arrangements must be made to allow consistent long-term FTR trading once the I-SEM goes live in 2017.

Similarly the JAO predominantly deals with HVAC interconnectors at the moment so the authorities must ensure there are no issues with HVDC interconnectors participating on this platform. Another important consideration that is closely linked to the point made in previous question with regard to secondary markets. An analysis of how secondary markets operate across Europe should be undertaken to see how they have been implemented. A decision must be made on whether it would be most suitable to centralise the secondary trading or allow OTC trading. The regulation of this market must be considered such as credit cover and market liquidity.

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

See above.

3 CONCLUSION

Given the importance of FTR's to risk hedging for market participants, Gaelectric feel these will form an important component of the new I-SEM. A liquid market and flexibility in product design will be integral to an effective design and can be ensured through a combination of appropriate allocation of FTR volumes across the auctions and liquid secondary market. While Gaelectric share the view expressed by the authorities that ramping should be absorbed by interconnector owners and TSO, we would emphasize that the authorities should remain cognisant of how the I-SEM design may influence interconnector flows and subsequently develop sustainable arrangements to account for ramping constraints.

While we acknowledge that the implementation timeline is subject to FCA progressing through the comitology process and subsequently the European Parliament, going forward Gaelectric would request that the authorities come forward with a timeline for implementation for the FTR products and an approximate timeframe on when the initial auction is scheduled to take place. This should be consistently be updated as the developments unfold. Updates on how the transition from the current future market to new future market in the I-SEM must also be provided by the SEM Committee.

Gaelectric welcome further engagement with the SEM Committee on FTR's and are happy to discuss any queries in relation to this response.