

SEM Market Power & Liquidity

A Consultation Paper

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1. Market Power and Liquidity Project

1.1. Background

Since 1st November 2007, the Northern Ireland Authority for Utility Regulation (or Utility Regulator) and the Commission for Energy Regulation (CER), together referred to as the Regulatory Authorities or RAs, have jointly regulated the all-Island wholesale electricity market known as the Single Electricity Market (SEM) covering both Northern Ireland and the Republic of Ireland. The SEM includes a centralised gross pool (or spot) market which, given its mandatory nature for generators¹ and suppliers, is fully liquid. The SEM rules are set out in detail in the Trading and Settlement Code (the TSC)².

In the second quarter of 2010 RAs commenced a review of market power and contract liquidity in the SEM. The overall aim of this market power and liquidity review project is to identify practical ways in which the RAs can further promote competition in the SEM by reducing/mitigating market power and/or improving contract liquidity over the course of the next 10 years. This project includes a review of the performance of the SEM market power mitigation measures in the context of experience to date and, looking forward, likely developments over the next 10 years which could alter market power. These developments include increased interconnection and new market participants (including, for example, wind generation).

The project also examines measures which might be necessary to mitigate any potential adverse effects on market power and/or liquidity resulting from the various components of ESB's proposed re-integration.

1.2. Terms of Reference & State of the Nation

As part of the project, in July the RAs appointed consultants, CEPA, to assist the RAs in this area by undertaking an independent review of market power and liquidity in SEM, with particular terms of reference as follows, taking account of the fact that the SEM is a market with a gross mandatory pool and a capacity payment mechanism.

1. Identify the sources of market power in the SEM today together with methodologies to assess their potential effects
2. Review the degree and quality of liquidity in the SEM today and how liquidity might be dependent on the degree of market power.
3. Assess the likely changes to market power and/or liquidity in the SEM over the next 10 years resulting from (i) expected new entry and exits, and (ii) further interconnection.
4. Assess the effects in the SEM today on market power mitigation and/or the provision of liquidity, resulting from:
 - a. The Bidding Code of Practice;
 - b. The Market Monitoring Unit;
 - c. DCs;
 - d. Ring-fencing licence conditions on ESB affiliates and NIE affiliates; and
 - e. The EPO on NIE ES and ESB CS (or any replacement measure following retail deregulation).

¹ Above 10 MW.

² Please see http://www.allislandproject.org/en/trading_and_settlement_code.aspx

Advise if any of the above measures should be relaxed or modified, over the course of the next 10 years, to better promote wholesale competition or the provision of forward contract liquidity and suggest any other measures (as applicable) to reduce market power and/or improve liquidity in the SEM.

5. ESB has proposed the removal of ring-fencing between its respective generation and supply businesses and their re-integration, both horizontal and vertical. This proposal is currently under consideration by the SEM Committee³. By horizontal and vertical integration we refer to the integration of all ESB's generation and supply businesses into one unit, i.e. allowing ESB generation covering ESB Power Generation (PG) and ESB Independent Generation (IG) to integrate fully with a supply arm covering both ESB Customer Supply and ESBIE. This review will also assess the effects of the various components of the ESB integration proposal (including ESB's liquidity proposal) on market power, liquidity and wholesale competition in the SEM over the next 10 years.
6. Suggest other measures which should be employed to mitigate any adverse effects on market power and/or liquidity resulting from the various components of the ESB integration proposal.

As part of this project, on 23rd August 2010 the RAs published a "State of the Nation" paper (SEM/10/057)⁴ whose purpose was to:

- Inform market participants of the scope of the review project;
- Provide a factual overview of the design and operation of the SEM, in particular:
 - (A) The market power mitigation strategy adopted to date by the RAs; and,
 - (B) The operation of the market since the inception of the SEM, particularly levels of market power in the spot and forward contract markets, as well as forward contract liquidity; and,
- Seek any initial ideas from market participants on the policy issues being examined as part of this review project. This included initial thoughts that market participants may have in relation to a number of questions on market power and liquidity which were posed.

2. CEPA Paper & Public Workshop

Now, having taken on board the comments received to the RAs' "State of the Nation" paper as well as input from the RAs on factual matters related to SEM market power and liquidity, CEPA has completed its independent market power and liquidity review. This review is published with this paper today by the RAs for comment and it includes a summary of comments received to the "State of the Nation". The liquidity proposals from ESB are also being published with this paper, for information.

³ The SEM Committee minutes No. 25 state that "In relation to both the EPO condition on ESBCS and the ringfencing conditions between ESBCS and ESBIE, there was agreement that these conditions could be removed, subject to replacement by any new conditions which the SEMC may deem necessary to address wholesale market power or liquidity issues." And that any new conditions would be considered in this review of Market Power and Liquidity. See http://www.allislandproject.org/en/SEM_meeting_minutes.aspx?article=abc303f0-a541-4435-af58-fc654587d8a6

⁴ Please see http://www.allislandproject.org/en/market_decision_documents.aspx?article=dcdad63-660c-4b28-b71f-9896f306e6cc

To explain the CEPA paper and discuss industry views, the RAs will host a public workshop in the CER office on **18th January 2011, from 10am to 12:30pm**. This will include a presentation by the RAs on the project and an overview by CEPA of the proposals contained within their paper.

Anyone wishing to attend the workshop should contact James Curtin (jcurtin@cer.ie) as soon as possible, as places for attendees are limited to about 40.

3. Request for Comment

Comments from market participants on the policy issues proposed in the CEPA paper for mitigating market power and improving contract liquidity should be sent by 17:00 on **Monday 31st January 2011**, to both Andrew Ebrill (aebrill@cer.ie) and Paul Bell (Paul.Bell@uregni.gov.uk).

The comments will then be considered by the RAs when developing a Decision Paper on the matter, which is expected by Q2 2011.

In particular the RAs would be interested in stakeholder views on the following issues/questions, which are also included in the Appendix to the CEPA paper.

1. Do the objectives and criteria for the Market Power Mitigation Strategy remain appropriate today and for the foreseeable future?
2. Will the new interconnector facilitate more competition from Great Britain? If so, what will be the impact on the appropriate market power mitigation strategy?
3. It would be helpful if market participants could explain why they believe demand for hedging products in the SEM exists, and how this demand is not addressed by alternative hedging options, such as through fuel markets.
4. In what way could DCs be reformed in order to promote contract liquidity while also mitigating market power? Do you see merits in replacing the HHI with the RSI in determining DC volumes?
5. Does the recent removal of the EPO condition from ESBCS for business customers and the earlier EPO removal from NIEES for customers with an annual demand above 150 MWhs, together with the removal of ring-fencing between ESBCS and ESBIE, negatively impact on the SEM spot or contract markets? If you consider that it does, are there any replacement conditions required in the SEM and what should they be?
6. Do you consider that the planned forthcoming removal of the EPO for domestic customers in Ireland will have an adverse effect on competition and liquidity in the SEM spot or contracts market? If so, what replacement would you recommend for the SEM? Would the removal of the EPO from NIEES for customers below 150 MWh per annum in NI have a similar impact – and if so, what replacement would you recommend?
7. What if any, implications for competition/ end customer do you see arising from ESB's proposed reintegration:
 - a) Horizontally,
 - b) Vertically,
 - c) Horizontally & Vertically.

What, if any, new measures would you recommend be put in place for each of the above forms of integration?

8. Would further divestment by ESB encourage deeper competition in the wholesale market?
9. What are the current incentives on generators and suppliers to offer and purchase contracts? Are there any impediments to trading contracts? Do you agree with mandating all generators to offer contracts and/or to become market makers? If not all generators, what criteria would you use for mandating generator to offer contracts or to become a market maker?
10. What product types and in what proportions should a minimum specification market maker offer? What eligibility restrictions should there be to trading with market makers?
11. Do you agree with the CEPA analysis of the ability of structural remedies to address the competition problems presented by the hypothetical structural scenarios outlined in section 6 of the accompanying paper?
12. Will ESB's liquidity proposal be effective in assisting contract liquidity in the market if it is allowed to vertically and horizontally integrate? Will this proposal facilitate competition in the wholesale and retail market? If so, why? If not, why not?
13. Will increased wind penetration affect demand for contracts and the need for market liquidity?

Those respondents who would like certain sections of their responses to remain confidential should submit the relevant sections in an appendix marked confidential.
