

**Power NI Energy Limited
Power Procurement Business (PPB)**

I-SEM Detailed Design

Financial Transmission Rights

Consultation Paper

SEM-15-061

Response by Power NI Energy (PPB)

19 October 2015.



Introduction

Power NI Energy – Power Procurement Business (“PPB”) welcomes the opportunity to respond to the Financial Transmission Rights Consultation Paper.

Comments

Establishing what is a limited and illiquid forward market in the SEM has been a challenge given the small size of the market in Ireland, the degree of market power in the market, and the increasing scheduling uncertainty as wind penetration grows. These market features will remain in the I-SEM with the added complexity of a splitting of the energy markets. The forward market is particularly important as it is the basis of pricing for the majority of customers. Our expectation is that participants will be seeking to use FTRs as part of their risk management strategy to hedge prices.

The RAs have indicated that there would be a complete change to FTRs from the commencement of I-SEM. However this could be a high risk approach, not least should there be any potential for a delay to I-SEM go-live. The scope for having a combination of PTRs and FTRs for a period could be considered. This could help address the issue of continuity of tariffs for customers as such an arrangement would enable suppliers to avoid a cliff-face as they continue to seek to offer continuous retail products. It would also lessen the impact of any late deferral of the commencement date for the I-SEM as it is not clear to us how any FTR could function with the current SEM market. The contractual arrangements for FTRs would therefore need to address what happens should the commencement of I-SEM be delayed.

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

The analysis presented in the consultation paper on the advantages and disadvantages of FTR Options and FTR Obligations is quite comprehensive. As FTR Obligations offer the perfect hedge and as the IC owner has the potential to net-off sales in opposite directions, thereby increasing liquidity, it would seem to us that an FTR Obligation would be the most useful instrument. However until the credit cover arrangements are known (will there be a pooling of credit across all markets) it is not possible to fully assess the benefits of both types of FTR. It may be prudent to delay the decision until the credit arrangements are known and a full evaluation can be undertaken. PPB has a preference for FTR Obligations subject to arrangements to pool credit across all markets being implemented.

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

The SEMC minded decision is for one FTR per Interconnector based on the rationale that *“the additional complexity and cost involved in the collaboration of the interconnector owners providing a single FTR product is not justified by the potential benefits that might accrue from a single product”*. As no cost benefit analysis has been presented in the paper it is impossible to assess or comment on whether this rationale is sound. The decision should be taken with the objective of maximising liquidity in the market and intuitively the simpler the arrangements the greater potential for trades, and the greater the value participants will place on the FTR.

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

- **Interconnector transmission losses;**
- **Ramping constraints;**
- **Curtailment risks.**

We note that the SEMC have taken a minded decision to discount payouts for losses. Should this decision be confirmed then it is essential that loss factors are published and locked-in for the period that FTR products are being sold. This will allow participants to build this risk into their bids which will reduce the amount they are willing to pay for the product.

The relevance of ramp rates and curtailment is unclear as such risks are no different to the risks any other generator takes on when they sell a forward CfD where the products are standardised and do not take any heed of generator unavailability,

scheduling, ramp rates, etc. It would therefore be discriminatory to only seek to protect interconnector owners from such risks and we believe there is a requirement to assess revenue adequacy for all participants, considering the full range of potential revenue streams (energy markets, CRM, DS3, renewable support mechanism). Therefore we believe that ramping and curtailment should not be discounted from FTR product payouts. To discount either of these from the product payouts increases the risk on participants as they will not be able to model or quantify them. This will lead to participants discounting the value of the FTR product to reflect this increase risk, leading to lower revenues for the IC owner and higher costs to customers, as they underwrite the costs of the interconnectors.

FTRs are a financial product that market participants can utilise as a risk management tool to hedge the price spread between two markets. They are not tied to a physical product and therefore should not be discounted for physical constraints.

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

The auction platform must be fit for purpose and must be ready in time to allow robust testing prior to any auctions being held. For an auction platform to be fit for purpose it must cater for the I-SEM/GB interconnectors which are both High Voltage Direct Current interconnectors and it must be able to cater for both FTR Obligations and FTR Options as the decision on which to adopt should not be dictated by an inadequacy of an auction platform. It is also essential for the auction platform to be ready before the end of 2016 to allow for robust testing of the first auction which is expected to be held in March 2017.

As it is critical for participants to have access to hedging tools thought must be given to fallback arrangements should there be a delay in delivery of the I-SEM (or to the development of the auction platform).

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

As stated in the response to the previous question the auction platform must be able to cater for High Voltage Direct Current interconnectors and must also be able to accommodate both FTR Options and FTR Obligations. Therefore our preferred approach would be for development of the current local allocation platform AMP as neither of the FUIN nor the JAO are being developed to cater for FTR Obligations at this time. The shorter procurement/development time associated with evolving the

AMP greatly reduces the risk of the auction platform not being delivered in time for the auctions.