

I-SEM Consultation Paper: Measures to promote liquidity in the I-SEM forward market

Moyle Interconnector Ltd response

August 2016

INTRODUCTION

Moyle Interconnector Ltd (Moyle) welcomes the opportunity to respond to this consultation and recognises that liquidity in the I-SEM forward market is a key concern to regulatory authorities and market participants alike. Moyle's responses are provided from the perspective of an interconnector owner who will be offering Financial Transmission Rights, a geographical forward hedge across the I-SEM/GB border. We consider that an efficient and liquid I-SEM forward market will support the cross-border FTR market (and *vice versa*). As a party that does not engage in forward energy trading we do not have strong views about the specifics of how forward market liquidity should be improved so provide a limited response including some points of clarification.

CONSULTATION QUESTIONS

1. Does the Consultation Paper correctly set out the nature of the problem to be solved? Is it correct that the lack of liquidity characteristic of the SEM will not be satisfactorily rectified through incentives inherent in the I-SEM design?

Efficient operation of the I-SEM does depend in part on a liquid forward market where market power concerns do not distort the market. Inefficiencies or distortions of the forwards market may have a knock-on effect in the other market timeframes and potentially lead to higher prices for consumers. While aspects of the I-SEM design are likely to mitigate against such concerns, other aspects mean there is greater perceived risk in the physical timeframes so we agree that liquidity in the forward market should remain a concern to the RAs and that additional measures are required to support an efficient and competitive forward market.

2. Does the scope of the Consultation Paper set out the full range of potential liquidity promotion measures that should be considered for implementation? If other regulatory interventions are considered appropriate please set out the nature, rationale and parameters of such intervention.

We do not propose any other measures.

3. Respondents are asked to provide their views on the rationale, parameters and potential effectiveness of each of the regulatory interventions described and explained in the Consultation Paper.

Removal of Barriers to Efficient Trading:

Removal of barriers to efficient trading is an important 'intervention' as there are significant gains to be made and it should be relatively uncontroversial – it is difficult to see anyone's view being that it is a bad thing. We agree that a central trading platform would provide price transparency and

reduced collateral costs and a central clearing counterparty would reduce the risk of default and provide more efficient clearing.

FCSO and MMO:

We have limited comment on the merits of FCSO versus MMO interventions. Both will clearly promote greater liquidity in the forwards timeframe, with the MMO option ensuring that prices are always available so perhaps could be viewed as better at promoting liquidity. On the other hand, an MMO is less practical to implement for I-SEM and the link with removal of ring-fencing adds further complexity.

Removal of Ring-Fencing:

We note the SEM Committee's view that removal of ring-fencing in conjunction with other measures has the potential to improve liquidity. However, such removal is a significant change to current regulatory practice and care obviously needs to be taken in making such a decision. A more stepwise approach at a time when the whole market design is being changed might be more appropriate. E.g. implement an option that does not require a change to the ring-fencing approach (option two), monitor the effect on liquidity in the forward market and then reconsider removal of ring-fencing if the potential for further improvement measures justify the risk at that time.

4. What are the important issues to be considered in each of the options? In what way might the options be made more effective? Please set out your views on the rationale for, and value of the parameters employed to determine, the quantity of the obligation in each option.

We make no comment here.

5. What is the preferred option and why do you consider it preferable?

We have a soft preference for Option 2, at least in the first instance. It significantly increases the available hedging volume versus the SEM/option 1. It is also a relatively low risk approach and appears to be the most feasible for implementation in time for I-SEM go-live. It also has the benefit of allowing the RAs the opportunity to assess how well the market functions before deciding if further interventions are warranted.

6. What parameters of the regulatory intervention option should be determined by the Regulatory Authorities and which should be left to market participants to determine?

Pricing is the one key parameter that should be left to the market to determine although we recognise that it will be necessary for the RAs to set reserve prices.

ADDITIONAL REMARKS

Moyle export capacity

We note the comments in section 3.6 of the consultation paper (p24) on restrictions to Moyle's capacity in Scotland from 2017, particularly the statement "*Discussions are ongoing between Mutual*

Energy, National Grid, Scotch Power, Ofgem and UR to determine a compensation scheme for the periods when Moyle's capacity to export is reduced due to transmission constraints in the Scotch side. For that reason the assumption is that FTRs would be sold based on Moyle's full capacity (500 MW)."

We wish to clarify the situation:

Moyle has always held firm, long-term Transmission Entry Capacity (TEC) in the GB system at 80 MW. This is a limit on the energy that may be exported across Moyle into Scotland. A temporary increase has been in place, providing for 287/295 MW (seasonal) TEC until November 2017 as the transmission network in south-west Scotland is becoming congested, primarily due to the construction of new wind farms.

Discussions have been underway for some time to develop a CACM compliant regional capacity calculation methodology for the "Ireland-UK" region. These discussions are between the relevant TSOs (National Grid, SONI/EirGrid, Moyle and EWIC) and the resulting methodology will need to be approved by the relevant NRAs (UR, CER and Ofgem). The TSOs expect that this will include proposals to keep interconnectors 'whole' in the event of a capacity reduction but the details have not been agreed and differing views exist. Timing for implementation of this methodology is driven by other CACM approvals but is currently expected to be Q4 2018.

Discussions have recently commenced between the TSOs around implementing an interim capacity calculation process for I-SEM go-live in 2017. It is unclear what this will look like but, given National Grid's historic approach to restricting Moyle exports, it is an optimistic assumption that FTRs will be sold based on Moyle export capacity of 500MW.

JAO

We also note the remarks in section 6.5 (p45) that JAO might provide an appropriate mechanism for central trading services other than FTRs. While Moyle has engaged with JAO on implementation of FTR products for cross-border trading, we caution that more general forward hedging is, as the committee acknowledges, not JAO's focus. It exists solely to allocate cross-border transmission capacity on behalf of TSOs so it seems unlikely that it would be able to develop a CfD clearing service for I-SEM.

Page 27 states, in the context of a central collateral provider: *"they could allow netting of credit positions, reducing net collaterals that have to be provided, and could also allow cross-market collateralisation allowing positions from different timeframes (and different markets such as forward CfDs and FTRs) to be netted off, further reducing collateral requirements."* Collateral for Moyle and EWIC FTRs will be provided by market participants directly to JAO and may be used to participate in interconnector capacity auctions throughout Europe. JAO is thus effectively a central collateral depository in respect of cross border electricity transmission capacity. Given that JAO is a European entity governed by harmonised rules developed at European level, this is likely to be a barrier to provision of FTR collaterals via an I-SEM central collateral provider.