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3rd August 2016

RE: Response to Measures to Promote Liquidity in the I-SEM Forward Market Consultation

Dear Gonzalo, Joe,

Tynagh Energy Limited (TEL) welcomes the opportunity to respond to this Measures to Promote Liquidity in the I-SEM Forward Market Consultation (SEM-16-030).

If the Market Power Decision (SEM-16-024) to place a forward contract obligation on all generators is to be implemented, TEL believes the obligation volume should not be so prohibitively high that it prevents innovation in the forward market and acts as a barrier to new entrants. Considering the lack of clarity, certainty and guidance provided in this consultation TEL does not believe that any of options 2 to 5 should be implemented before I-SEM go live. As per the Market Power Decision, TEL believes "*it is more appropriate to wait to develop such guidance after Go-Live once there is greater clarity on the functioning of the market*".

This response has been separated into four sections: Section A describes TEL's views on the current forward market structure and issues that TEL have experienced. Sections B and C describe TEL's views on a Forward Contract Sell Obligation (FCSO) and a Market Maker Obligation (MMU) respectively. Section D answers the questions presented throughout the consultation and the slides from the market forum held in Dundalk on the 6th of July.

<u>Section A – Current SEM Forward Market</u>

TEL does not believe there is a market failure in the current SEM forward market. TEL believes that the lack of liquidity is not due to a lack of buyers and sellers but due to a significant difference between the price that generators are willing to sell and the price at which suppliers are willing to purchase.

In the initial assessment of the options, the consultation states that options 2 to 5 "rest on the premise that there is a problem, or market failure, that needs to be solved administratively and that, even with the removal of trading barriers, the problem will not be resolved". TEL believes that there is no market failure. From our experience, outside of the collateral requirements, the biggest problem in the market is the difference in prices. TEL is a single generator that wants to hedge forward but not any cost. From our experience the DC pricing sets an unrealistic price expectation among buyers and inhibits generators selling to suppliers at a price which they deem equitable. The options presented in the consultation are just about driving liquidity figures up and do not take into account the needs of both sides of the forward contracts.

Section B – Forward Contract Sell Obligation

TEL does not agree with the potential introduction of a FCSO for a number of reasons. Firstly, the FCSO stifles innovation in the forwards market as participants will be required to sell all/the majority of their forward position through the FCSO.

Secondly, the proposed methodology provides the generators with no control over the price at which they have to sell the FCSO. Our generation costs are higher than other generators and forcing TEL to sell a FCSO potentially below the cost of generation is an unfair regulatory procedure. This also contravenes section 9.4 in the Electricity act which states "….The Minister and the Commission shall have regard to need: (a) to promote competition in the generation and supply of electricity in accordance with this act;… (c) to secure that license holders are capable of financing the undertaking of the activities which they are licensed to undertake…".

Thirdly, the proposed FCSO to force generators to sell FCSO at a price that they have no control over will not encourage new entrants into the market. The introduction of a FCSO reduces generators options and flexibility regarding forward trading. This will be be a disincentive to new generation.

Section C – Market Maker Obligation

TEL disagrees with the MMO concept and would strongly recommend an impact analysis of the removal of the vertical integration on the I-SEM Day-ahead, Intra-day and Balancing markets. TEL does not believe that a decision on the removal of the successful market power mitigation measure (ring fencing) can be made in isolation without considering the impact across all timeframes in the market.

Section D – 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?*
   TEL does not agree with the analysis performed suggesting a lack of liquidity. The absence of bilateral contracts in the liquidity analysis is a fundamental oversight. This leads to a conclusion showing a particularly poor level of liquidity. Furthermore, there is a severe lack of quantitative analysis on the extra liquidity provided through additional hedging sources (i.e. PSO contracts ending).

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.*
   TEL thinks the consultation paper fails to accurately identify if there was a lack of liquidity in the SEM. If such an issue existed the consultation paper should have identified the scale of the liquidity problem and included a section that identified the reasons for a lack of liquidity. The scope of the consultation paper appears to be more focused on proposing measures that other markets implement rather than identifying and addressing the liquidity issues relevant to the I-SEM. This can be seen in the measures proposed. The FCSO appears to target generators as the reason for a lack of liquidity whereas the MMO appears to be targeting the vertically integrated companies.

   Considering the impact each of these proposed measures can have on participants in the forward market and also market power in the energy markets (Day-ahead, Intra-day and Balancing), a targeted approach is critical. TEL thinks the scope of the consultation should have included a section that addressed the reasons for reduced liquidity and proposed targeted solutions. Section 6 attempts to propose potential solutions through the central services. However, it does not address which participants (generators or suppliers) are reducing the liquidity in the SEM.

One of the questions identified in the scope relates to the success of market power measures in addressing the shortfall in liquidity. TEL does not think the success of measures to prevent market power should be determined by the amount of liquidity they produce. This document appears to confuse both of these issues. Furthermore, the consultation does not identify ring fencing as a cause for a lack of liquidity. This measure was introduced to prevent market power and has been deemed successful, it shouldn't be removed to increase liquidity in the forward market. The barriers to liquidity should be addressed while accommodating the successful measures to prevent market power.

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.*
   The proposed FCSO regulatory intervention removes all flexibility available to market participants in the current forward market. Requiring generators to provide approximately 70% of their forecasted MSQ on an auction as a price taker limits the ability of the generators to offer non-standard products to the market.

   The lack of analysis on the introduction of market power issues in the energy markets due to the MMO proposal make it impossible to comment on the effectiveness of the MMO regulatory intervention. As discussed in Section C, TEL do not believe that a decision on the removal of the successful market power mitigation measure (ring fencing) can be made in isolation of the forward market only.

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.*
   Please see above.

5. *What is the preferred option and why do you consider it preferable?*
   TEL believes that the consultation has not addressed the right questions and as a result has not provided adequate solutions.

   TEL believes that Option 1 is the only viable option from the list provided in the consultation paper. It is from our experience in the SEM forward market that TEL believes there is no market failure in the forward market. The problem with the current market is not just that there is not enough buyers or sellers, but that generation is selling at a higher price than supply is willing to buy. There is a logical reason for this, baseload plant is already committed either through self-supply or through a power purchase agreement.

   The removal of trading barriers should greatly increase the liquidity in the forwards market as in our experience this is a significant roadblock to selling forward.

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?*
   TEL does not believe that the introduction of further regulatory intervention is required to increase liquidity in the forward market. The first action should be to remove barriers to the increase of liquidity such as the potential central services solution identified in section 6.2.

TEL would like to reiterate some key comments in the market power decision paper that need to be considered in conjunction with this consultation. Unfortunately, TEL does not think that this consultation has answered the SEMC question involving liquidity and vertical integration, as stated in the Market Power Decision (SEM-16-024) "*In terms of liquidity, the SEM Committee has not found evidence that vertical integration has resulted in low liquidity, and it is therefore unclear whether an expansion of vertical ring-fencing would improve forward market liquidity*".

TEL does not think that this consultation has provided the adequate justification to permit imposing an FCO on a volume of a generation companies MSQ. This coincides with the Market Power Decision (SEM-16-024) where "*the SEM Committee recognises that imposing an FCO on a volume of a generation company's capacity/output is significant and would not seek to do so without adequate justification*". The proposal to force generators to sell a FCSO at a price potentially below the cost of generation is an unfair regulatory procedure. This also goes against section 9.4 in the Electricity act where is states "….The Minister and the Commission shall have regard to need: (a) to promote competition in the generation and supply of electricity in accordance with this act;… (c) to secure that license holders are capable of financing the undertaking of the activities which they are licensed to undertake…".

Should you have any queries, please do not hesitate to contact me.

Yours sincerely,

Paraic Higgins

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I-SEM Analyst