SEM Market Power and Liquidity Consultation

Moyle Interconnector Ltd response

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Moyle Interconnector Ltd owns and operates the 500MW HVDC interconnector between Scotland and Northern Ireland and welcomes the consultation on market power and liquidity. While we are slightly disappointed that the paper focuses on the hedging positions of suppliers (instead of including merchant generator or power importers hedging positions and opportunities) we are appreciative of the opportunity to communicate our views.

<u>Demand for hedging products</u>

Moyle generates its revenue by auctioning capacity on the interconnector to interested parties. This revenue is maximised when there is both competition for this capacity and substantial arbitrage opportunities available between the SEM and BETTA markets.

While there is little Moyle can do to produce arbitrage opportunities it does try to create competition by attracting new participants to its capacity auctions and hence SEM.

The market for Moyle import (East-West) capacity is, and historically has been, dominated by participants who are vertically integrated in the SEM market – these participants obviously have a natural hedging position via their associated supply businesses.

GB based participants who have previously had an interest in acquiring Moyle capacity have expressed the view that the unavailability of hedging contracts is acting as a barrier to trade that prevents them from effectively participating in the SEM. These pure arbitrage traders need large price differences between the markets to cover their market price risks so their participation will be very limited.

Given that the major players in the SEM already participate in Moyle's capacity auctions this makes it very difficult to attract new participants.

<u>Increased completion from GB via new interconnector</u>

We would expect that there will certainly be increased competition from GB when the level of interconnection increases (assuming SEM prices remain above those of BETTA). Our concern would be that there is a risk that there will be insufficient demand for interconnector capacity due to there being a limited number of parties willing to trade across the interconnectors for the reasons set out above. This is likely to result in the interconnectors being under-utilised – this position would therefore fail to deliver the benefits of increased interconnection. We feel this is a critical issue at a time when interconnector owners are endeavouring to comply with EU requirements to maximise the availability of capacity and that it would be very disappointing if these efforts were in vein due to the particular characteristics of the SEM.

Another issue that this raises is the possibility that demand for capacity will be so low that neither interconnector is able to charge participants for using them. European legislation dictates that interconnector capacity auctions must be "congested" for the interconnector owner to charge its users. This would become a major issue if we are unable to attract new participants to use the SEM interconnectors as they could both be uncongested, not earning any auction revenue, and having to pass their total costs through to consumers.

Possible improvements

As set out above, it is not in the interest of the major SEM players to significantly increase the level of hedging opportunities available to interconnector users as increased imports from interconnection would be detrimental to their generation portfolios. We feel that the regulatory authorities therefore have an important role to play in removing this barrier to trade in order to crystallise the benefits to consumers (i.e. lower prices) that interconnection can deliver.

We would suggest the following possible high-level regulatory interventions which could substantially improve the availability of hedging opportunities with SEM

1. Place an obligation on SEM's vertically integrated participants to contract a proportion of their output and supply externally.

2. Place an economic purchasing obligation on all licence holders within the vertically integrated players – i.e. A supply division can contract with its associated generation portfolio but if it is subsequently found that cheaper sellers were available then they may be penalised

3. SEMO could offer a certain amount of hedging contracts e.g. yearly, seasonal, monthly, weekly and daily to both the buy and sell sides of the market.

Conclusion

It is not necessarily in the interest of the vertically integrated incumbents to offer generator/interconnector user hedging contracts as this would introduce unwanted additional competition. It is therefore our view that the regulatory authorities should intervene to ensure that appropriate hedging opportunities are available to increase the efficiency of the market and ultimately lead to reductions in electricity prices.

Note:

We note that Section 5.8 of the CEPA paper analyses the flows across Moyle and whether these are economic or not, concluding that this is not the case 50% of the time. It is not clear whether the SEM price used here includes the capacity payments received by interconnector users when they are dispatched. Our own analysis indicates that flows can often be from BETTA to SEM even when the BETTA price is higher than SMP. This may initially appear uneconomic but when one considers the capacity payment element then these flows are actually profitable to the interconnector users. To conclude that a reality of uneconomic flows persist across an interconnector is strange, unless vertically integrated utilities are balancing their own positions without reference to the market prices – a more credible conclusion is that the some element of the analysis is flawed.

This section suggests that these apparent uneconomic flows may be due to imperfections in the arrangements for accessing capacity. It is not clear what this means, it suggests that interconnector capacity is readily accessible for flows in an uneconomic direction but not for flows in the economic direction. This seems bizarre, consequently we would welcome clarification. Moyle's capacity is sold on a yearly, 6 monthly, quarterly and monthly basis. Additionally Moyle welcomes offers for unsold capacity at any time. Capacity holders can also transfer/ sell on their capacity to other users at any time. Moyle has never received complaints from interconnector users regarding their ability to access capacity. Access to capacity cannot therefore be seen to be a reason for West-East arbitrage opportunities not being taken; rather the reason for this is likely to be a lack of appetite for pure arbitrage trading. We would see the incompatibility between SEM and Betta being a more likely cause of uneconomic flows (as CEPA correctly state, due to ex-post price determination in SEM).