Charging for interconnector capacity allocated intra-day in SEM – Interconnector Owner Recommendations

1.0 Background

A consultation paper was issued to participants and published on the EastWest and Moyle websites on 21st February seeking their opinions on charging for intraday implicit auctions. There were ten responses as follows:

- Airtricity
- Bord Gais Eireann
- Electroroute
- Energia
- Endesa
- ESBI
- Power NI
- PPB
- RWE
- Synergen

The respondents provided a number of different opinions on the questions that were asked.

2.0 Interconnector Owner perspective

The interconnector owners have reviewed the responses and have come to the following agreed view:

1. Regulatory input is required on the UIOSI / UIOLI question. All responses are being forwarded to the Regulatory Authorities together with this paper so that their guidance can be provided
2. In line with the feedback from six of the ten respondents, Option 1 is preferred for the definition of Congestion
3. For calculation of the charge, a hybrid version of options 1 and 2 is proposed, to address feedback from respondents.

2.1 UIOLI / UIOSI

The preferred approaches of respondents are UIOSI (b) and UIOLI, with more respondents preferring UIOSI (b). The responses to this question included the following:

- Six respondents expressed a clear recommendation of UIOSI(b)
- One respondent said that both have merit but a UIOSI mechanism would appear to be more equitable
- Two clearly recommended UIOLI
- One respondent recommended UIOLI from an alignment perspective whilst expressing a preference for UIOSI (b)

- A number of respondents highlighted a concern with the possibility of paying for capacity twice

The rationales expressed by respondents for preferring UIOSI (b) included:

- Interconnector owners in self dispatch markets can clearly signal their intention to use or not use capacity. Capacity holders in SEM are unable to do similar so UIOSI is more appropriate to recompense them for "involuntary" transfer of their capacity rights.
  With Intra-Day Trading, what changes is the nature of the rights to transmit electricity – from physical rights to financial rights
- The value of long-term capacity rights must be preserved particularly in a centrally-dispatched market such as the SEM
- UIOSI should apply to long term capacity which has been nominated but has not been scheduled; to capacity which was not nominated and was not sold by daily explicit auction; as well as to capacity allocated for the first time by daily explicit auctions
- Enhance the value of Long Term capacity and prevent double payment to interconnector owner
- Capacity holder should get some form of rebate if the interconnector unit is not scheduled and the capacity is further sold
- UIOSI encourages the most participation in long-term auctions, with buyers facing less risk of having to write off the value of their investment. UIOSI gives both potential parties in a secondary market for capacity a more balanced position - both buyers and sellers have a fall back route for access to a market for capacity.
- A number of respondents expressed the view that because SEM is unique within FUI the suitability of arrangements for SEM should take precedence over mirroring other arrangements in FUI

Note: The interpretation of what UIOSI means (use, sale, etc.) may not be consistent among respondents

Recommendation:

As the interconnector owners do not have an agreed recommendation in line with respondents' preferences, regulatory guidance is required.

2.2 Superposition

The consultation paper stated that it was intended that any congestion charges collected for flows made possible by superposition would be due to the interconnector owner and would not be payable to EA1 capacity holders under any UIOSI arrangements. Most respondents had no comment on this but views received were as follows:

- One respondent agreed that this was a reasonable approach
- One respondent queried this approach and suggested that charges collected for flows made possible by superposition should be paid to EA1 capacity holders

- One respondent stated that a participant should not be charged for superpositioning against their EA1 or EA2 position i.e. unwinding a scheduled flow to zero in a later gate closure.

Having considered the latter two points we do not believe the User proposals are in line with the arrangements on the other interconnectors in the FUI region nor are they aligned with the direction of travel of the European proposals for interconnector trading. Superpositioning is applied on all interconnectors and is not accounted for in the manner proposed by the two respondents. Capacity rights apply to a particular direction and a particular timescale. After the EA1 gate closure long term capacity rights have either been used or lost/sold. When we move into the intraday timescale, previous capacity holders have no additional rights in respect of the capacity they previously held and need to be allocated intraday capacity if they wish to change their position. As such we have not adjusted our proposed treatment of superpositioning.

Recommendation:

Any charges collected for flows made possible by superposition will be due to the interconnector owner as originally proposed. Users will not be exempt from congestion charges (if applicable in the relevant direction in the relevant period) in the case that they are attempting to unwind a previously scheduled position.

2.3 Congestion definition

Two options were provided in relation to the definition of congestion:

- Option 1: Sum all the interconnector offers at a gate closure and compare to available capacity
- Option 2: Sum all the *in merit* interconnector offers at a gate closure and compare to available capacity

Six respondents recommended Option 1, three respondents recommended Option 2 while one respondent suggested a flow based approach.

Recommendation:

The feedback from respondents is in line with the Interconnector owners' original recommendation, which was that the key determinant of whether an interconnector auction is congested should be whether demand for capacity exceeds supply. Therefore our recommendation is that Option 1 is implemented.

2.4 Method of calculating the congestion charge

Three options were provided in relation to calculating the congestion charge:

- Option 1 – Marginal pricing i.e. for import: (SMP-Highest scheduled offer)
- Option 2 – Pay as bid pricing i.e. for import: (SMP-Individual user offer)*factor
- Option 3 – Pricing based on SEM-Betta market spread i.e. for import: (SMP-Betta price)*factor

Respondents provided various different views on the most appropriate method for calculating the congestion charge:

- Two respondents recommended Option 1 as it was presented (based on ex-ante SMP)
- One respondent recommended a variant of Option 1 to include capacity payments (only if UIOSI adopted)
- Three respondents recommended Option 2 (Pay as Bid)
- One respondent recommended Option 3 (Difference between SEM & BETTA)
- The other views included:
    - If UIOLI adopted, no charge. (If UIOSI, Amended Option 1 taking into account capacity payments as stated above)
    - (1) Half hourly pricing Tariff set in advance based upon the historic difference between IU bids and Shadow Price OR (2) Amended Option 2, using ex-post Shadow Price (and a % of the difference)
    - A function of the clearing price in the previous daily auction

Although there was a complete spread of opinions, there was a fairly even split between those who favoured option 1 and those who favoured option 2.

Of those who expressed concern with option 1, the main issue seemed to be that interconnector bids from different traders would fall within a fairly narrow band as all would be based on the same Betta price. This would mean that insufficient infra-marginal rent would be available to incentivise trading as the cost of capacity would be excessive. This view seems reasonable and would suggest that a factor would need to be applied to the margin in order to share the infra-marginal rent between the trader and original capacity holder, as proposed in option 2.

It was also suggested that the Shadow Price (SP) was the more appropriate reference price than SMP for calculating capacity charges. The rationale for this is that the interconnector schedule is determined by the SP so interconnector users discount their offers into SEM to account for this (i.e. IC offer = GB price - estimate of "uplift" - estimate of "capacity payment") as the GB price may be above the shadow price but below SMP[1]. If SMP was compared to the interconnector offers to calculate the charge the value of the capacity would therefore be overstated as we are not comparing like with like since the uplift is stripped out of the latter. The interconnector owners' assessment is that there is logic to the use of the Shadow Price for import (GB to SEM), and this approach might also alleviate concerns expressed by other respondents.

For exports (SEM to GB) our view is that SMP is still the appropriate reference price. An exporter does not need to adjust their bid into SEM for uplift as the bid simply needs to be *higher* than SP to be scheduled. Comparing export bids with SMP *is* therefore comparing like with like. If SP was used for

[1] This highlights a possible anomaly in the current SEM market scheduling in relation to interconnector bid and offer prices, Shadow Price and SMP.

exports the capacity charge could be excessive as it would be based on the difference between bid and SP - this would overstate the infra-marginal rent as the trader would actually pay the higher SMP.

An anomaly may also arise where an export bid is greater than SP but less than SMP. This would result in the export flow being scheduled and the trader paying a higher price than their bid. In this case it would not be appropriate to apply a congestion charge and the charging mechanism should reflect this.

Some participants highlighted a preference for ex-post pricing rather than ex-ante pricing. The interconnector owners' preference is to use ex-ante pricing for the following reasons:

- Ex-ante pricing is simpler and less costly to implement, as the information required (Market Prices, interconnector bids and capacity allocations) are taken from a single market run
- Ex-ante pricing facilitates transparency and enables participants to have early visibility of the price of the trade
- Ex-ante pricing is more closely aligned with other European markets

Recommendation:

The interconnector owners recommend that the charging methodology adopted is a variation of options 1 and 2, with the prices calculated as follows:

- For export (SEM to GB), Price = Max[0,(Lowest Accepted_Bid – Ex_Ante_SMP) x Factor]
- For import (GB to SEM), Price = (Ex_Ante_Shadow_Price – Highest Accepted_Bid) x Factor

Note: The factor can be a value between zero and one – we would recommend 50% is used in line with Option 2 as proposed in the consultation paper.