Response to Consultation Paper on

Charging for Interconnector Capacity Allocated Intra-day in SEM

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Options regarding implementation of UIOSI or UIOLI on SEM Interconnectors

Airtricity regards that long-term capacity holding on the SEM interconnectors grants firm transmission rights to holders. In our view, the introduction of Intra-Day Trading in the SEM does not fundamentally alter these rights. With the introduction of Intra-Day Trading, which is a means to manage congestion on interconnectors, what changes is the nature of these rights to transmit electricity – from physical rights to financial rights.

On that basis we maintain our view, expressed at various times, that with the introduction of Intra-Day Trading into the SEM, UIOSI should be implemented through all the trading windows to the final relevant gate closure. This would be Option 3 as identified in the consultation paper.

The comparative analysis, provided in the consultation paper, of what obtains on other FUI-region interconnectors is a useful exercise which highlights the similarities as well as the differences between those interconnectors and the SEM interconnectors. One of these differences is extremely crucial and on that basis a differential treatment of interconnector capacity in the SEM can be argued – interconnector users in the other FUI-region markets self-dispatch and hence, subject to technical events on the interconnectors, are in full commercial control of their transmission across interconnectors. Given the central dispatch nature of the SEM, interconnector users in this market are restricted in this ability to link commercial intent to transmit across interconnectors and such actual transmission.

The implication is that capacity holders on other interconnector can clearly 'signal' their intentions to use or not use interconnector capacity; with the prevailing structures, capacity holders in the SEM are unable to do similar.

A means however to get around this limitation could be considered. Given that interconnector users in SEM can submit Commercial Offer Data (COD) for every Trading Period, 'nominations to use capacity' could be based on actual submission of

COD by a capacity holder rather than been based on the intermediate market schedules.

The consultation paper advances a number of arguments against UIOSI. We address some of these next.

Impact on Availability of Capacity:

The paper argues that under UIOSI there would be less incentive for traders to free up available capacity by attempting to sell ahead of gate closure, instead of waiting out for revenue at the intra-day stage. In our view, this amounts to advancing a pre-judged view that selling capacity ahead of gate closure is somehow better than 'selling' capacity at intra-day stage hence the need to incentivise such actions. The introduction of Intra-Day Trading ensures that capacity is made available to non-capacity holders, whether such capacity is sold prior to or after gate closure, hence we don't see the role for an incentive for when such capacity is to be sold.

In addition, the implication that traders will prefer to hold out to the intra-day stage to 'sell' capacity rather than selling ahead of gate closure misunderstands how traders operate. It is largely about option value, which incidentally is generally greater the more time to delivery exists. Hence for a trader that does not intend to use some capacity, there is more value to a buyer (and hence to the seller) if it is sold well ahead of when it would be used. However in some cases, the reverse may hold true.

The essence of the counter-argument here is that it is market direction that ought to guide traders' actions in terms of capacity trades, not a regulated instrument that determines when best for such trades to occur. In terms of making capacity available (i.e. uncongested), the introduction of Intra-Day Trading will ensure this, not UIOSI or UIOLI.

Impact on Trading Opportunities:

Again, the argument made here misses out a number of crucial elements of trading, as well as the Intra-Day Trading design in SEM. First, on the Intra-Day design in SEM, participants would not receive the EA1 schedule before EA2 gate closure and hence cannot have the opportunity to revise bids for EA2 based on analysis of EA1 results. But even if they could, as schedules are available to the market such action would amount to providing a 'free' service to all intending interconnector users as to the 'true market level', an arguable market efficiency mechanism.

Ignoring the impracticality of the argument however, as a counter-factual the fact that a capacity holder loses first rights to capacity holdings after EA1 entirely undermines this argument. How would a speculative bid in EA1 (when a capacity holder is 'guaranteed access') uncover the bid of a participant that can only bid in EA2 (when rights have become equalised and when the new bidder can under-bid the original capacity holder)?

Furthermore how this would not be the case anyway under UIOLI is not clear. The incentive, if it exists, for a trader to engage in the action described in the consultation paper would be underpinned by the fact of initial capacity holding and 'guaranteed access' to EA1, not the fact of potential proceeds from capacity holdings at EA2. If a trader were to engage in 'market testing', presumably it would be for the value inherent in energy price differentials.

What the arguments advanced in the paper fail to take cognisance of is that the value of long-term capacity rights is in 'guaranteed access' to the market. The arguments examined above imply that capacity is a commodity of value in and of itself. We view this not to be the case and hold that UIOSI simply recompenses a capacity holder for the 'involuntary' transfer of such rights given its inability to clearly indicate intention to use or not use such capacity.

Impact on Value:

The consultation is right in identifying that UIOSI has the potential to increase the value of long term capacity. However it misses an opportunity to follow this observation to its logical conclusion.

With an increase in the value of long term capacity, there is also likelihood for an increase in the demand for such capacity, which by implication increases the likelihood of achieving congestion on the interconnectors, an implication that cannot be ignored by the interconnector owners regarding the funding of their assets. A charging basis that decreases the chances of congestion by implication increases the likelihood that TUoS customers may be called upon to fund as asset that would be enjoyed by capacity users who do not contribute to its funding.

Options regarding determination of congestion intra-day on the SEM Interconnectors

Airtricity agrees with the interpretation in the consultation paper that the "key determinant of whether an interconnector auction is congested should be whether demand for capacity exceeds supply" and that this is satisfied in Option 1.

Options regarding calculation of congestion charges for implicitly allocated capacity on the SEM Interconnectors

Airtricity agrees with the interconnector owners that Option 1 is most suitable given the arrangements implemented at the other FUI-region interconnectors, the basis for pricing capacity on the SEM interconnector in the explicit auctions, as well as the overall philosophy of pricing that exists in the SEM.