

[By email]

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Charging for interconnector capacity allocated intra-day in SEM

Dear Paul and Rodney

Thank you for the opportunity to respond to the above joint consultation paper on charging for interconnector capacity allocated intra-day in SEM.

You will be aware that Energia has actively traded on the Moyle for several years. There is already significant price risk trading on the interconnector (IC) given the unique SEM market arrangements. In this context the preferred options proposed in the consultation paper, particularly for calculating when congestion occurs and how it should be charged, would in our view increase price risk and result in overpayment for IC capacity, creating additional barriers to cross border trade. For this and other reasons elucidated in this response and in Annex 1 we strongly caution against the preferred options proposed in the consultation paper. We do not consider them optimal and suggest alternative approaches that we consider more appropriate.

By way of background it is crucial to appreciate that arrangements implemented on other borders has limited relevance in deciding upon appropriate arrangements in the context of the Moyle or EWIC given the significant difference in market arrangements.

We set out below our detailed comments, please do not hesitate to contact us if you would like to discuss.

Yours sincerely



Kevin Hannafin

Energia's detailed comments

Use-it-or-lose-it (UIOLI) or Use-it-or-sell-it (UIOSI)

We have a preference for UIOSI on long term (LT) capacity holdings with all receipts going back to LT capacity holders – i.e. UIOSI option (b).

UIOSI will enhance the value of long term capacity and will prevent potential double payment of capacity to the interconnector owner.

Superpositioning

It is our view that participants should not be charged for superpositioning against their EA1 or EA2 position – i.e. if scheduled for 50MW import in EA1 you should not have to pay for export capacity to export 50MW in EA2 – i.e. reduce your net flow to zero.

Options for determining congestion

We note the preferred option in the consultation paper:

'Sum all the interconnector offers at a gate closure and if this total is greater than the available capacity in the relevant direction at that gate closure, then congestion has occurred'

The alternative option is:

'Sum all the in merit interconnector offers at a gate closure and if this total is more than the available capacity at that gate closure then congestion would have occurred'

In our view the stated rationale for the preferred option over the alternative approach is not convincing, and will result in overpayment for IC capacity and will disincentivise efficient use of the IC.

We strongly contend that a methodology based on in merit offers is in fact a much truer reflection of demand for capacity. This is because only in merit bids show a real intention to trade. Participants submitting very high or very low price bids do so knowing they are very unlikely to ever be dispatched, but rather because of the remote chance that something unusual happens in SEM that would present an unexpected short term arbitrage opportunity. These bids are therefore not a real indication of IC demand and should not be taken as a competitive bid for IC capacity. One would not submit bids to an explicit auction on this basis as there would be no prior indication that any such event would occur. To include these bids in determining congestion would clearly disincentivise these bids and would therefore reduce the potential use of the IC in extreme pricing scenarios – i.e. when it would be most useful to meet system requirements. Energia strongly recommends the alternative option of determining congestion based on in merit offers.

Options for calculating the congestion charge

In relation to congestion charging there are three options proposed in the consultation paper:

Option 1 – Adopt a marginal pricing approach

Option 2 – Adopt something more akin to “pay as bid” approach

Option 3 – Use a BETTA price in place of interconnector offers.

Each of the options proposed reference ex ante SEM SMP. In the first instance we do not consider that referencing ex ante SMP will work under options 1 and 2 proposed and suggest instead that *ex post* shadow price (SP) be referenced because it's the ex post SP that sets energy payments/charges. Ex ante SP increases price risk for traders and acts as a further barrier to cross border trade. These points are further explained in Annex 1.

Our preferred option for short term capacity pricing is not proposed in the paper. We strongly suggest that short term capacity pricing be based on a half-hourly pricing tariff for intra-day import and export capacity on the basis that this is the simplest both in terms of central administration and trading because capacity costs are known upfront. The tariff should be set sufficiently low to encourage cross border trading, and should only be charged when congestion has occurred as per the alternative option for determining congestion. SEM participants already have substantial price risk to manage so charging excessively for IC capacity would discourage participants from trading.

Our second preference is a variation of option 2 above, which would calculate the congestion charge as a % of IMR based on SP (not SMP as explained below) – Bid Price on a pay as bid basis. The % should be kept low c10% to encourage IC trading – SEM participants already have substantial price risk to manage so charging excessively for IC capacity would discourage participants from trading. Alternatively it may be possible to use this methodology on historic data to set a price tariff as proposed in the paragraph above.

It is Energinet's considered view that marginal pricing (as per option 1 above) would be a barrier to trade as participants are likely to bid within a tight range as everyone is referencing the same BETTA price. This could therefore result in a redirection of benefits from IC traders to the IC owner (under UIOLI) again disincentivising cross border trade.

With regard to option 3, it would seem difficult to administer but would be preferable to option 1 for the reasons outlined above. If progressed, we would suggest that GB imbalance prices (SBP and SSP) should be used for the GB price mark. Using GB imbalance prices as a reference would mitigate price risk on participants and would encourage trading whereas using APX prices or the Market Index Price may have the opposite effect. Option 3 would also require adjustments to be made for BSUoS and GB and SEM losses in the calculation for determining the value of IC capacity.

Annex 1: the problem with SMP as a reference

Using SMP as a mark is inappropriate because the IC is scheduled based on shadow price (SP) and therefore IC users discount their forecast of SEM uplift when constructing bids. This lowers IC bids relative to the GB power price and inflates the spread between the IC bids submitted and the SMP revenues relative to the actual spread between GB power price and SMP. We provide an example below for illustration:

GB Power Price	=	£40/MWh
IC User SEM Uplift Forecast	=	£10/MWh
IC User SEM Capacity Forecast	=	£5/MWh

IC User Offer Price = £25/MWh (GB Power Price minus Uplift Forecast minus Capacity Forecast)

SEM SMP = £50/MWh
Actual SEM Capacity = £4/MWh

Derived benefit on IC trade as calculated under Option 1 and Option 2 = £25/MWh (SMP minus Offer Price)

Actual achieved benefit on Trade = £14/MWh (SMP plus Capacity minus GB Power Price)

Error on derived 'benefit' under Option1 and Option 2 = £11/MWh

We provide an example below of using SP (instead of SMP) for illustration:

GB Power Price	=	£40/MWh
IC User SEM Uplift Forecast	=	£10/MWh
IC User SEM Capacity Forecast	=	£5/MWh

IC User Offer Price = £25/MWh (GB Power Price minus Uplift Forecast minus Capacity Forecast)

SEM SMP = £50/MWh
SEM SP = £41/MWh
Actual SEM Capacity = £4/MWh

Derived benefit if using SEM SP (instead of SEM SMP) minus IC Offer Price = £16/MWh
Actual achieved benefit on Trade = £14/MWh (SMP plus Capacity minus GB Power Price)

Error on derived 'benefit' using SP = £2/MWh

We furthermore suggest using ex-post initial SP rather than the ex-ante SP as it is the ex-post initial market run that sets the value of capacity for IC users as it determines their actual energy receipts. To use the ex-ante price opens IC participants up to additional price risk between the ex-ante and ex-post runs and could act as a barrier to trade.