

**Consultation response to:
High Level Design for Ireland and Northern
Ireland from 2016**

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1 CONSULTATION QUESTIONS

1.1 RESPONDENT DETAILS

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MAIN INTEREST IN CONSULTATION	Independent Research Institute

1.2 GENERAL COMMENTS

We are grateful for the opportunity to respond to this consultation paper.

We focus on a subset of questions in our response and specifically on the implications of the four options on market power and on the balancing market.

We stress the importance of limiting potential market power abuse.

Market power problems are more likely in a small system as the SEM. The current regulation provides great transparency which facilitates market monitoring. Greater interconnection might or might not bring more competition, but in any case any increases in interconnection capacity are as a minimum a decade or two away. We therefore recommend against moving away from transparency in the I-SEM.

One of the largest changes from the time when the SEM was initially adopted is the penetration of wind generation. As the regulators highlight, there has been an increasing gap between the day ahead nominations and the actual dispatch. Some of this may be due to the congestion on the North-South tie line, but part of the issue is likely to be the increased penetration of wind. This situation is not unique to the SEM. Schwenen and Neuhoff (2014) point out that the same is taking place in Germany.

Balancing costs should fall on all parties responsible for balancing costs, including wind. A move towards increasing balancing costs of wind may deter new investment in wind generation at current REFIT levels. We think this is appropriate as it internalises externalities that are currently hidden (see also Vandezande et al., 2010).

References for articles cited in this submission:

Deane, P., J. FitzGerald, L. Malaguzzi Valeri, A. Tuohy and D. Walsh (2013) Irish and British electricity prices and implications for the future, ESRI WP452

de Frutos, M. and N. Fabra (2012) How to allocate forward contracts: The case of electricity markets, European Economic Review, 56, 451-469

Schwenen and Neuhoff (2014) The declining value of peak forward contracts, IAEE Energy Forum, Quarter 1 2014, 7-8

Vandezande, L., L. Meeus, R. Belmans, M. Saguan and J. Glachant (2010) Well-functioning balancing markets: a prerequisite for wind power integration, Energy Policy, 28, 3146-3154

Wolak, F. (2007) Quantifying the supply-side benefits from forward contracting in the wholesale electricity markets, Journal of Applied Econometrics, 22, 1179-1209

1.3 PURPOSE OF THE DOCUMENT (SECTION 1)

Question	Answer
<p>1. Which option for energy trading arrangements would be your preferred choice for the I-SEM market, and why?</p>	<p>We favour options where there is unit bidding as opposed to portfolio bidding since this ensures market transparency. We believe that the first two options are not conducive to controlling potential market power abuse. If one of the first two options were adopted, the only effective tool in controlling market power would be the use of forward contracts. However, forward contracts are effective only if a. forward markets are liquid (Wolak, 2007 and Wolak, 2014); b. contracts are allocated carefully across market participants (de Frutos and Fabra, 2012).</p> <p>It is important to have a well functioning balancing market, not only for the integration of the SEM with other European markets, but also to facilitate the efficient integration of increasing wind generation.</p> <p>The Mandatory Centralised Market has the advantage that interconnection flows are determined and optimised at the same time as the main day-ahead and intraday markets. Moreover, it allows the balancing process to be integrated in the market. It deals with the issue of market power by providing transparency.</p> <p>The main advantage of the Gross Pool with Net Settlement is that it is the closest to the current market, which implies that market participants will presumably be able to adapt to the new rules without much of a learning period. It might be challenging to ensure liquidity of the day-ahead market, which is necessary for an efficient allocation of interconnector flows. The other challenge of this model is assuring that balancing costs are spread across the market participants responsible for them.</p>
<p>2. Is there a requirement for a CRM in the revised HLD, and why?</p>	<p>In order to maintain the current bidding code of practice and short run marginal bidding (as we recommend), it will be necessary to have some remuneration for capacity. The market currently has excess capacity, in part due to the economic downturn. This means that in the short run prices might decrease without a CRM and without any negative effect on reliability. However, as the need to invest in more generation arises, there would have to be a further change to the market. We believe it is better to maintain a CRM regime throughout to ensure regulatory certainty.</p>
<p>3. If there is a requirement for a CRM in the revised HLD, what form would be your preferred choice for the I-SEM, and why?</p>	<p>We favour market wide CRMs as they are more transparent.</p>

1.4 TOPICS FOR THE HIGH LEVEL DESIGN OF ENERGY TRADING ARRANGEMENTS
(SECTION 4)

Question	Answer
4. Are these the most important topics to consider in the description of the HLD for the revised energy trading arrangements for the single electricity market on the island of Ireland?	
5. Are there other aspects of the European Internal Electricity Market that should form part of the process of the High Level Design of energy trading arrangements in the I-SEM?	Issues of how balancing costs are spread across market participants are relevant to the decision. Balancing costs should be apportioned to the parties responsible for them, including wind generators.

1.5 SUMMARY OF THE OPTIONS FOR ENERGY TRADING ARRANGEMENTS (SECTION 5)

Question	Answer
6. What evidence can you provide for the assessment of the HLD options with respect to security of supply, efficiency, and adaptability?	

1.6 ADAPTED DECENTRALISED MARKET (SECTION 6)

Question	Answer
<p>7. Are there any changes you would suggest to make the Adapted Decentralised Market more effective for the I-SEM (for instance, a different choice for one or more of the topics or a different topic altogether)?</p>	
<p>8. Do you agree with the qualitative assessment of the Adapted Decentralised Market against the HLD criteria? If not, what changes to the assessment would you suggest (including the relative strengths and weaknesses of an option)?</p>	
<p>9. How does the Adapted Decentralised Market measure against the SEM Committee’s primary duty to protect the long and short term interests of consumers on the island of Ireland?</p>	<p>We think that this option is not in the best interest of consumers on the island of Ireland. By limiting transparency it limits the ability of the regulators to monitor the market. This is a major drawback in a system as small as the SEM, as argued more extensively in our answer to question 1.</p> <p>This type of market is closest to BETTA, which is our analysis does not compare favourably with the SEM (Deane et al., 2013).</p>

1.7 MANDATORY EX-POST POOL FOR NET VOLUMES (SECTION 7)

Question	Answer
10. Are there any changes you would suggest to make the Mandatory Ex-post Pool for Net Volumes more effective for the I-SEM (for instance, a different choice for one or more of the topics or a different topic altogether)?	
11. Do you agree with the qualitative assessment of Mandatory Ex-post Pool for Net Volumes against the HLD criteria? If not, what changes to the assessment would you suggest (including the relative strengths and weaknesses of an option)?	
12. How does the Mandatory Ex-post Pool for Net Volumes measure against the SEM Committee's primary duty to protect the long and short term interests of consumers on the island of Ireland?	We think that this option is not in the best interest of consumers on the island of Ireland. By limiting transparency it limits the ability of the regulators to monitor the market. This is a major drawback in a system as small as the SEM, as argued more extensively in our answer to question 1.

1.8 MANDATORY CENTRALISED MARKET (SECTION 8)

Question	Answer
13. Are there any changes you would suggest to make the Mandatory Centralised Market more effective for the I-SEM (for instance, a different choice for one or more of the topics or a different topic altogether)?	
14. Do you agree with the qualitative assessment of Mandatory Centralised Market against the HLD criteria? If not, what changes to the assessment would you suggest (including the relative strengths and weaknesses of an option)?	We would argue that allowing wind to be exposed to the imbalance prices might be a positive feature of this option, especially since wind generators are allowed to correct their position in the intra-day market as wind forecasts become more accurate. We address this issue also in our answer to question 1.
15. How does the Mandatory Centralised Market measure against the SEM Committee's primary duty to protect the long and short term interests of consumers on the island of Ireland?	This option can protect the interests of consumers. The main drawback is that it does not have a track record in the SEM environment.

1.9 GROSS POOL – NET SETTLEMENT MARKET (SECTION 9)

Question	Answer
<p>16. Are there any changes you would suggest to make the Gross Pool – Net Settlement Market more effective for the all I-SEM (for instance, a different choice for one or more of the topics or a different topic altogether)?</p>	<p>As we argue in answers 17 and 18, this option would need to be accompanied with appropriate incentives to lower system balancing costs. It is especially important to provide incentives for wind generators to minimise any costs caused by the uncertainty surrounding wind forecasts.</p>
<p>17. Do you agree with the qualitative assessment of Gross Pool – Net Settlement Market against the HLD criteria? If not, what changes to the assessment would you suggest (including the relative strengths and weaknesses of an option)?</p>	<p>We agree with the qualitative assessment of this option. We think that this option faces two main challenges:</p> <ol style="list-style-type: none"> 1. the need to encourage liquidity in the day-ahead market for interconnector flows to be efficient; 2. the need to accompany this model with appropriate incentives to lower balancing costs for the system as a whole. <p>The main advantage of this option is that it is the most similar to the current SEM, which has a good track record. This also implies that there would be limited learning efforts for market participants.</p>
<p>18. How does the Gross Pool – Net Settlement Market measure against the SEM Committee’s primary duty to protect the long and short term interests of consumers on the island of Ireland?</p>	<p>This option can protect consumers’ interests, provided that it is accompanied with a mechanism that gives an incentive to lower balancing costs for the system as a whole.</p>