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Dear Joe and James,

PrePayPower, as Ireland's largest prepay electricity provider, welcomes the opportunity to contribute to the SEM Committee "I-SEM Market Power Mitigation" Discussion Paper (SEM-15-031).

PrePayPower believes a fully liquid forwards market is key to mitigating market power in ISEM. We believe that continued regulation of directed contracts, and indeed an expansion of that programme, is required not just as the market transitions to the ISEM design but throughout ISEM. We would caution against any view that the ISEM interconnection can be relied upon to mitigate market power.

We therefore don't believe that interconnection in ISEM will necessarily manage local Bidding Zone market power in the physical markets. Strong regulation on local market participants will continue to be required. Cost reflective bidding, particularly in the balancing market, should be required under regulation via license condition, monitored by the local market monitoring unit.

Finally, we urge that the SEM Committee consider forwards market liquidity as a market in its own right subject to issues of market power such as withholding. Forwards markets are not just a mitigation to market power in the physical markets; they are an important risk management tool for suppliers to hedge market price volatility when offering customers fixed price retail contracts.

#### **Further Discussion on Forwards Contracts Market**

PrePayPower believes that the commercial risks of entering into forwards contracts without physical generation have resulted in an illiquid forwards market in SEM. This will continue during the transition into I-SEM. Generators that are independent and are free to trade energy are the only parties that can prudently offer hedging contracts, given that I-SEM has no track-record in pricing outcomes. Current non-energy investment signals for such generators remain under consultation

(Reliability Options, System Services under DS3) and PrePayPower does not envisage that independent generation investment is likely this side of 2018. This leaves only utilities that are long in generation as the only parties capable of offering forwards contracts. Such utilities, however, have negligible incentive to support competitors in managing their risk.

So with no regulatory intervention, forwards contracting liquidity will remain an issue moving into I-SEM, irrespective of the changes in market design. A lack of risk management tools is not just a liquidity issue; it is a market power issue. The SEM Committee must consider an expanded form of directed contracts, or a form of “Secure and Promote” for the start of the new market.

We are uncomfortable time-based criteria, such as “flexibility” and “sunset ability” being used in the evaluation of market power mitigation support. These criteria imply a hands-off approach to the development of a centralised platform for forwards trading. If there is no such structure for a forwards market, PrePayPower predict there can be no forwards market liquidity for several years into the start of I-SEM. PrePayPower requests the SEM Committee to make an enduring commitment to regulatory involvement in a forwards market design, which:

- Minimises collateral costs in a sensible manner, with integration with other physical spot market timeframes to minimise those collateral costs;
- Provides for contract structures and forms which interact appropriately with the capacity remuneration mechanism design;
- Obliges participants on an ongoing basis to offer their generation into the forwards market arrangements.

#### **Further Discussion on Strong Regulation of Bidding Behaviours**

The ISEM does expand the potential range of generation that can influence market prices. Nevertheless, this influence is limited to the available flow on Interconnection, which is currently limited on both EWIC and Moyle for technical reasons. The influence of the wider European markets will be secondary to the potential for market power within the local ISEM Bidding Zone. Continuation of regulation of cost reflective bidding, monitored by the MMU, must continue with the ISEM to protect the interests of consumers.

We have responded briefly to the specific questions raised in the discussion paper below.

Our response is not confidential and may be published in full. If you wish to have further communication in relation to our submission, please don't hesitate to contact me.

Yours faithfully,

Cathal Fay

## **Section 2.2**

*Q1 Are the market power concepts and examples provided appropriate and sufficient for I-SEM?*

We believe that it is financially imprudent to offer a non-physically backed hedge within a transition period to a new market. Only physical generation can take a view on providing long-term financial hedging.

*Q2 Are the potential constraints on market power referred to in this section appropriate for I-SEM?*

No response given.

## **Section 2.3**

*Q3 Given the emerging I-SEM design, including closer integration to European electricity markets and a number of energy trading timeframes, what is the appropriate geographic market(s) and/or trading period(s) definition for the measurement of market power and determination of a mitigation strategy in I-SEM?*

Forwards markets should be considered as an area for market power review and control, and not just as mitigation to potential physical market power, e.g. like Directed Contracts are today. Furthermore, market power should be analysed across markets, i.e. are trading behaviours commercially consistent across day-ahead, intraday, and balancing market. Finally, it is difficult to see how a market power strategy cannot be arranged without coordination with Ofgem in particular, considering the influence of Interconnection on the day-ahead and intraday markets.

PrePayPower do not support a methodology of measuring market power that assumes regular participation of European generators within the local Bidding Zone price formation. Such assumptions are based on the technical availability of interconnection and the discretion of those generators to participate, which is by no means guaranteed. A more benign measurement of market power could result in the reduction, or even the cancellation of the directed contracts process.

*Q4 Are the various (other) market design issues referred to in this section and their potential impacts on market power captured appropriately and fully?*

PrePayPower believes that as the trigger for reliability options under the new Capacity Remuneration Mechanism is linked to dynamic market prices, this could create more market power issues than the implicit price cap will resolve. Those market prices which trigger the reliability options will be influenced by generators who are not subject to reliability option calls. Furthermore, it is uncertain at this time as to what volume of a supplier's served energy the price cap will apply.

## **Section 2.4**

*Q5 What is the appropriate approach to measuring market power when developing a mitigation strategy for I-SEM?*

PrePayPower supports emphasis on market-wide indicators of market power, given the nature of the centralised physical trading arrangements. Liquidity is intrinsically linked to market power. Liquidity measures in the forwards market should be considered within the metrics used. Intraday market liquidity and concentration should be given appropriate emphasis as well.

*Q6 Should the measure be determined at a snapshot in time or based on historical or potential future trends in market share (or both or all three)?*

A proactive approach to market power issues should be taken, which implies SEM Committee review of market power across both historical and future timeframes.

### **Section 3.2**

*Q7 How effective have the SEM market power mitigation strategy and measures been?*

PrePayPower supports the underlying cost reflective physical pricing that the I-SEM has delivered, primarily through the combination of the BCOP monitored by the MMU, supported by the Capacity Payment Mechanism. We believe that the SEM forwards market was developed more in principle as mitigation to physical market power, rather than resolving an issue with market power in that market within its own right. It is questionable the degree to which an absence of the forwards market in SEM would have impacted physical prices with the existing of the BCOP and MMU. The forwards market is highly valued in the SEM, however, not because it manages market power, but it allows suppliers to hedge out price volatility in underlying commodity markets.

*Q8 To what extent is the strategy and measures applicable to I-SEM?*

PrePayPower believes that in coordination with Ofgem, utilising the structures of REMIT, that cost reflective bidding across all market timeframes – and particularly the balancing market – must be enshrined in the I-SEM design.

*Q9 Are there other market power mitigation measures worth considering in the context of I-SEM? (See Appendix 2 for a review of a number of other European markets).*

We recommend that promotion of liquidity in hedging arrangements (equivalent to Secure and Promote) and direct regulatory involvement in the forwards market are considered.

*Q10 What are the barriers to entry for non-asset backed traders in the SEM financial forwards market?*

See response to Q1 and introductory letter.

### **Section 3.3**

*Q11 Are the principles of market power mitigation outlined in this section appropriate?*

Enduring structural support for cost reflective bidding and for support for a forwards market should be made. Should an illiquid forwards market exist, the directed contracts process, or a form of Secure and Promote, should continue indefinitely until such a market has fully developed. Such enduring activities do not seem to be supported within the regulatory principles, which lean too much towards transitional responses to problems which are assumed transitory. We are approaching eight years of SEM, and market power remains an issue. The principle should be to commit to market regulation of market power until it can be demonstrated that all markets (forwards, day-ahead, intraday, balancing) are appropriately liquid.

*Q12 How should these or other principles be applied in I-SEM?*

It is too early a stage in the process to discuss the application of principles into concrete actions, particularly while certain elements of the reliability options and DS3 system services design remain undecided.