

I-SEM Market Power Mitigation – Consultation Paper (SEM-15-094)

Moyle Interconnector Ltd response

Moyle Interconnector Ltd (Moyle) notes the work undertaken by the SEM committee on this paper and welcomes the opportunity to respond.

While Moyle recognises the need to address market power issues in I-SEM, as an interconnector owner without direct involvement in energy markets, we offer a small number of general remarks only.

In I-SEM, interconnectors will in the first instance be scheduled through the Euphemia algorithm based on the price spread between the two interconnected markets at day ahead (DA). Our preferences therefore primarily relate to the DA market.

Regulation of the Forwards Market

We note the statement in section 4.3.7:

‘Furthermore, ongoing EU regulatory developments such as EMIR24 and MiFID25 assist in detecting and preventing market power abuse in the forward financial market, with a role for the relevant financial regulatory authorities in relation to this matter. The RAs will co-operate with the financial regulatory authorities to the extent appropriate, but it is not anticipated that the RAs will be the lead authorities in this area.’

Similar statements elsewhere in the document appear to also state the view that the energy RAs will play a secondary role with regards to regulation of the forwards market. We understand that forward financial contracts relating to the energy market will be captured under EU financial regulations, requiring reporting to financial regulators. However, we do feel it is important that the energy regulators do not defer to financial regulators as having priority, since the forwards market remains a critical part of I-SEM.

The I-SEM forward market is likely to be a relatively small portion of the financial regulators’ portfolio of interests and their approach to cross border coordination is relatively unclear. The focus of financial regulators, and their approach to regulation, is likely to be quite different to that of the energy RAs. Most critically, their appreciation of energy markets and likely issues will be well behind that of the energy RAs. On the other hand, regulation of the energy markets on the island of Ireland, is managed through well-established cross border co-operation between the respective energy RAs, most apparent through the activities of the SEM committee such as the I-SEM design process.

We therefore consider that the energy RAs are best placed to be the primary regulator(s) in the I-SEM forwards market rather than deferring to the financial regulators. We consider that, to the extent permitted under law, it would be more efficient to keep all energy related regulation within the gift of energy regulators, in order to avoid duplication of reporting and inefficiency.

We note the paper does not expand on how financial regulatory oversight of the forward market would operate and seek clarification in a number of areas:

- Have the RAs discussed with financial regulators their respective expectations of future roles? Has legal advice been sought on this?
- Who are the “relevant financial regulatory authorities”? That is, would this be both FCA and the ROI equivalent in all cases due to all-island nature of I-SEM?
- We note that TSOs allocating cross zonal capacities benefit from an exemption under the MiFID II delegated acts – to this end we expect that the RAs will continue to be the regulator of primary issuances of FTRs.

Market Coupling

Market coupling is the centrepiece of interconnected electricity market design and interconnectors will be scheduled through the Euphemia algorithm based on the price spread at DA between the two interconnected markets.

The effect of market coupling should be that the market with higher pricing will benefit from the additional source of lower-priced energy through the interconnector, so that ultimately prices in the two markets will converge.

Misalignments of the markets result in inefficient interconnector flows. When pricing in interconnected markets is set by different mechanisms so that prices are not comparable like for like there is a danger that inefficient interconnector flows will be scheduled. This is currently the case due to different gate closure timings and capacity markets and we suggest that care needs to be taken to ensure that the most efficient flows are scheduled in the new market design.

We note the priority attached throughout this document to bidding at short run marginal cost (SRMC) as a market power mitigation strategy. While SRMC bidding offers benefits to consumers through competitive pricing, as well as the market power benefits, we note that this approach has the potential to distort market coupling if enforced too rigidly.

For example, in one market, market 'A', bids are constrained to SRMC and in a connected market, market 'B', using an identical portfolio of generation technology, bids are unconstrained. If both markets are competitive it is reasonable to expect prices in both will tend towards SRMC. However, it is also reasonable to expect that DA prices will tend to be higher in market 'B' as generators have more bidding freedom and markets are not perfectly competitive. This will mean interconnector flows will be scheduled towards market B when the underlying economics do not warrant them. More pertinently, prices in market B will be higher at times of scarcity whereas prices in market A will continue to be constrained to SRMC. Again, interconnector flows will be scheduled according to enforced SRMC bidding rules rather than actual market conditions at either end.

In order to mitigate against such scenarios, the design of markets on which interconnector flows are based should be as similar as possible. Therefore, since no SRMC bidding constraint is imposed in the GB market, any such constraint in I-SEM should be as targeted as possible. In the DA market, we suggest a combination of option 3 (ex-post enforcement only) and option 4 (market abuse condition). Option 3 imposes no explicit bidding controls or principles, similar to the GB market, which should provide for closer market coupling and consequently more efficient interconnector scheduling, while permitting the market monitoring unit to review bids for market power exploitation.

Option 4 would impose a licence requirement disallowing market abuse, which should be acceptable to market participants, and only placing additional reporting requirements on market participants with structural market power would avoid a significant additional burden on other market participants. We consider that penalties for breach of this licence requirement should be clearly defined. The freedom of option 3 backed up with the licensing and reporting requirements of option 4 would together form an effective, targeted, flexible, transparent and practical approach to mitigation of market power at DA.

Financial Transmission Rights

We agree that holding an FTR may increase the incentive to exercise market power in either bidding zone, but does not in itself have any effect on the ability to exercise market power in the physical markets. That said, we consider that market power interaction with FTRs is likely to be a minor concern - if a party could drive up the DA market price then their main incentive would likely be the increased price paid to them for their generation rather than FTR pay-outs where they are unlikely to have the same influence on the remote market.

We note the rationale set out in footnote 21 on page 29 of the consultation. While it is correct that increasing the spot price will have knock on effects of increasing the price of FTRs in auctions we do not necessarily agree that this will mean market participants will refrain from cross border hedging

because it is too expensive. The price of FTRs will have risen because cross border hedging has become more valuable and thus more attractive. Choosing not to hedge cross border in this example would therefore be an illogical and costly decision as the market participant would leave themselves exposed to the high local spot price.

Our view is that the focus of market power mitigation should therefore remain on the energy contracting markets to avoid scenarios where the DAM price can be easily manipulated through exercise of market power. Any FTR impact would simply be a side effect of a larger issue.