

## Forward risk-hedging products and harmonisation of long-term capacity allocation rules – 28<sup>th</sup> October 2012

### Mutual Energy Ltd response to Acer consultation

Mutual Energy owns and operates the Moyle Interconnector which links the electricity systems of Northern Ireland and Scotland through submarine cables running between converter stations at Ballycronan More in Islandmagee, County Antrim and Auchencrosh in Ayrshire. The link has a capacity of 500MW. This response addresses each of the questions posed by the consultation in turn:

1. PTRs with UIOSI or FTRs are appropriate so we do not suggest any alternative options. With regard to the comparison between the transmission risk-hedging products, we have several observations on points made here:
  - It is stated that nomination of PTRs is a disadvantage as it reduces liquidity in the day-ahead market. It is not clear that this is a disadvantage – if the capacity is nominated it is being utilised in, one would assume, an efficient manner and contributing to bringing market prices closer together. To state that this is a disadvantage is to overemphasise the importance of day-ahead markets at the expense of other timeframes.
  - We are concerned by the statement “...there is a positive effect on revenues, due to lower auction prices”. This appears to value the revenue/profit of traders above all else as long term auction prices are a sunk cost so are irrelevant to power trading decisions. Lower auction prices impact on interconnector owners and hence consumers (where they underwrite costs of interconnection). This is not necessarily a positive if it has a negative impact on consumers.
2. The forward market retains its importance to traders even with day-ahead and intraday target models implemented. The vast majority of power is traded and locked in well before the day-ahead stage and we do not expect this to change. Parties use interconnector trade as a long term hedge against volatility in their own market and intraday/daily markets are irrelevant to demand for such products. For example, most demand in the Irish market is for longer term products and we do not see this changing as a result of the target model – demand for short term products may increase but this will be due to an increase in wind generation and associated intermittency.
3. Our expectations of required evolution would be:
  1. Limited evolution required.
  2. Possible evolution required if this were to result in capacity becoming unusable. There would be a need to either ensure that only long term capacity that is going to be available is sold or to develop products which take account of this risk.
  3. This would be a major change as the characteristic of products would be completely redefined.
4. As an interconnector owner rather than a trader we do not feel we are best placed to comment on what is the most suitable model for effective long term hedging.

5. Again, we are not best placed to comment here.
6. The response below, which addresses the various headings in the wish-list, also covers questions 7 and 8.

Scope – It would appear sensible to harmonise access rules for all long term auctions rather than just annual and monthly.

The statement that the rules will be governed by the laws of the member state where the allocation platform is registered is not acceptable. Those who have invested in interconnection should have the right to allocate capacity on their interconnector in line with their own local law. The location of the allocation platform is irrelevant as it is merely a tool used to administer the access rules.

Level of harmonisation – as long as market rules are harmonised this should be fine but if they are not there may be additional areas of access rules that cannot be harmonised.

Auction rules – Interconnector owners should have a lead role in any modification of the rules.

Entry into force – this timing is unlikely to be feasible in all member states.

Firmness – it should be specified who is responsible for underwriting the provision of firmness. There is little benefit in providing firmness if the party underwriting it does not have the means to compensate when required and wholly unacceptable for this risk to be transferred from traders to the interconnector owner alone.

Cancellation of an auction after the end of the contestation period – We do not see that there is an argument for compensating traders in these circumstances beyond them not having to pay or being rebated at the marginal price of the auction. Given that this is a long term auction they are unlikely to have incurred any cost by the time of cancellation.

Payment deposit – we do not see that all interconnector owners should have to accept the same security provisions or that this would have a significant positive impact on trade.

Recovery of payments – Our view is that a bank guarantee would be the preferred option. In line with our view on payment deposit calculation, the size of the guarantee required (i.e. 1/12<sup>th</sup>, 2/12<sup>th</sup> etc) should be determined by the owner of the interconnector to which the capacity relates.

9. We do not see a need for any part of the rules to be harmonised in binding codes.
10. Again, we are not best placed to comment here.
11. If what is being proposed here is to allow capacity on several borders to be purchased at once (i.e. as a single product) then yes this would be an improvement as it would result in

simplifying access to non-neighbouring markets. If we are simply referring to holding auctions at the same time this would not add much value.

12. The capacity calculations should be consistent with each other as both will need to consider the same issues. In the long term timeframe, for our interconnector at least, we do not see that there is much scope for interdependency/optimisation of capacity across different borders. This will likely differ for locations with high levels of interconnection across multiple borders.
13. It is our view that availability of products of different durations is very important for effective hedging. Different price zones may have different seasonality effects (both timing and quantum of effect) so having a small number of product types throughout the region would reduce the ability to effectively hedge price differentials between bidding zones. Multi-year products would be less important than, for example, seasonal products but there would be demand for relatively small volumes of such products. Demand suggests they are useful so should be retained.
14. The split of interconnector capacity across different timeframes should not be fixed and should not necessarily be the same for all borders. Interconnector owners need the flexibility to respond to demand and to tailor their capacity offering accordingly. For example, the split on the Moyle Interconnector is different in each direction in response to the demand experienced, our view on future demand and understanding of the connected markets. We cannot therefore express a view on what split between timeframes is appropriate as this view is fluid in line with demand and market developments. If such a split was to be harmonised it would be better to agree a minimum proportion to be offered in each timeframe which would allow the interconnector owner some flexibility to tailor their offering.
15. These products should be kept as maximising the availability of capacity is more important than “gold-plating” the standardisation of all long-term products. We do not feel that standardisation is as important in the long term (compared to day-ahead) as there is sufficient time in the long-term to adjust positions as necessary due to outages etc. Even with the best intentions there will always be occasions where what is delivered is slightly different from what is sold for long term periods even with standardisation. It should be possible to offer standardised products and these “non-standard” products to give traders choice.
16. Local market specificities and demand should drive any decision to offer such products. We do not see this as an area for standardisation, particularly in the long term. We would not favour offering these products so, if they were introduced; our view is they should be a small percentage compared to base load. Any argument for such products is likely to be based on traders expecting to make savings on capacity costs which is not economically sound.
17. We struggle to see the societal benefit of such an approach. TSO’s have the option to trade/countertrade without having to buy back long-term capacity. Traders who are

requested to sell back their capacity will expect to be compensated for the opportunity cost of not being able to trade so it may well be more efficient for TSO's to trade/countertrade as at present. Notwithstanding this, we would be in favour of maximising the options available to TSOs to manage their system so would not object to this option if others see value in it. We would expect that such a process could be organised via the auction platform, with a notice board facility allowing the TSO to make capacity holders aware that they wish to buy back capacity.

18. Removal of nominations does not present a problem for us although we do favour PTRs with UIOSI.
19. We are an interconnector owner therefore do not have a hedging strategy. Our view is that moving to FTRs would be more complex and less transparent.
20. It is likely that some harmonisation/alignment of nominations process (both contractual and technical) would be beneficial and more convenient for traders. Without being familiar with nominations on other borders we cannot comment on how feasible this is or the potential CBA of such harmonisation.
21. We are not familiar with the detailed features of auction platforms apart from the Damas system that is used on our own interconnector (and the other interconnectors within France-UK-Ireland) so cannot comment on the advantages/weaknesses of the various other systems. Our own experience is that the Damas system is fit for purpose and has been tailored to be suitable for four separate interconnectors, albeit with broadly aligned access rules.
22. We do not see that a single platform adds significant value to the long term timeframe. Interconnector owners have invested in their own systems and it will be difficult for many to accept that the benefits outweigh the risks and loss of control that this would represent. If a single platform is the accepted solution (and I note the consultation quotes the CACM FG "regional platforms may operate, as long as this does not hamper the improvement and harmonisation of allocation rules") the transitional phase should gradually absorb regions into the single platform to enable the transition of each region to be individually handled resulting in a smaller number of issues being dealt with at once. If all were to move to the single platform at once it is likely to be an unwieldy and problematic exercise. This process should be voluntary but it does not seem feasible to merge existing systems from different manufacturers. A procurement process is likely to be required for a new system with suitable flexibility to add new regions/interconnectors in turn and deal with any non-harmonised aspects of their markets. We would not favour a deadline being set in the Network Code on Forward Markets as we do not see the establishment of a single platform being in any way key to delivering the target model.