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L I M I T E D**

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Ref: TEL/CJD/16/007

18th January 2016

RE: Market Power Consultation Paper (SEM-15-094)

Dear Gonzalo, Joe

TEL welcomes the opportunity to respond to this consultation. TEL has divided its response into two sections: Section A highlights TEL's views on Market Power in the I-SEM and Section B answers the questions raised in the consultation.

SECTION A

We would like to raise the following points in response to this consultation:

1. The Market Power Framework
2. Local Market Power
3. Structural Market Power
4. Balancing Market (Redispatch Timeframe bidding)
5. EUPHEMIA data

1. The Market Power Framework

The objective of the Market Power consultation should be to implement a solution to prevent future abuse. However the consultation paper appears to presume that Market Abuse will take place, and proposes strict regulated bidding rules to prevent this. Yet the paper accepts that the GB market is clearing at a competitive price without these prescriptive bidding rules. Furthermore the GB market has less surplus generation than the I-SEM and under the DS3 Competition Consultation, the RA's are happy that where there is sufficient competition, there will be a competitive market. As such, this premise that Market Abuse will occur appears to be without foundation.

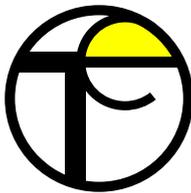
2. Local Market Power

The consultation suggests that plants that set the price have Market Power. TEL believes this is a mistaken view based on the OECD definition of market power:

Market power refers to the ability of a firm (or group of firms) to raise and maintain prices above the level that would prevail under competition is referred to as market or monopoly power. The exercise of market power leads to reduced output and loss of economic welfare.

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In the Market Power workshop (02/12/2015), an example was presented showing that a specific generator set the price 6% of the time. The implication being that that this generator has market power. This is not the case. If the participant were the marginal plant and were to raise their prices they would be replaced by another generator from their price band. They would lose their place in the merit order and would lose revenue.

From a price aspect the SEM is currently effectively grouped into 7 price bands:

- a) Priority Dispatch
- b) Moneypoint, Kilroot, Seal Rock and Dublin Bay.
- c) Whitegate, Great Island, Aghada 2
- d) Tynagh, Coolkeeragh, Huntstown 2
- e) Huntstown 1, Poolbeg, Ballylumford
- f) Peakers
- g) DSM

For any unit within one of these bands to abuse market power they must be sure that they are the marginal plant, that they will set the price, and that they can still run at a higher price. This is not possible in the SEM and it certainly won't be possible when there is efficient Interconnector Flow under EUPHEMIA with higher wind generation.

This reasoning (that setting price gives market power) also colours the RAs discussion of local market power and the mitigation measures suggested on pg 86. The only plant that are in a position to exercise local market power are those that are must-run or a member of a small group that can alleviate a transmission constraint e.g. the Dublin Constraint or the North West Generation Constraint. It does not include plant that are part of a large constraint group (i.e. min 5 units in the south). Nor does it include plant that are brought off to make way for those plant. This is because the TSO has a choice between which plant to constrain down/off therefore an individual plant could not maintain prices above competitive level regardless of how it bid.

3. Structural Market Power

When discussing market power the OECD states the following:

A firm's ability to raise its prices is usually constrained by competitors and the possibility that its customers can switch to alternative sources of supply. When these constraints are weak, a firm is said to have market power and if the market power is great enough, to be in a position of dominance.¹

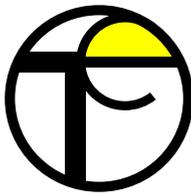
If there are to be mitigation measures these should be on those market participants that are pivotal. From the analysis in the consultation paper two participants have a significant market share. According to the OECD these are the players that are in a position of dominance and therefore should bear the most scrutiny. To this end any mitigation measures employed in the Forward and DA/ID markets should be focused on these two participants. Option 4 together with a Forward Contracting Obligation on these identified participants is the most appropriate of the options listed.

Day Ahead / Intra Day Options

Option 4: Market Abuse Condition

Option 4 with a FCO is targeted as it only applies to the dominant participants, effective as the FCO removes the incentive to raise prices in the DAM, practical as it would enable RAs to focus resources where they are most effective, and transparent as it recognises the fact that Euphemia bids will not allow strict SRMC at all times and generators must be free to structure bids accordingly.

¹ <http://www.oecd.org/competition/abuse/>



Option 1: Prescriptive Bidding Controls

This option does not target the abuse of market power by participants who hold market power. Instead it attempts to control market competition through SRMC bidding. Out of all of the options it is the least flexible, practical, targeted and effective at preventing/mitigating the abuse of market power. We would agree with point 8.9.8 that “it is not appropriate to implement this option”.

Option 2: Bidding Principles and Ex-Post Enforcement

A deviation from SRMC does not represent abuse of market power. The reason for applying this option because “there is a concern of not being able to differentiate between the exercise of market power and genuine legitimate behaviour leading to high price of scarcity” (point 4.2.6) should not be considered. This option does not prevent market power abuse through a targeted and effective procedure. This option would also require more resources from the MMU to monitor the bidding strategies of each participant.

Option 3: Ex-Post Enforcement Only

As highlighted in point 8.10.5, the practicality of this option being ready for I-SEM go live is questionable. Similar to option 2, the use of other metrics, rather than deviation from SRMC, to determine market power abuse is required to develop a market that has liquidity and is truly competitive.

Balancing Market

If there are to be Market Power mitigation measures then these should be targeted at those market participants that can both “raise and maintain prices” as these are the participants that have market power according to the OECD definition. To this end Option 2a seems the best of the available options as it is the most targeted and effective.

Option 1: MMU Triggered Intervention

This is not an option to prevent/mitigating market power abuse as it is performed ex-post. It is more a “punishment” type option. The punishment for market power abuse is for the TSO to replace the unit’s offers with SMRC for a “number of future settlement periods”. A big problem with this option is how will the number of future settlement periods be determined? Will it be dependent on the type and impact of market power abuse? Will industry and RAs agree within the tight timelines required to deliver the I-SEM? This option could cost more to implement considering it requires significantly more MMU resources than the other available options and the transparency of the option depends heavily on increased publication of operations by the MMU.

Option 2b: Automated Intervention Flagging and Tagging

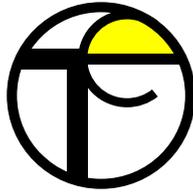
This option is based on the Flagging and Tagging process which is currently requiring significant analysis in the Market Rules working group. Considering the discussion in the market rules working group, the transparency of this option does not appear to be as straight forward as first thought. Further clarification is required on the point at which the TSO replaces the offer i.e. is it the flagging or tagging step? This option still requires significant analysis on the impact the flagging and tagging process has on identify market power abuse. The transparency of the option is heavily dependent on the publication of TSO flagging and tagging.

Option 3: Prescriptive Bidding Controls

This option does not target the abuse of market power by participants who hold market power. Instead it attempts to control market competition through SRMC bidding. Out of all of the options it is the least flexible, targeted and effective at preventing/mitigating the abuse of market power.

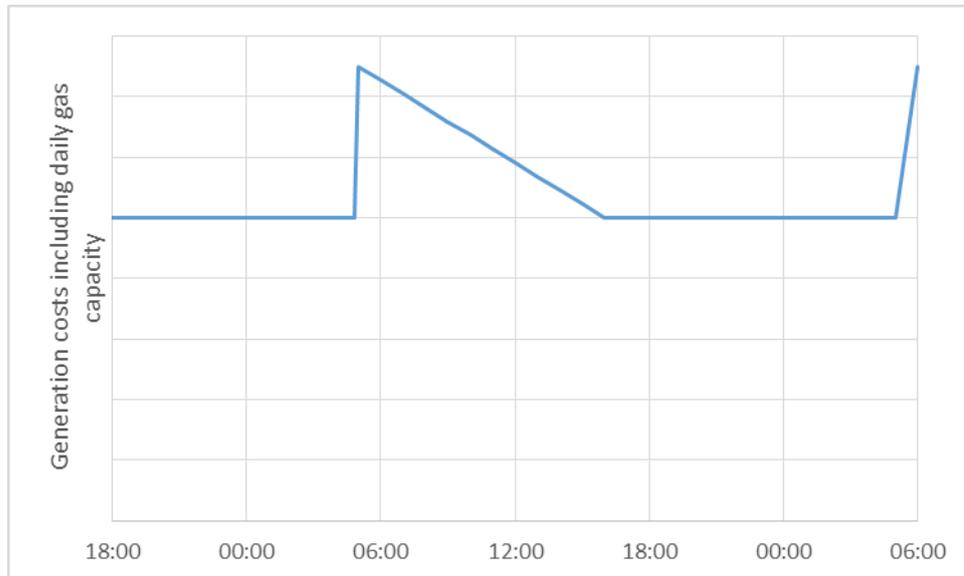
4. Balancing Market (Redispatch Timeframe Bidding)

The latest from the Market Rules Group suggests that the Balancing Market will be split into two markets. A Redispatch timeframe for the 23 hours up to the last hour, and a ‘Last Hour’ timeframe. The ‘Last Hour’ timeframe will be simple incs and decs, while the Redispatch will



have complex bids. In the Redispatch timeframe plants will be required to submit one bid which will stay active for every subsequent trading period until it is replaced.

SRMC in the Redispatch timeframe will be extremely complex for CCGT's who have an annual Gas Capacity holding.



Take for example a CCGT that is not running and has an Annual Gas Capacity holding equivalent to 50% of the requirement for baseload running. The plant's bid into the Redispatch market will not initially (at 11PM) take into account the cost of Daily Gas Capacity (see diagram). The annual booking will be sufficient to account for the six hours until the start of the new gas day (5AM). However if the plant is called on at 5AM it may be subject to running for 24 hours at baseload and therefore would need to increase prices to include daily gas capacity. For every subsequent hour the price would fall as can be seen in the curve, until the point where the annual gas capacity would again be sufficient for the remaining hours.

The trouble is, if there is an open instruction at 11PM, the plant may be called on and may stay for a number of hours, possibly for the subsequent full gas day. The open instruction will use the price at 11PM. This SRMC price will not include the price of daily gas capacity and the generator might bear a significant loss.

5. EUPHEMIA Data

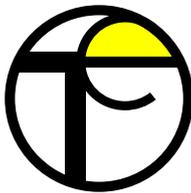
The current SEMO website publishes a large quantity of data that allows all generators to know where they stand relative to all other generators in the market. The current proposal is that bids into EUPHEMIA will not subsequently be published. This is a huge Market Power issue. If this data is not published those generators with a portfolio position will be able to establish with a degree of certainty other generators bids, and be able to devise a bidding strategy accordingly. However those single unit generators will only know that they are not running.

TEL urges the SEMC to ensure that the current levels of market data continue to be available under the new market.

SECTION B

2.7.1 - Do you agree with the policy developments and trends identified (above) as potentially impacting on an I-SEM market power mitigation strategy?

Yes.



2.7.2 - Are there other factors not identified here which you consider relevant?

No. But it is worth bearing in mind, that the purpose of the paper is not to mitigate against market power, but only against market power abuse.

3.6.1 - Do you agree with the proposed appropriate markets/trading periods for assessing market power in I-SEM's energy and financial markets?

The Imbalance Pricing plain English document states that complex orders (start costs, no load costs and incremental price and quantity pairs) are to apply to the Redispatch timeframe (up to H-1) and simple bid offers (incremental price and quantity pairs only) are to apply to the Last Hour timeframe (from H-1). This paper does not discuss how the market power rules in the balancing market apply to the complex and simple bid orders in the Redispatch and Last Hour Timeframes.

3.6.2 - Do you agree with the proposed geographic scope of the proposed markets/trading periods?

Yes.

4.8.1 - Do you agree with the proposed definition of competitive behaviour and pricing in I-SEM?

This definition is based on “a concern of not being able to differentiate between the exercise of market power and genuine legitimate behaviour leading to high price of scarcity” (4.2.6). It is unfair to assume that any deviation from SRMC bidding is uncompetitive behaviour or abuse of market power.

4.8.2 - Do you think that the suggested examples in which market power can be exercised in I-SEM captures the relevant issues?

TEL agrees with the suggestion of physical/quantity withholding, financial/economic withholding, pricing strategy and transmission related strategies as examples of abusing market power. However, TEL do not agree that any deviations from SRMC is the abuse of market power. Is the purpose of this consultation to prevent market power or to prevent the abuse of market power?

4.8.3 - Do you agree that the potential for market power abuse in I-SEM appears to be weaker in the forward financial market compared to the physical markets?

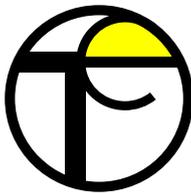
Yes.

4.8.4 - Do you agree with the implications for market power arising from interactions between the physical markets, CRM, FTRs and DS3 System Services as shown above?

No. TEL disagree with the comment “the SEM committee remains concerned about the ability and incentive of market participants to exercise market power up to the level of the strike price” in point 4.5.2. This concern is incorrect as no power plant will be able to push up the price without losing market position and losing revenue, as described in Section A.

5.5.1 - Do you agree that these are the appropriate metrics to identify market power ex-ante and ex-post in I-SEM?

If a plant bids above SRMC it does not indicate market power. The PST is the best indicator of market power, but does not indicate market abuse.



5.5.2 - Are there other metrics that you consider should be applied?

No. But the operational constraints should be borne in mind.

6.7.1 - Do you agree with the approach taken by the RAs to modelling market power in I-SEM?

No, as the assumptions used have limitations. The only difference between the day-ahead model and the balancing market model is a 10% increase in demand levels as the balancing market model does not include system operating constraints. 6.5.4 states the analysis was “meant to illustrate how shorter-term supply-demand condition might look for energy actions in the balancing market and ignores non-energy actions and local market power”. This is a significant limitation considering the balancing market will be predominately non-energy actions.

6.7.2 - Do you agree with the conclusions for I-SEM market power that have been drawn from the modelling results?

The results show the potential market power participants could have in the day-ahead market. However, this does not mean market power abuse has occurred. The lack of system operating constraints in the balancing market means there are limitations in the results for participant's market power in the balancing market.

7.4.1 - Do you agree with the SEM Committee's view on the effectiveness of each of the SEM market power mitigation measures?

Yes.

7.4.2 - Are there any particular aspects of the SEM market power mitigation strategy that you think should be applied differently, especially in relation to I-SEM?

Similar to 2.6.1.5, TEL believe that “the need for market rules to be targeted at dominant players/ESB rather than at all participants.”

8.12.1 - Do you agree with the five key principles for assessing market power mitigation policies as outlined in this section 8.3? If you think there should be alternatives, please state the reasoning.

Yes. All of the principles are critical to the success of policies and neither principle should be sacrificed.

8.12.2 - For the Forward Contracting Obligation:

- What should be the measure and threshold that results in a market participant being included or excluded in the FCO, i.e. what is its applicability?

If generation market share is greater than 15% then that market participant should be included in the FCO.

- What should be the volume and product definition of forward contracting required from a market participant who falls under the FCO?

- How should the price be set for the volume contracted under the FCO?

There should be an obligation to sell a forecast volume of FCOs with the RA's setting the reserve price and allowing the market to bid up the price in an auction.



- What type of access should buyers have to FCO volumes?

8.12.3 - Which of the balancing market mitigation options do you consider most appropriate, i.e. MMU-triggered intervention, automated intervention via a PST or via the “flagging and tagging” approach, or prescriptive bidding controls? Where feasible please relate the preferred approach to the five key principles for this workstream of effective, targeted, flexible, practical and transparent.

Option 2a is the most appropriate mitigation option once the PSI is calculated for multiple generators as mentioned in 5.3.5. It is effective as it is ex-ante based and will only apply to the generating units with market power if a PST fails. The transparency of the option is clear as the PST will indicate which supplier has the market power and subject to examination.

8.12.4 - Which ex-ante bidding/offer market power mitigation options for the DA and ID markets do you favour – bidding principles and ex-post assessment, or ex-post assessment only? Where feasible please relate the preferred approach to the five key principles for this workstream of effective, targeted, flexible, practical and transparent.

Option 4 should be explored in more detail as it represents a free market but allows the regulator to determine the abuse of market through the reporting from market participants with market power.

8.12.5 - If ex-ante bidding principles were to be adopted, how flexible should they be and how would this be facilitated/enshrined in their wording?

TEL believe that bidding principles should not be adopted.

8.12.6 - Under what structural conditions or in combination with other market power mitigation measures should vertical ring-fencing of the incumbents be relaxed?

TEL doesn't think vertical ring-fencing should be relaxed until market power for the participants in question has been properly addressed.

8.12.7 - Under what circumstances and criteria (or metrics) should the application of ring-fencing to other market participants be considered?

Any market participant with a combination greater than 10% in one market and 20% in another for supply or generation should be considered for ring-fencing.

I trust that these comments will prove helpful and should you have any queries, please do not hesitate to contact me.

Yours sincerely,

Cormac Daly
Risk and Regulatory Manager