TYNAGH ENERGY
L I M I T E D

James Curtin
Commission for Energy Regulation
The Exchange
Belgard Square North
Tallaght
Dublin 24

Joe Craig
Utility Regulator
Queens House
14 Queens Street
Belfast
BT1 6ED

Ref: TEL/DV/15/060

27th March 2015

RE: Forwards and Liquidity Discussion Paper (SEM-15-010)

Dear Sirs,

Tynagh Energy Limited (TEL) welcomes the opportunity to respond to the I-SEM Forwards and Liquidity Discussion Paper (SEM-15-010). TEL would like to commend the SEM Committee (SEMC) on the decision to publish this discussion paper ahead of schedule. The early publication outlining initial views of the issues of relevance to this workstream will improve market participants' understanding. It will also strengthen both the consultation process and engagement from industry stakeholders.

The introduction of the I-SEM will couple the electricity market with the single European market for the first time. EUPHEMIA compliant bidding formats will also require the relaxation of the SRMC bidding rules and market participants will be Balance Responsible Parties. This will likely weaken the link between gas prices and SMP and will expose market participants to the risk of a marginal imbalance price. The development of liquid forward markets in the I-SEM will be crucial to market participants' manage of this risk.

TEL agrees that prior to implementing any additional measures to foment liquidity the SEMC should review the lessons learnt from forward contracting in the SEM. The SEM has not been able to achieve the levels of forward liquidity observed in other markets with a liquid spot market. The SEMC has raised a number of possible causes for this lack of liquidity along with areas of discussion for the forward market in the I-SEM. TEL wishes to comment on the following areas:

- Infrequency of trading opportunities
- Collateral and credit levels
- Specification/nature of forward products
- Mediums for trade and trading Institutions

1. Infrequency of trading opportunities

The current SEM OTC forward market generally only provides the opportunity to trade twice per calendar month. The SEMC note that other European forward power markets typically trade on all business days throughout the year while exchanges typically operate 24/7 providing continual access to trading opportunities. TEL would caution against the assumption that increasing the available hours that CfDs can be traded will increase liquidity.

The I-SEM will be a relatively small market. "Always open" trading session will lack the depth required for consistent and competitive price discovery. This effect was clearly demonstrated in the lack of liquidity on SEM OTC forward market on 25th March 2015 due to the Directed Contract Auction being held in the same week on 24th March 2015. Should the I-SEM drive demand for larger volumes of near term products there may be merit in these products being offered on a weekly basis. It is unclear at present how additional sessions will increase liquidity for longer term products.

2. Collateral and credit levels

The SEMC is correct in their assessment that required credit cover is a significant impediment to liquidity. A first step in resolving this would be to ensure that there is a single standardised master agreement for the trade of CfD's in the I-SEM similar to the GTMA in BETTA. The credit terms of this agreement must also be standardised and the required credit support documents must be available to all market participants. For example, it would not be practical to require that the entity providing a Letter of Credit have a long term credit rating of AA from Standard and Poor's when no bank operating in Ireland has this credit rating.

Current legislation[1] restricts both the ability of semi-state companies to transact derivative instruments and the credit worthiness of the counterparties with which they can execute these instruments. To comply with these restrictions ESB's credit terms are onerous. The CfD forward contracts in the SEM require both the buyer and the seller to post collateral but ESB will not post collateral whether it is buying or selling CfDs. This is not equitable and has had a significant impact on liquidity.

An exchange and a clearing house are not the same thing. An exchange is simply the trade execution venue. A clearing house on the other hand would significantly reduce counterparty risk as all CfD trading would be transacted with a centralised counterparty. This would also reduce the collateral required from a market participant; a single line of credit could cover all transactions. TEL would welcome the SEMC investigating how a clearing house may operate in the I-SEM. Membership fees for any clearing house should be proportional to the potential market share of forward trading of each market participant. Due to the relatively small size of the market a clearing house will only succeed where central clearing is mandated. However the first priority for the SEMC should be a standardised contract and credit terms.

3. Specification/nature of forward products

The I-SEM forward market should at a minimum enable market participants to execute annual, quarterly and monthly CfDs. These durations align with the available forward fuel indices and gas capacity products, inputs required by generators to calculate and manage their risk through hedging. At a minimum baseload, mid-merit and peak products should be available. The definition of mid-merit and peak should be specified by the RAs following consultation with industry. However a route to market for new products should be clearly set out to assist the development of market.

4. Mediums for trade and trading Institutions

As stated previously an exchange is simply the trade execution venue. The exchange centralises the communication of bids and when two parties reach agreement the price at which the transaction is executed is communicated throughout the market. Exchange based trading mediums are generally transparent. They provide a means of price discovery to all market participants and could afford new entrants "pre-trade price transparency". TEL would argue that the RAs should ensure that any exchange is tasked with delivering these benefits to the I-

[1] Financial Transactions of Certain Companies and Other Bodies Act, 1992

TYNAGH ENERGY LIMITED

The Crescent Building, Northwood Park, Santry, Dublin 9, IRELAND

TEL: +353 (0) 1 8578700 • **FAX:** +353 (0) 1 8578701

SEM but exchange based trading should not be mandatory. Bilateral trading should still be an option for market participants.

The I-SEM will be a relatively small market. While being mindful of the recent EU Commission antitrust decision[2], TEL would argue that pooling liquidity on a single exchange would be preferable. It would be TEL's preference that an I-SEM exchange would take the form of an I-SEM screen on an existing exchange. This would enable market participants to exploit arbitrage opportunities across borders in the forward time frame using one service provider.

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

Yours sincerely,

David Vaughan
Commercial Risk and Regulatory Manager

[2] IP-14-215_EN

TYNAGH ENERGY LIMITED

The Crescent Building, Northwood Park, Santry, Dublin 9, IRELAND

TEL: +353 (0) 1 8578700 • **FAX:** +353 (0) 1 8578701