

Interconnector Allocation Arrangements

2005-06

**Consultation Paper
August 2004**

Introduction

- 1.1 Trading arrangements have been in place for the North-South interconnector since February 2000 and for the Moyle interconnector since January 2001. Auctions have been used as the most competitive and economically efficient way to allocate capacity.
- 1.2 This paper presents those issues which require consultation with industry and other interested parties. Following this consultation process, Ofreg will produce a decision paper in September 2004 on interconnector allocation for 2005/06.
- 1.3 The issues to be discussed in this paper are as follows:
 - summary of the 2004/05 auction
 - committed and available capacity 2004/05 and 2005/06
 - available transfer capacity (ATC)
 - allocation methods and type of products offered
 - British electricity transmission and trading arrangements (BETTA)
 - superposition and the North-South interconnector
 - proposed trading arrangements in the Republic of Ireland
 - short-term trading

2004/05 Auction

- 1.4 The auctions for the allocation of interconnector capacity for 2004/05 were held in December 2003. The process commenced with a consultation paper in June 2003 entitled "Interconnector Allocation Arrangements 2004/05".
- 1.5 The 2004/05 auction was conducted via a multi-stage process. The available interconnector capacity was sold over two separate auctions held six days apart. In principle, any unsold capacity in the first auction became available in the second auction (by the same product type). The process left open the possibility of a third, or residual auction if the auction did not clear in round two. A pay-as-bid rule applied to the auctions and the NIAER reserved the right, at any time during the process, to declare the auction void if it determined that the process appeared to have been gamed or that the outcome would lead to an anti-competitive situation in the Northern Ireland wholesale electricity market.
- 1.6 The multi-stage approach was decided upon to allow bidders the opportunity to correct/reassess their bids following the disclosure of the average price bid in the first iteration. A time period of six days was given between the first and second iterations to allow bidders to revisit their bidding strategy and reassess the market.
- 1.7 Products of 3,2 and 1 year duration were auctioned. Three and two year capacity, auctioned the previous year, was also carried over along with three year capacity auctioned in 2003/04.

- 1.8 The reserve price for one, two and three year Moyle import products was £1,750/MW/Month (indexed from October 2002). The reserve price for the North-South export product it was £400/MW/Month.
- 1.9 All four bidders were successful in obtaining capacity in the auctions. 40MW were allocated to 3 year Moyle import, 40 MW were allocated to 2 year Moyle import, 75 MW were allocated to 1 year Moyle import and 165 MW were allocated to North-South export.
- 1.10 The capacity which each bidder received by product type is highlighted in the table below.

	3 Year Moyle Import	2 Year Moyle Import	1 Year Moyle Import	North-South Export
Airtricity	30	25	40	125
Energia	-	-	20	20
ESBIE	10	15	15	20
Bord Gais	-	-	-	30

- 1.11 The average successful bid price for all Moyle products at the first iteration was £5,356.32 and was £4,109.79 for the second iteration. The average successful bid price for the North-South product was £457.17.
- 1.12 Thus with a combination of pay-as-bid, the ability to reassess bids and the fact that the auction was oversubscribed and fully allocated it is reasonable to maintain that the capacity was allocated according to the value the market placed upon it. The market cleared easily and the NIAER did not set a limit on the number of capacity units allocated to any one bidder. In the 2004/05 auction no single buyer secured 40% or more of the capacity and intervention was not considered to be warranted.
- 1.13 The total revenue collected from the auctions was approximately £18 million. This figure includes the 2004/05 Moyle, North-South and MEE revenues and revenue from the three-year capacity carried from 2002/03.

Committed and Available Moyle Capacity 2004/05 and 2005/06.

- 1.14 Interconnector capacity across Moyle has been allocated by product type varying by duration. The fact that three and two year products have been auctioned inevitably means that a proportion of capacity is engaged until these contracts expire. Therefore the amount of capacity allocated to the two and three year products must be deducted from the total available transfer capacity each year in order to determine what is available to the market.
- 1.15 For the year 2004/05 a total of 400MW were allocated as follows:

- 75 MW one year
- 40 MW two year

- 40 MW three year
- 50 MW of 2002/03 three year product
- 35 MW of 2003/04 three year product
- 35 MW of 2003/04 two year product
- 125 MW of MEE

1.16 In addition, for the year 2005/06 the amount of capacity currently committed is as follows:

- 35 MW of 2003/04 three year product
- 40 MW of 2004/05 two year product
- 40 MW of 2004/05 three year product
- 25 MW of 2003/04 three year MEE product
- 15 MW of 2004/05 three year MEE product
- 20 MW of 2004/05 two year MEE product

1.17 Therefore in 2005/06 the capacity remaining available for auction is 160 MW of Moyle and 65 MW of MEE.

1.18 Moyle Export capacity (ie NI to Scotland) of 80 MW was made available to the market for the 2004/05 period. No bids were received for this product. Moyle Export capacity will be again be offered in the 2005/06 auctions and the views of respondents as to whether the product should be differently designed, e.g. with regard to duration and reserve price, would be welcome.

ATC

1.19 It is expected that the Moyle ATC will remain at 400MW, with a reduction to to 300MW during the summer nights, as in previous years. This decision will be confirmed in the decision paper, which will be issued in September. The 400MW includes the 125MW allocated to NIE's PPB under the Scottish Power contract. Given this contractual obligation, and the MWs currently committed under existing two/three year products, 160MW will be available for auction for the 2005/06 trading period.

1.20 The North-South ATC will be also be confirmed in early autumn after a review by SONI and ESBNG.

Allocation Methods and Type of Products Offered

Allocation Methods

1.21 Auctions have the advantage that the buyer or seller does not have to search for the best price for a good. Auctions should be simple by nature and competitors should find it profitable to bid honestly. Predicting the effect of rules and rule changes is a difficult matter. Pay as bid auctions have been used to date as it is felt they are less subject to strategic manipulation in a market with only a few traders. Even if a lower value bidder does not bid at the actual level he values the

prize, the higher value bidder will continue to bid until as long as a lower value bidder continues to bid sufficiently aggressively. In addition, a sealed bid auction is currently the most cost effective method given the existing systems. Alternative auction formats, for example electronic bidding through a screen based auction, would require the development of new systems and hence there would be an associated cost burden.

- 1.22 Reserve prices are a way of possibly increasing expected revenue. Economic theory suggests that the effect of a reserve price upon expected revenue can be significant, especially when the number of buyers is small. It is the intention that the reserve price will be set on the same basis as in previous years i.e. to recover approximately half the cost of the interconnector. Any surplus made from the auction receipts is used for the benefits of electricity customers in Northern Ireland. In the case where interconnector revenues do not meet the operational cost, then the TUoS charge makes up the remainder.
- 1.23 Therefore a pay-as-bid sealed auction remains the preferred auction format with a reserve price calculated via the same method as previous years. It is also proposed that the two iteration nature of last year's auction be repeated. The detailed form of the procedure has yet to be finalised, and the views of respondents would be helpful in this regard.
- 1.24 Any entity, which is a signatory to the relevant licences and industry codes, for example Interim Settlement Code, Supply Competition Code, Grid code, will be eligible to bid. Entities, which are part of the same holding company, will be treated as separate entities with respect to the submission of bids.

Types of Products Offered

- 1.25 The 2004/05 auction offered a variety of products of varying duration. The minimum was a one-year product and the maximum was a three-year product. This consultation needs to address whether the same variety of products should be offered for the 2005/06 allocation, whether some should be excluded or whether new products should be added.
- 1.26 It is in the interests of customers in Northern Ireland to maximise the receipts from the interconnector auction as customers underwrite any deficits in revenue in relation to the cost of the interconnector and receive the benefit of any surplus.
- 1.27 For the 2005/06 allocation it is proposed that only firm capacity products, which simply differ by duration, will be auctioned.

Proposed Auction Dates

- 1.28 It is proposed that the auctions will be held on the following dates:
 - 1) 11 October
 - 2) 18 October
 - 3) 25 October (if necessary)

Betta

- 1.29 The Department of Trade and Industry and Ofgem, are working to implement the Betta arrangements by October 2004 and the Government has set a deadline for implementation of April 2005 at the latest.
- 1.30 Generation in Scotland, at present, is not fully competitive and wholesale prices are pegged against those in England and Wales. In addition, the Scottish companies run their own arrangements to balance the system. However with the implementation of Betta, all generators will have greater choice when they sell their electricity into the wider GB market. Customers in Great Britain, including suppliers importing across the Moyle Interconnector into the markets in Northern Ireland and the Republic, will have wider choice than before since they will be able to source supplies from generators, power exchanges or other traders in the market throughout Great Britain. Betta will create a common set of trading rules and rules for access to, and charging for, the transmission network. Under Betta, a GB system operator will be established.
- 1.31 The implementation of Betta will have an effect on trading across the Moyle interconnector. The potential impacts are currently being investigated by Ofreg, Moyle and SONI to ensure that the appropriate arrangements are in place to allow trading to continue in 2005/06. However there may not be complete clarity before the 2005/06 auction takes place.
- 1.32 It is essential that market participants pursue their own enquiries with the relevant generators and other trading counterparties in Great Britain, NGC and Elexon in order to assess how Betta may impact on their individual business interests. In particular, suppliers who currently use the Moyle Interconnector to import from Great Britain should consider whether it will be in their future interest to register in GB under the Balancing and Settlement Code (BSC) or to rely on a trading counterparty in GB to do so. Whereas the former would entail some additional costs, it would enable suppliers to obtain the benefits of the wider trading choices available under BETTA. Moyle and SONI will try to facilitate either way of trading.
- 1.33 NIAER has agreed that it is appropriate for Moyle to appoint SONI as both Interconnector Administrator (IA) and Interconnector Error Administrator (IEA) under the BSC to facilitate trading from or to BETTA across the Moyle Interconnector. To enable SONI to carry out these functions, it will require certain agreements with Moyle Interconnector Capacity Holders (MICHS) or their trading counterparties. Consequently, the acquisition of Moyle capacity will be conditional on the MICH ensuring that such agreements are in place. This condition will be included in the new Moyle Interconnector Capacity Agreements (MICAs).
- 1.34 Views of respondents are invited as to the form in which the necessary agreements with SONI would best be implemented. One way of doing this would be to appropriately amend the Interim Settlement Code, to which MICHS are already

required to be parties. Alternatively, it could be done by putting in place another code or a set of bilateral contracts.

Superposition and the North-South Interconnector

- 1.35 Superposition was introduced in April 2003 due to constraints on the physical transfer capacity of the interconnector as a result of transmission system congestion in RoI. Superposition allows trading greatly in excess of the physical limits on flows of electricity. Superposition can also be accommodated when committed transfers of energy are known.
- 1.36 Superposition does not increase the long-term capacity available to the market but does maximise the utilisation of the physical transfer capacity by making available short-term capacity allocated two days prior to the trading day. Therefore superposition currently works on the basis that superposition trades are created from the firm rights of long term capacity holders.
- 1.37 The Superposition trading approach has worked well and will therefore be continued in the 2005/06 trading year. SONI are to consult with ESBNG on the short term energy charge and a decision is expected early autumn.

Proposed Trading Arrangements in the Republic of Ireland

- 1.38 Ofreg, for the next stage of NI market opening, has been cognisant of trading arrangement proposals in the ROI market. Where possible Ofreg has adopted procedures similar to those in the ROI, in an attempt to minimise barriers to trade and further divergence between the markets.
- 1.39 Ofreg will continue to hold regular meetings with CER to discuss the progression of an all-island market.

Short-term Trading

- 1.40 Ofreg favours short term trading as a means of making the market more competitive and will try and encourage SONI to facilitate this.

2. Consultation Summary

2.1 The above discussion has led to a number of key questions which necessitate answers as part of this consultation process, namely:

Question 1.

2.2 Is there a need to hold a North-South auction (particularly in light of the introduction of superposition)?

Question 2.

2.3 If a North-South auction is desirable then should a reserve price be set and how do you feel superposition could potentially affect the value of any capacity auctioned?

Question 3.

2.4 What is the optimum blend of products in terms of duration of product (for Moyle and N-S)? In particular, in what form should Moyle Export capacity be offered?

Question 4.

2.5 When would respondents prefer the auctions to be held?

Question 5.

2.6 Should the necessary agreements with SONI as IA and IEA for trading under BETTA be made by amending the Interim Settlement Code or by another means?

Response

Respondents are asked to comment by 10 September 2004

Ofreg, Moyle and SONI will consider the responses and the NIAER will publish a Final Proposals Paper containing details of allocation methods, interconnector products and prices in September, allowing auctions to take place in October.

Responses should be sent to:

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Please include a one-page summary with responses.