ESB Customer Supply Response

to

Risk Management in the All Island SEM Consultation

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1. Introduction

The Regulatory Authorities (RAs) have issued a consultation paper on Risk Management in the All Island Single Electricity Market (SEM). ESB Customer Supply (ESBCS) welcomes the opportunity to comment on potential arrangements for enabling market participants to manage their risks in the SEM environment.

The establishment of an appropriate risk management platform in advance of SEM Go-Live would offer ESBCS, and no doubt other market participants, an important means of managing their business both during these market reforms and also on an on-going basis in the longer term.

2. Availability of Hedges and Timing Considerations

While a risk management solution might be available in advance of the SEM Go-Live date, it may not be available in time for the tariff setting process during 2007. In any event, ESBCS will need to refine its position for 2007/08 (e.g. post DCs) and to consider its contract position for 2009 in time for the next tariff setting round. In short ESBCS has a succession of risk management needs and requires effective means for meeting these needs so the platform should be set up as soon as possible even if it cannot be available in time for the tariff setting process in 2007.

ESBCS has significant risk management needs including those arising from a large volume of wind generation contracts and a significant component of temperature-sensitive demand within its portfolio. Consequently, while an effective trading platform is a welcome component of the overall market reforms, it is unlikely to satisfy all our hedging requirements. Hence, ESBCS will have to pursue other procurement methods in parallel, both initially (if the platform is not ready in time for the tariff setting process in 2007) and to a lesser extent on an ongoing basis.

3. Harmonisation of Regulatory Arrangements

ESBCS clearly states its position as being in favour of an appropriate risk management solution. ESBCS believes that, amongst other benefits, it will bring necessary transparency to the market and provide an important role in the ultimate success of the market reforms and an important means for market participants to manage their risk on an ongoing basis.

In considering the different risk management alternatives, ESBCS is conscious that it will need to comply with the terms of an Economic Purchasing Obligation (EPO). While Option 2 will make it easier for ESBCS to demonstrate compliance with an

EPO, since it brings some transparency to the market, it may not in itself enable ESBCS to both acquire all the hedges it needs and also fully comply with its EPO. Hence ESBCS may need to consider other procurement options.

If the arrangements relating to EPO and Public Service Obligation (PSO) levies are not applied equitably and fairly in each jurisdiction, then significant distortions of the market could result. Such distortions could severely undermine the success of the SEM. Consequently ESBCS requests that these regulatory aspects are urgently reviewed and clarified and that action is taken by the RAs to ensure that these cannot undermine the achievement of overall market reform goals.

4. Preferred Risk Management Solution

Option 2, the imposed sector solution, together with a mandatory obligation on ESBPG and NIEPPB to sell all non-Directed Contract volumes via the web-based platform, is ESBCS's preferred solution because it will bring significant volumes to the market on a transparent and non-discriminatory basis.

This would deliver a platform that would enable forward contract sales offers to be "posted" by ESBPG and NIEPPB and market participants would have a transparent means of identifying, reviewing, and taking up risk management opportunities.

Such a mandatory obligation on both generators will be required for successful operation of this platform and so, if this were not possible, then ESBCS believes that this option should not be pursued.

There is no guarantee that the "derivatives" traded via such a platform would meet the needs of all market participants. In particular, due to its significant (AER) contracts with wind generation and high levels of temperature-sensitive demand, ESBCS has significant risk management needs which such a platform is unlikely to meet in full and thus ESBCS will have to pursue other procurement methods in parallel.

It is unclear whether one or two web-based platforms are envisaged. It is ESBCS's view that there should be a consistent solution to guarantee uniform quality provided by both generators working together. There may also be cost efficiencies to be gained from adopting this approach. This may require the RAs, as "sponsor", to take a role in overseeing the design and delivery of the project.

While the costs of this solution would fall initially on ESBPG and NIEPPB, arguably all those trading via this solution benefit. Consequently, the shared cost should be capable of recovery possibly through a realistic transaction charge. Given that trading volumes may initially be low then a proportion of the cost could be recovered from all licensees.