The Single Electricity Market (SEM)

Risk Management in the All-Island Single Electricity Market

AIP/SEM/122/06

ESB Power Generation Response

Introduction

ESB Power Generation (PG) welcomes the recent circulation of AIP Paper, “Risk Management in the All-Island Single Electricity Market” (AIP/SEM/122/06) for consultation by the Regulatory Authorities (RAs). PG is pleased to have this opportunity to submit comments on this paper.

Overview

PG’s view on the most appropriate form of risk management arrangements for the All-Island market reflects its concern over the operation of the NIE PPB PSO. PG considers that it is important that there is no obscurity regarding the implementation of this PSO. To this end, PG’s view is that it is in the best interests of the market that all electricity power sales associated with the PSO is market tested, to ensure that it is transacted at fair market prices and does not distort competition.

To ensure that this is the case, PG proposes that the NIE PPB be required to trade any power hedge outside the Pool, either via Directed Contracts (DC) (assuming they will be fair market price reflective) or via CfDs traded on a Bulletin Board with open access to all market participants, and be precluded from undertaking any OTC or other power trades.

We consider that the preclusion of OTC trades on PPB is necessary to provide sufficient price transparency given the continuing existence of the PSO, and to provide market confidence that the PSO is not distorting competition. Whilst the Bulletin Board solution will provide price transparency, it is also our view that it is in the best interests of NI suppliers that PPB be subject to a level of DCs which is material in the context of NI demand, to ensure that Sterling denominated hedge instruments are guaranteed to be made available.

In return for such guarantees of pricing transparency on PPB, PG would be prepared to accept a similar requirement to post any hedges other than DCs on the Bulletin Board rather than hedge OTC. However, this is subject to the proviso that the Bulletin Board is designed with an appropriate set of products and contractual terms. We believe that mandating both parties will also bring sufficient liquidity to the process.

Other market participants will be able to post bids and offers on the Bulletin Board at their discretion (subject to meeting appropriate credit cover requirements- see below).

Overall, we believe that this approach will be more attractive to other market participants than the default “do nothing” option, however, if there was a satisfactory resolution to the issue of NIE PPB PSO transparency a “do nothing” approach may be the solution.

PG firmly believes that if a mandatory order was not placed upon both NIE PPB and PG a Bulletin Board would **not** be successful. We are therefore of the opinion that before a decision is taken on this work stream, the PPB PSO issue needs to be clarified. Given that there is only 12 months to market opening and that a Trading Platform solution will require a significant lead time to implement the PPB PSO issue needs to be resolved within the next month.

How would the Bulletin Board work?

In PG's view, whilst PPB and PG would be required to post any offers (or bids[1]) on the Bulletin Board, they should have discretion over what volumes to hedge (or alternatively to leave open to the Pool) and over the timing of the offers, in order to allow them to manage their own volume risk and fuel liquidity risk. If they so choose, they could leave any or all of their volume not covered by DCs unhedged in the spot market.

In PG's view, PG/PPB could tender for a third party to operate the Bulletin Board-existing PX operators or brokers are likely to be able to provide such a service more efficiently than PG/PPB using their existing platforms and/or expertise. Another advantage of using a third party to operate a Bulletin Board is that it is likely to promote greater confidence amongst other market participants than a Bulletin Board operated by PG/PPB.

Once an appropriate operator has been appointed, the market participants will need to work with them to develop appropriate products and contractual terms for the All-Island market. In this regard we have two observations at this stage:

- Available products. The market will require an appropriate mix of short term, weekly, monthly quarterly and seasonal products to provide a range of potential instruments to meet the risk management requirements of market participants. However, PG/PPB should have discretion over which products it wishes to post offers (or bids) for at any given time.

- Credit cover. The terms and conditions will need to provide sufficient credit cover protection for market participants (including for replacement risk, as well as for delivered but not yet settled power) whilst avoiding tying up excessive cash through margining. Other forms of credit cover such as reliance on credit ratings, letters of credit etc should be considered in addition to application of initial and full variation margining often practiced by exchanges. We note that this comment also applies to the design of DCs.

[1] If for instance a generator needs to "buy-back" energy to cover unplanned outages

Finally, PG notes that given the small size of the All-Island market, and the fact that "churn" in traded volumes is unlikely to be high initially, the Bulletin Board operator may be unable to fully recover costs by charging the level of fees typically charged by other brokers/exchanges. In our view a smooth functioning Bulletin Board, with levels of charges comparable to other power markets is in the wider interests of the development of the All-Island market. Therefore we propose that charges be kept to levels in other comparable markets, and that any deficit be funded by some other market mechanism.