

# **Single Electricity Market Committee**

## **Contracts for Differences (CFDs) in the Single Electricity Market (SEM)**

### **Indicative Detailed 2009 Timetable**

**An Information Paper and Invitation to Comment**

SEM-09-051A

20 May 2009

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## 1. Introduction and Background

The Commission for Energy Regulation and the Northern Ireland Authority for Utility Regulation (the Regulatory Authorities) have developed a single all-island electricity market, the Single Electricity Market (SEM), which came into operation on November 1<sup>st</sup> 2007. Further details on the project can be found on the AIP website ([www.allislandproject.org](http://www.allislandproject.org)).

Risk Management is an integral element of the efficient and effective operation of the SEM. Over the past two years there have been offerings of a substantial volume of 2-way Contracts for Differences (CFDs) which have enabled generators and suppliers to manage price risk. These contracts were generally offered through what is known as Directed Contract (DC) and the Non Directed Contract (NDC) processes.

A fundamental element of the Regulatory Authorities' (RAs') market power mitigation strategy is the requirement on the incumbent generators, ESB Power Generation (ESBPG) and NIE Energy Power Procurement Business (NIEEPPB), as applicable, to offer contracts (Directed Contracts) at quantities, prices and in a specified form, the purpose of which is to remove the incentive to attempt to profit from the use of market power.

ESB PG and NIEEPPB have also offered CFDs in the so-called Non Directed Contracts market. This market essentially includes the offering of all other hedge contracts not imposed by the RAs on incumbents or any other party under the market power strategy. In the past two years Ireland PSO-backed contracts were also offered under the ESB PG's NDC auction process.

The RAs have welcomed the development of the NIEEPPB and ESB PG auction processes in facilitating the conduct of CFD transactions between them and other SEM participants in a transparent and fair manner to meet the stipulated aims of both Regulatory Authorities of ensuring that all suppliers have equal access to CFD contracts.

The RAs also welcome the recent development of a Multi-lateral Trading Facility (MTF) and, as the next step in advancing SEM contract trading, would expect this to lead to significant gains in terms of enhanced competition through increased liquidity and transparency, and to administrative efficiencies, to the ultimate benefit of electricity customers.

Further details on the Ireland Power Auction platform can be the Tullett Prebon website <http://www.tullettprebon.com/irelandpowerauction/index.aspx>.

On 11<sup>th</sup> February 2009 the SEM Committee<sup>1</sup> published an Information Note, which set out its view on how the contracting process should develop this year (SEM-09-016). This took account of experience gained over the past two years and feedback from industry participants. The Information Note provided for a longer hedging window compared to the previous two years<sup>1</sup>, and set out the position that a more dynamic and ongoing approach to risk management should be adopted. The high-level indicative timetable in that note has not been followed.

This Information Paper is intended to provide a more detailed timetable to market participants on the scheduled contracting processes over the coming months. The RAs have developed this timetable with the cooperation of ESB PG and NIEPPB.

The RAs invite interested parties to comment on the timetable and issues in this paper. Comments should be submitted by 5 pm on Tuesday 26<sup>th</sup> May, preferably in electronic format, to:

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Belfast BT1 6ED

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<sup>1</sup> The SEM Committee is established in Ireland and Northern Ireland by virtue of section 8A of the Electricity Regulation Act 1999 as inserted by section 4 of the Electricity Regulation (Amendment) Act 2007, and Article 6 (1) of the Electricity (Single Wholesale Market) (Northern Ireland) Order 2007 respectively. The SEM Committee is a Committee of both CER and NIAUR (together the RAs) that, on behalf of the RAs, takes any decision as to the exercise of a relevant function of CER or NIAUR in relation to an SEM matter. The words 'SEM Committee' and 'RAs' are used interchangeably in this paper.

## 2. Non Directed Contracts (NDCs)

Non Directed Contracts have been primarily offered by ESB PG and NIEEPPB to date. The standard products on offer have been quarterly Baseload, Mid-Merit (MM1 and MM2) and Peak products in the form of 2-way CFDs.

### Indicative Auction Dates

The provisional dates for ESB PG and NIEEPPB NDC auctions are set out in the table below.

<b>NIEEPPB NDC Auctions</b>	<b>ESB PG NDC Auctions</b>
Tuesday 12 <sup>th</sup> May (completed)	DRY RUN - Wednesday 13 <sup>th</sup> May
Thursday 14 <sup>th</sup> May (completed)	Tuesday 7 <sup>th</sup> July
Wednesday 20 <sup>th</sup> May	Thursday 9 <sup>th</sup> July
Wednesday 27 <sup>th</sup> May	Thursday 16 <sup>th</sup> July
Tuesday 2 <sup>nd</sup> June	Tuesday 21 <sup>st</sup> July
Thursday 4 <sup>th</sup> June	Thursday 23 <sup>rd</sup> July
Tuesday 9 <sup>th</sup> June	Tuesday 28 <sup>th</sup> July
Thursday 11 <sup>th</sup> June	
Tuesday 16 <sup>th</sup> June	
Thursday 18 <sup>th</sup> June	
Wednesday 24 <sup>th</sup> June (Reserve)	

NIEEPPB and ESB PG have confirmed that they will offer their NDC quantities (as indicated below) on the Tullet Prebon MTF.

### Indicative NDC Auction Volumes

NIEEPPB and ESB PG have provided the RAs with indicative volumes by product and quarter that are anticipated to be offered on the platform. Please note that these volumes are subject to change.

<b>NIEPPB NDC Indicative Volumes</b>				
	<b>Baseload</b>	<b>Mid Merit</b>	<b>Mid Merit 2</b>	<b>Peak</b>
Quarter 4 2009	200	300	200	75
Quarter 1 2010	200	300	200	100
Quarter 2 2010	150	200	200	N/A
Quarter 3 2010	150	150	150	N/A

<b>ESB PG NDC Indicative Volumes</b>			
	<b>Baseload</b>	<b>Mid Merit/Mid Merit 2*</b>	<b>Peak</b>
Quarter 4 2009	250	300	0
Quarter 1 2010	350	200	0
Quarter 2 2010	225	50	N/A
Quarter 3 2010	225	200	N/A

\*Breakdown of Mid Merit 1 (MM1) and Mid Merit 2 (MM2) has not yet been determined, however ESBPG have confirmed that MM2 contracts will be offered.

### **Indicative NDC Reserve Prices**

The indicative NDC reserve prices provided by NIEPPB and ESB PG are shown in the table below. Again, the reserve prices are subject to change and would be expected to reflect the sellers' latest estimate of forward electricity prices given trends in underlying drivers including fuel and system data.

<b>NIEPPB NDC Indicative Reserve Prices (Sterling)</b>				
	<b>Baseload</b>	<b>Mid Merit 1</b>	<b>Mid Merit 2</b>	<b>Peak</b>
Quarter 4 2009	£51.00	£57.00	£57.00	£79.00
Quarter 1 2010	£58.00	£65.00	£69.00	£90.00
Quarter 2 2010	£52.00	£58.00	£62.00	N/A
Quarter 3 2010	£50.00	£56.00	£60.00	N/A

<b>ESB PG NDC Indicative Reserve Prices (Euro)</b>			
	<b>Baseload</b>	<b>Mid Merit/Mid Merit 2*</b>	<b>Peak</b>
Quarter 4 2009	€ 55	€ 60	
Quarter 1 2010	€ 60	€ 66	
Quarter 2 2010	€ 56	€ 62	N/A
Quarter 3 2010	€ 55	€ 63	N/A

\*Break down of Mid Merit 1 (MM1) and Mid Merit 2 (MM2) has not yet been determined

As with the SEM gross mandatory pool, the SEM Committee strongly encourages an appropriate degree of transparency in the contracts market. The RAs would encourage the main NDC sellers (ESB PG and NIEEPPB) to publish (or to make available to the RAs for publication) their individual volumes of trades and the corresponding strike prices in a timely manner after the NDC auctions.<sup>2</sup>

### 3. Ireland Public Service Obligation (PSO) - backed Contracts

As was the case in the past two years Ireland PSO-backed contracts will be made available to the market through the NDC process by ESB PG on the dates indicated in the table below.

This will comprise 600 MW of quarterly Baseload products, to be offered over 6 X 100MW auctions.

PSO Contract Auctions
Monday 22 <sup>nd</sup> June
Wednesday 24 <sup>th</sup> June
Friday 26 <sup>th</sup> June
Monday 29 <sup>th</sup> June
Wednesday 1 <sup>st</sup> July
Friday 3 <sup>rd</sup> July

The reserve prices for these PSO contracts will be set on the basis of the methodology for setting the benchmark PSO price used to determine the PSO levy for the period 1<sup>st</sup> October 2009 to 30<sup>th</sup> September 2010. This will be based on the RAs' updated and validated PLEXOS model of the SEM using forward fuel prices before the date of publication of CER's PSO levy decision paper.

The CER are minded to instruct ESB PG to offer the PSO contracts on the Tullet Prebon platform rather than through ESB PG's faxed-based auction mechanism. Comments are invited on this issue.

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<sup>2</sup> It is understood that the non directed contract auction results will be posted on the Tullet Prebon website at <http://www.tulletprebon.com/irelandpowerauction/index.aspx>

## 4. Directed Contracts (DCs)

The SEM Committee's Directed Contract timetable (SEM-09-041), provided for the DC primary subscription window to commence on Tuesday 5<sup>th</sup> May 2009 and to close on 3<sup>rd</sup> June 2009, and the supplemental subscription window to open on 8<sup>th</sup> June 2009 and close on 19<sup>th</sup> June 2009. Therefore, the directed contracts subscription process was to extend over a 6-week period.

On 6<sup>th</sup> May 2009 the SEM Committee issued a decision to suspend the directed contract subscription windows with immediate effect (SEM-09-045). This was due to material errors made in the backcast work of the model validation exercise by the RAs' independent consultants. The errors in the model validation work called into question the accuracy of the forecast prices advised to the RAs and contained in the SEM Committee decision paper on the quantification and pricing of directed contracts (SEM-09-043).

The RAs are currently working with their consultants to rectify the errors made in the Plexos validation work. Once this is completed, that RAs will issue a final decision on the date for the resumption of the directed contract subscription window. The RAs will also publish the validated forecast model, KEMA's validation report, and make available to interested parties the SEM backcast file.

The SEM Committee anticipates that the material errors will impact on the pricing of directed contracts only, rather than on the quantity of contracts imposed on ESB PG and the individual supplier eligibilities for those contracts. The SEM Committee appreciates that suppliers and ESB PG require a large degree of certainty about directed contract quantities to participate meaningfully in the other contracting processes.

On this basis, the SEM Committee has decided that the volumes contained in SEM-09-043 and the individual eligibilities communicated to each supplier will stand. The overall volumes of directed contracts are shown in the table below.

The SEM Committee intends to compress the DC subscription window from the original 6-week process to 4 weeks, i.e. the primary window will last for 3 weeks and the supplemental window for 1 week. The SEM Committee's indicative dates for the DC process are for the primary subscription window to resume on Friday 22<sup>nd</sup> May and run through to Friday 12<sup>th</sup> June. The supplemental window would commence on Tuesday 16<sup>th</sup> June and end on Friday



19<sup>th</sup> June. However, the RAs will make a final decision on the date for the resumption of the DC process in the next day or so, and participants should note that the recommencement date could be in the week commencing 25<sup>th</sup> May.

	<b>ESB PG</b>		
	<b>Directed Contract Quantities</b>		
<b>Quarter</b>	<b>Baseload Quantity (MW)</b>	<b>Mid-Merit Quantity (MW)</b>	<b>Peak Quantity (MW)</b>
Q4 2009	223	226	200
Q1 2010	258	174	172
Q2 2010	240	334	n/a
Q3 2010	263	98	n/a

## **5. Summary – Indicative Detailed 2009 Timetable**

Comments are invited on the overall contracting timetable in this paper. In particular, the SEM Committee is interested in the views of interested parties on the length of the overall contracting window and if parties believe it appropriate to extend it beyond July 2009. It should be borne in mind, however, that an extension beyond this date is likely to have an impact on the accuracy of input data for incumbent supplier regulated tariffs and therefore on the risk of correction factors (K factors) arising in subsequent years.

An overview of the indicative contracting timetable is shown in the figure below.

May 2009

Calendar

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
17	18	19	20 <b>NIEPPB NDC Auction</b>	21	22 <b>ESB PG DC Window</b>	23
24	25	26 <b>ESB PG DC Window</b>	27 <b>ESB PG DC Window</b> <b>NIE PPB NDC Auction</b>	28 <b>ESB PG DC Window</b>	29 <b>ESB PG DC Window</b>	30
31	01 Jun	02 <b>ESB PG DC Window</b> <b>NIE PPB NDC Auction</b>	03 <b>ESB PG DC Window</b>	04 <b>ESB PG DC Window</b> <b>NIE PPB NDC Auction</b>	05 <b>ESB PG DC Window</b>	06
07 <b>ESB PG DC Window</b>	08 <b>NIEPPB NDC Auction</b> <b>ESB PG DC Window</b>	09 <b>ESB PG DC Window</b>	10 <b>NIEPPB NDC Auction</b> <b>ESB PG DC Window</b>	11 <b>ESB PG DC Window</b>	12 <b>ESB PG DC Window</b>	13
14	15	16 <b>ESB PG DC Supp Windo</b> <b>NIE PPB NDC Auction</b>	17 <b>ESB PG DC Supp Windo</b>	18 <b>ESB PG DC Supp Windo</b> <b>NIE PPB NDC Auction</b>	19 <b>ESB PG DC Supp Windo</b>	20
21 <b>ESB PG PSO Auction</b>	22	23	24 <b>ESB PG PSO Auction</b> <b>NIE PPB (Reserve) NDC</b>	25	26 <b>ESB PG PSO Auction</b>	27
28 <b>ESB PG PSO Auction</b>	29	30	01 Jul <b>ESB PG PSO Auction</b>	02	03 <b>ESB PG PSO Auction</b>	04
05	06	07 <b>ESB PG NDC Auction</b>	08	09 <b>ESB PG NDC Auction</b>	10	11
12	13	14	15	16 <b>ESB PG NDC Auction</b>	17	18
19	20	21 <b>ESB PG NDC Auction</b>	22	23 <b>ESB PG NDC Auction</b>	24	25
26	27	28 <b>ESB PG NDC Auction</b>	29	30	31	01 Aug