NIE energy

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Northern Ireland Authority for Utility Regulation,
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04 March 2011

Dear Kevin and Colin,

Re: Contracts for Differences – Option for Directed Contracts 2011/12 Consultation (SEM-11-007)

NIE Energy Supply (NIEES) welcomes the opportunity to respond to the SEM Committee's (RAs) Consultation Paper on Contracts for Differences – Option for Directed Contracts 2011/12.

NIEES as one of the few non-vertically integrated suppliers active in the SEM is acutely aware of the issues surrounding contract liquidity. Real difficulties were experienced sourcing adequate levels of hedging cover during 2010. Indeed there is strong evidence to suggest that the shortage of available hedges has unnecessarily created a lack of choice for customers and a scarcity price premium for the 2010/11 tariff year.

The market reality is that the prices secured through hedges set the tariff levels offered to customers. The contract and hedging market therefore represents one of the single most important issues affecting the ongoing operation of the entire wholesale and retail electricity market. NIEES considers the current contracting market to be significantly flawed and requiring both urgent short term solutions as well as a viable long term framework.

NIEES note that the RAs have requested that respondents limit their comments to the Directed Contracts (DCs) and that concerns over the pricing of Non Directed Contracts and the availability of PSO backed contracts can be raised through forthcoming consultations.

DCs, as acknowledged through the Market Power and Liquidity Workstream, are designed primarily as a market power mitigation measure with their contribution to liquidity a secondary feature. It is widely acknowledged that the DC product has a number of flaws such as the contract timing window, type of offer, volume etc however as an active participant in the contracting market, NIEES view the DC provision as essential and would welcome the DC volumes increasing.

NIEES would strongly support increased flexibility in the hedging period however this is dependent on sufficient volumes of alternative hedges being available in the market to facilitate such flexibility. Considering the potential significant 2011/12 tariff year volume decrease introducing this methodology without consideration of the wider contract, would result in NIEES setting tariffs on the back of a much lower level of hedging than would be preferred. NIEES therefore would advocate retaining the current DC process and significantly increasing the volumes should alternative sources be lost.

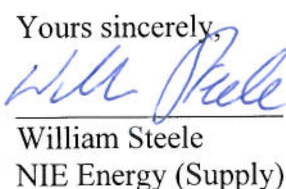
In addition NIEES believes that the DC methodology needs to go further and should look to cover a rolling 2 year subscription window to help participants achieve a more optimal hedged position.

NIEES considers the removal of the DC pricing regression formula as a backward step by the RAs and strongly advocate its continued development and publication. In the absence of an established liquid market the DC formula is the only truly independent pricing reference. It is transparent, common to all participants and is validated as part of the annual Plexos modelling exercise undertaken on behalf of the RAs.

The DC formula is also a fundamental component of other contract functions including product valuations and credit calculations. Should participants no longer be in a position to avail of such a formula this will create difficulties with pricing, validation and reduce transparency (a fundamental objective of the SEM) across a range of inter related activities. This would clearly be a significantly negative outcome and flawed market development.

Please do not hesitate to contact me should you wish to discuss this response further.

Yours sincerely,



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