

**Response from Viridian Power and Energy**

**To**

**Risk Management in the All-Island Single Electricity  
Market Consultation Paper**

**13<sup>th</sup> October 2006**



Viridian Power and Energy (VPE) welcome the regulatory authorities publication of a consultation on risk management. Creating an environment that facilitates stable risk mitigation tools will lower the risk premium associated with the market; lower risk in the market encourages new entry and lowers the cost of future generation investments. The result is that customers will benefit from improved services at a lower sustainable cost.

VPE acknowledge that many of the more sophisticated risk management tools outlined in the paper are features of large, mature and liquid markets and are unlikely to be available in the Irish market for some time. We do not, however, consider many of them essential from day 1 of the SEM. What we do consider essential is that it should be possible for market participants to source sufficient volume of baseload, mid-merit and peaking type swap contracts at reasonable cost from day 1 in the market. Of the three CfD products our analysis shows that the majority of market participants will need a greater volume of mid-merit and peaking swap contracts than baseload products. This observation is supported by the consultation paper on the quantification of directed contracts where it is rightly recognised that mid-merit and peaking type contracts volumes need to be greater to mitigate market power.

VPE have a preference for an exchange or other mechanism that promotes public price discovery as we consider that this will enhance liquidity in a small market with high levels of concentration such as the island of Ireland. This process must make available significant volumes of particularly mid-merit and peaking type CfDs as these are needed by virtually all suppliers in the market. Independent generators should have a right to sell surplus hedging capacity into this market as well as purchase from this market. The bid offer spreads should be low.

In relation to the role of the Regulatory Authorities (RAs) we consider that they should certainly have oversight of these markets for risk management tools and ensure that this does not distort the overall competitive dynamic in the market. In particular, we contend that the natural sellers of contracts in the market (ESBPG and PPB) should act in an economically reasonable manner and should be able to demonstrate that they neither withhold volume from the market nor favour purchasing from their own plant when cheaper alternatives are available. We also suggest that the RAs should encourage price transparency in all transactions.

We do not agree that a 'do nothing' strategy by the RAs will necessarily preclude the development of a transparent liquid and non-discriminatory contracts market in Ireland. We are not convinced, in the first instance, that the regulatory authorities should take control of setting up this marketplace but suggest that they should be aware of and facilitate the process. We also suggest that the RAs facilitate an industry working group to consider the issue. We further suggest that the RAs should only intervene if there is demonstrable market failure in this area.

**Detailed comments:**

## Form of contract

There has been significant discussion on the form of contract for directed contracts. Assuming that market participant comments are fully considered in the drafting of the directed contracts, we suggested that a similar form (possibly identical form) should be used in the non-directed contracts market. This will reduce the transactions costs for establishing the market.

## Traded Products

A standard set of traded products needs to be defined, this is best done by market participants. To encourage liquidity, the products should be few in number and simple, we suggest that around 3, two-way swap products should be sufficient for SEM participants. These products should be tradable over different timeframes: quarterly, monthly, weekly and daily.

## Liquidity

Any market (no matter how well designed) will fail without liquidity. We suggest that regulation needs to be in place to ensure that the natural sellers of contracts in the market (ESBPG and PPB) should act in an economically reasonable manner and should be able to demonstrate that they neither withhold volume from the market nor favour purchasing from their own plant when cheaper alternatives are available. This can be achieved by monitoring the bid / offer spreads of these market participants and should encourage liquidity. We also suggest that the RAs should encourage price transparency in all transactions. In this regard VPE consider it important that both organisations have a requirement to make CfD contracts available to all market participants using public prices via an exchange or bulletin board. To achieve this it may be necessary to prohibit OTC or bilateral contracts that have not been offered to the market through the public pricing arrangement. Such a requirement could be imposed on both ESB PG and NIE PPB either through license obligations or other regulatory mechanism.

## Third party platform

The cost of a third party hosting an established trading platform (e.g. based on the Trayport<sup>1</sup> software) for well-defined products should be low and should therefore be considered. However, it is possible that a lower cost solution could be developed and delivered by indigenous market participants.

In the event a third party option is considered we are concerned about the extra costs that it could cost market participants and ultimately customers. While a third party might seek to sell all sorts of exotic products, particularly where they do not have to pay for these costs if they are unattractive to the market, we consider in the first instance that a simple

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<sup>1</sup> See [www.trayport.com](http://www.trayport.com), this product is used by UK brokers such as Spectron, Prebon, GFI and others.

set of reasonably price CfDs is what is needed. The Irish market participants currently have the skill set and motivation to deliver such a market indigenously and should be allowed to develop this before customers are required to pay extra for other, perhaps inappropriate, solutions to be imposed from outside the all-island market.

#### Authority of RAs in contracts market

It would be useful for the RAs to set out whether CER and NIAER have full jurisdiction over a contracts market or whether Financial Services Regulators could have oversight in either jurisdiction.

#### Manipulation of contracts market

It is not clear from the consultation paper whether the RAs are concerned about any parties manipulating the contracts market to damage competition. Is this an issue that will be addressed? VPE suggest that a high degree of transparency in the contracts market will reduce the risk of systemic manipulation of the market.

#### Industry Working Group

VPE suggest that an industry working group is established to address the points above. This should be facilitated by the RAs. It needs to be recognised that many market participants are significantly resource constrained in responding to the SEM decisions and processes and thus it could be useful if the regulatory authorities supported an industry working group with consultant support from the bank of consultants currently retained.