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Electric Ireland response to Directed Contracts (DCs) Consultation Paper

(SEM-12-009, 8th Feb 2012)

Dear Kevin and Andrew,

Electric Ireland welcomes the opportunity to respond to the above paper, the purpose of which is to consult on one key issue – the process/timeline for offering DCs for the 2012/13 contract year and possibly beyond. The two options presented with regards to the timeline would see the DCs offered either:

(1) Once annually as previously, or
(2) Quarterly on a rolling basis

If, as expected, the volume of Directed Contracts will rise “significantly” this year, Electric Ireland has a very strong preference for Option (2). This option would :

- Take better account of the increased scale of DCs which will form a greater proportion of supplier hedge amounts than heretofore.
- Facilitate more longer-term risk mitigation and tariff stability
- Allow for continuous update/correction of DC quantities on offer and of supplier eligibilities, being responsive to changes in :
    - forecast fuel price movements and updated generation plant availabilities impacting generation merit order and thus the DC quantities

- o updated customer movements and market shares by supplier which determine the associated DC allocations

The choice of DC product pricing approach with the adoption of the rolling quarterly approach, however, is not as clear-cut. Again two options for use by the RAs are presented :

(1) Calculation and Publication of the DC regression formula once a year as it is now, and
(2) Direct PLEXOS modelling

We do not believe either of these options is entirely optimal for the following reasons :

- As it stands, the calculation of the DC pricing regression formulae once a year (with the existing once-off annual DC subscription period) requires that the formula remains valid for 5 quarters beyond its derivation, pricing products for the final 4 of these quarters. If the preferred rolling quarterly DC offering were adopted, the once-a-year calculation would extend the required period of validity to 8 quarters out, pricing products for the final 7 of these. We do not consider this to be an acceptable proposition.
- We consider it appropriate that the regression formulae should be recalculated quarterly so that the validity period for the formulae would correspond to the existing situation (valid for 5 quarters out, pricing product for the final 4 of these).
- Direct PLEXOS modelling by the RAs would require a model run for each day of a DC subscription period and communication of results to participants. Furthermore, reliance on the results of a single PLEXOS run cannot be recommended since it will be influenced not only by fuel price movements but also by the modelling of random events such as forced outages.
- On the other hand, the regression formulae which are determined by the RAs' Econometric Pricing Model derive from multiple runs of the PLEXOS model based on different forced outage schedules and ranges of input fuel and carbon price combinations thus reducing the prominence of outliers and giving more dependable results.

The consultation states that "For practical reasons, the DC Regression Formulae could not be calculated and published quarterly" without explanation of what these 'practical reasons 'are and how significant a constraint they may be. This should have been explained and elaborated upon in the consultation. If the issues are linked to resources we believe it would be prudent to address the resource deficit rather than adopt less favourable methodologies given that the volume of DCs is expected to be very significant. Also, it should be noted that the existing formulaic approach already allows for recalculation of the formulae within the year. In this regard, the RAs have always reserved the right to "suspend subscription and rerun the econometric pricing model or otherwise to amend the determination of the DC strike prices to correct any mispricing". This implies that the formulae could be updated at least once within a year. Perhaps a compromise is possible until such time as the Commission fully addresses all the 'practical reasons' that prevent quarterly operations:

- If the formulae were calculated every second quarter, (e.g. in Q2 and again in Q4 of each year, then with the rolling quarterly approach the period of validity would be 6 quarters

out while pricing product for the last 5 of these. This would push out the validity period by a month compared with the existing case.

This should also reduce to a minimum any associated changes to the existing Master Agreements and, in particular, credit arrangements.

Summary:

Electric Ireland's view is that the DC process/timing should now be revised, so that DCs for the 2012/13 contract year and beyond would:

(1) Be offered every quarter on a rolling basis, and
(2) Continue to be priced according to the existing Econometric Pricing model approach with the resultant regression formulae being set by the RAs more frequently than once per year.

Yours sincerely,

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