
# Hedging Policy Statement

# Summary

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# 1 Introduction and Regulatory Context

In setting tariffs NIE Energy Supply must abide by various conditions of its licence, particularly those in relation to its Regulated customer base with regard to controlling its prices and preventing undue discrimination between customers or cross-subsidy.

Under its price control NIE Energy Supply is permitted to recover an amount equal to its wholesale generation, transmission costs, distribution costs, renewable obligation costs, and any correction factor for amounts outstanding from previous years plus an allowed revenue for the supply business itself. Since it is able to recover expenditure on hedging contracts as part of its wholesale generation costs it is required to specify its policy for purchasing such hedges in advance in this hedging policy statement.

# 2 Objectives

NIE Energy Supply's objectives in purchasing hedges against the risks of its SEM electricity purchases are to acquire electricity at the best effective price reasonably obtainable having regard to the sources available.

NIE Energy interprets the best effective price to be that which best furthers its customers' long term interests in respect of price, price stability and the security of supply. NIE Energy Supply will use its judgement in balancing the price stability objective against the low price objective as it is almost always, in the long term, more expensive to hedge prices than to pass through market prices directly to customers.

In assessing its portfolio NIE Energy Supply will use its best endeavours to be hedged to an optimal level in respect of the customers' long term interest and customer demand associated with fixed price tariffs, subject to hedges being available, suitable and economic.

NIE Energy Supply will pass through the unhedged proportion of pool price exposure to its Regulated multi-rate, maximum demand tariff customers and any other variable-priced tariffs which may be offered, to the extent that tariff structures allow via pool price linked tariffs.

The assessment of hedging purchases will involve consideration of their impact on the likely level and variability of final prices to customers. It may also include longer term considerations relating to the future security, reliability and diversity of sources of electricity available for purchase.

# 3 Hedging Policy

In deciding whether a hedge should be purchased NIE Energy Supply will need to consider the impact on both the likely price and its variability.

- If a hedge both lowers the expected price and reduces variability it is likely to be an efficient purchase unless there is an available alternative product that does so to a greater extent.
- Similarly, if a hedge reduces variability without affecting the expected price it is likely to be an efficient purchase unless there is a superior product available.
- If a hedge raises the expected price but reduces variability, NIE Energy will need to take a view on the relative values of those impacts. In doing so it will be guided by its view of its customers' preferences.

In assessing the likely price level, NIE Energy will model the cost of SEM purchases, hedge costs and other costs in the circumstances of one or more sets of customer demand and pool price projections. In assessing the variability of the price level, NIE Energy will consider the likely variability in customer demand, including in response to weather variation, and of generation purchase, hedging and other costs, including in response to variations in pool prices, fuel prices, exchange rates and customer demand. Its calculations will be based on its evaluation of projections of pool prices and on models of demand and of risk, both of which will be transparent to NIAUR.

In assessing whether a hedge should be secured for its regulated customer base, NIE Energy Supply will take into consideration an assessment of the extent to which the price level, economic conditions and competitive activity may potentially affect the level of forecast customer demand.

In hedging costs related to tariffs for the 2009-10 year, NIE Energy Supply is conscious of both the current lack of sophistication of products and also the limited volumes of hedges available to do so. It will not be possible to hedge its generation purchases completely even if it were otherwise sensible to do so.

Hedges may be obtained in a currency other than Sterling. This would result in a currency exposure between the currency denomination of the hedging instrument and that of the hedged item (Sterling pool cost). Where NIE Energy is exposed to currency risk it may hedge some or all of the associated exposure using an appropriate financial instrument.

# 4 Sources and Governance

In order to obtain hedges NIE Energy Supply will assess the directed contracts (DCs) available to it, participate in non-directed contract (NDC) and Public Service Obligation (PSO) seller led auctions arranged by ESBPG and PPB, consider Moyle auction capacity and associated GB market purchases or sales and investigate purchases or sales resulting from other bilateral negotiation, competitive tenders or by participating in the bulletin board during the tariff year. In addition it will assess its contracted de-minimis generation and will consider the possibility of obtaining: long term hedges to provide a degree of price stability over a period of more than a year if they become available; and also, any other product which may act as a hedge against price or volume risk.

With the exception of purchases through the DC and NDC processes, NIE Energy Supply will not procure bilateral contracts from affiliates without the prior approval of NIAUR.

Procurement activities and decisions taken will be auditable to provide assurance of compliance with economic purchasing obligations. They will be undertaken according to procedures notified to NIAUR and supervised by NIE Energy Supply's Risk Committee. NIE Energy Supply will manage risk by assessing the Value at Risk (VaR). VaR will be calculated using a model that compares purchase costs under probable and pessimistic price scenarios. Total VaR, including temporal analysis, will be monitored by the Risk Committee, who will receive reports showing the total value at risk and the contract levels supporting their objectives, and will direct hedging activities. Hedging will be procured to reduce the VaR to a specified target; which will be reviewed as market conditions are revealed. A factor likely to affect the value of the target is that NIE Energy Supply considers that in-year tariff adjustment is likely to be required if the forecast discrepancy between revenues and costs assigned to a tariff exceeds 2.5%.

NIE Energy will report to NIAUR the hedging purchases and sales it has made on behalf of its regulated customer base (including those relating to currency) with respect to any time period both in advance, when tariffs are set, and after the event. If NIE Energy Supply were to transfer any hedges between its regulated and deregulated market, the transfer would be made at the fair value at the point of transfer and NIAUR will be notified of the transaction.