

Imperfections Charges

For

October 2013 – September 2014

Consultation Paper

SEM-13-038

19th June 2013

1 EXECUTIVE SUMMARY

The purpose of this consultation paper on the proposed Imperfection Charges for October 2013 to September 2014 is to inform and obtain the views of market participants and other stakeholders.

Imperfection Charges are made up of a number of components, the largest of which relates to Dispatch Balancing Costs (DBC). Other costs include Make Whole Payments and any net imbalance between Energy Payments and Energy Charges. Furthermore, adjustments are made to reflect the offset from Other System Charges together with an adjustment for previous years to reflect the difference from forecast to actual outturn.

The Transmission System Operators (TSOs) submitted their forecast for the 2013/14 Imperfections revenue requirement (Appendix 1). This submission forms the basis of the total Imperfections revenue requirement for 2013/14 of €146.7 million compared with €154.9 million for 2012/13. Once combined with forecasted demand figures this translates to a 2013/14 Imperfection charge of €4.42 per MWh compared with €4.71 per MWh for 2012/13.

A number of key factors influencing the 2013/14 forecast include:

- full operation of the East West Interconnector impacting the reserve requirement;
- Moyle Interconnector is assumed to operate on half capacity for the full tariff year;
- decrease in all fuel prices when compared to 2012/13, particularly coal prices;
- Carbon Price Floor exemption is assumed to apply to Northern Ireland Generators during 2013/14.

Comments are invited from the industry and the public by 19 July 2013 as detailed in section 4.

2 INTRODUCTION

2.1 THE SINGLE ELECTRICITY MARKET

The All-Island wholesale electricity market was established as a Single Electricity Market (SEM) effective from November 2007. The SEM is a centralised or gross mandatory pool market, with electricity being bought and sold through the pool under a market clearing mechanism.

Generators receive the System Marginal Price (SMP) for their scheduled dispatch quantities, capacity payments for their actual availability, and constraint payments for changes in the market schedule due to system constraints and other, specific factors.

Suppliers purchasing energy from the pool will pay the SMP for each trading period, capacity costs, and system support charges. The SEM market rules are set out in the Trading and Settlement Code (TSC). The SEM is governed by the SEM Committee which was set up by the Governments in Ireland and Northern Ireland. This Committee has representatives from both Regulators together with an Independent Member. The SEM is operated by the Single Electricity Market Operator (SEMO) which is a contractual joint venture between the System Operators Eirgrid and SONI.

2.2 IMPERFECTIONS CHARGE & DISPATCH BALANCING COSTS

The Imperfections Charge is levied on suppliers by SEMO who recovers the anticipated Dispatch Balancing Costs (less Other System Charges), net cost of Make Whole Payments and Energy Imbalances together with any necessary adjustments for previous years.

The TSOs submitted a paper to the RAs on 30 April 2013 detailing the costs relating to Dispatch Balancing Costs (Appendix 1). Dispatch Balancing Cost refers to the sum of Constraint Payments, Uninstructed Imbalance Payments and Generator Testing Charges. The details relating to these are covered in Section 3 of this Consultation Paper.

2.3 OBJECTIVE OF PAPER

The objective of this consultation paper is to solicit comments from interested parties on a range of proposals associated with Imperfections Charges and in particular Dispatch Balancing Costs.

3 IMPERFECTIONS CHARGE

3.1 OVERVIEW

Imperfection Charges are made up of a number of components, the largest of which relates to Dispatch Balancing Costs (constraint costs). Other costs include Make Whole Payments and any net imbalance between Energy Payments and Energy Charges. Furthermore, adjustments are made to reflect the offset from Other System Charges.

The interaction between the components making up the Imperfections Charge is depicted in Figure 1 below.

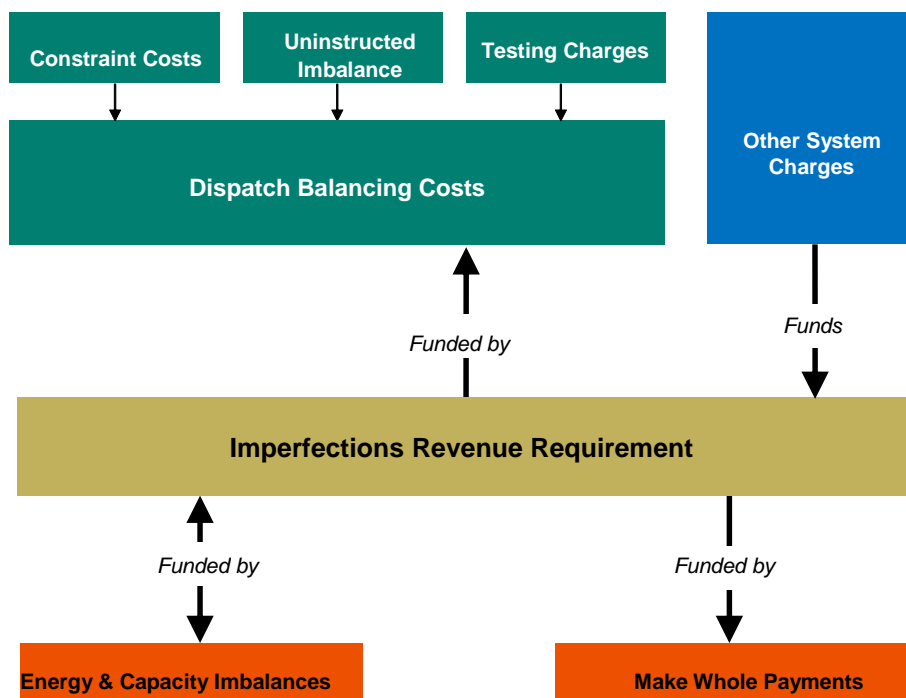


Figure 1: Imperfection Charge Components

Dispatch Balancing Costs is the collective term for Constraint Costs, Uninstructed Imbalance Costs and Testing Charges, which are provided by the System Operators, EirGrid and SONI. In addition to these, there may also be Energy Imbalances and Make Whole payments for which SEMO would provide the budget requirement to the TSOs.

The Transmission System Operators (TSOs) submission was prepared jointly by Eirgrid and SONI, and captured an all-island estimate of Dispatch Balancing Costs. The forecast of Dispatch Balancing Costs is for the period from 1 October 2013 to 30 September 2014.

All these costs are estimated *ex-ante* and recovered from suppliers on a MWh basis through the Imperfections Charge.

3.2 DISPATCH BALANCING COSTS

The TSOs estimate of Dispatch Balancing Costs for the tariff year 2013/14 is €165.5M compared to €142.1M for the tariff year 2012/13.

Further detail regarding this forecast is provided by the TSOs in Appendix 1.

3.3 ENERGY IMBALANCES

It is assumed that minimal energy imbalances will arise. A zero net cost has been provided for this.

3.4 MAKE WHOLE PAYMENTS

The proposed provision for Make Whole payments remains level with the amount forecast for the previous year. Therefore the forecast continues to be €100,000 for 2013/14.

3.5 RECOVERY OF IMPERFECTION COSTS

As stated previously, the dispatch balancing costs are estimated *ex-ante* and this estimate is recovered during the relevant tariff period through the imperfections charge.

Differences between the estimated costs being recovered and the amounts paid out will lead to instances where SEMO will:

- require working capital to fund constraints payments that exceed revenue collected through the imperfections charge, or,
- have collected revenue through the imperfections charge that exceeds the amount being paid out on constraints.

To allow for the first scenario, the mechanism adopted for previous SEMO Revenues and Tariffs was that the funding required to cover fluctuations during the tariff period, and any allowed under-recovery of revenue during the tariff period will be paid to SEMO in the subsequent tariff period(s) with the appropriate amount of interest. This reflects the cost of short-term financing required to provide SEMO's working capital needs.

Similarly, for situations where the revenue recovered by SEMO through the Imperfections Charge is greater than that paid out in constraints (second scenario above), the Imperfections Charge in the following tariff period will be reduced by an appropriate amount to reflect the allowed over-recovery and the associated interest.

A 'K factor' mechanism is used to adjust the Imperfection Charge to reflect the difference between the forecast and actual outturn. The 'K factor' expected to be applied to the Imperfections Charge for 2013 /14 is €18.932m. This is comprised of:

Summary of K factor adjustment

Over-recovery in year 2011/12	€14.6m
Advance given for year 2011/12 (not required)	<u>€14.3m</u>
Total Imperfections Over-recovery in year 2011/12	€28.9m
Less: Estimated advance required for tariff year 2012/13	<u>(€10.0m)</u>
Total Imperfections K factor to be applied in 2013/14	<u>€18.9m</u>

This €18.932m over-recovery will reduce the 2013/14 Imperfections Charge. Further detail of the 'K factor' is provided in Appendix 2.

3.6 DEMAND FORECAST

The forecasted demand provided by the TSOs is 33,220 GWh for 2013/14 compared to 32,900 GWh applied to the 2012/13 Imperfection Charge.

3.7 IMPERFECTIONS CHARGE

The TSOs have submitted an estimate for the net value of Dispatch Balancing Costs of €165.5 million, to be recovered through the imperfections charge during tariff year 2013/14. The amount allowed will be subject to review and determination ex-post, with allowed under or over-recoveries feeding into the subsequent tariff period(s). Adding €100,000 for Make Whole Payments and the K Factor of €18.932 million, gives a total Imperfections Charge for 2013/14 of €146.7 million.

Using an estimated forecasted demand for 2013/14 of 33,220 GWh and the total Imperfections Charge above (€146.7 million), the resulting Imperfections Charge is €4.42 per MWh. (The figure for 2012/13 was €4.71 per MWh).

This is summarised in Table 1 below:

Summary of Imperfections Charges

	2013-2014	2012-2013	2011-2012	2010-2011	2009-2010	2008-2009
Total Constraints costs	165,500,000	142,008,742	142,600,000	110,500,000	106,000,000	122,041,147
Uninstructed Imbalances	-	-	-	-	-	-
Testing Charges	-	-	-	-	-	-
Dispatch Balancing Costs	165,500,000	142,008,742	142,600,000	110,500,000	106,000,000	122,041,147
Energy Imbalance		-	-	-	-	1,981,238
Make whole payments	100,000	100,000	100,000	330,000	311,652	524,332
K factor Adjustment	- 18,932,000	12,788,000	42,500,000	- 3,510,000	-12,580,000	-
Total Imperfections Revenue Required	146,668,000	154,896,742	185,200,000	107,320,000	93,731,652	124,546,717
Forecast Demand (MWh)	33,220,000	32,900,000	34,030,000	34,430,000	34,060,000	37,788,000
Imperfection Charge	€ 4.42	€ 4.71	€ 5.44	€ 3.12	€ 2.75	€ 3.30

Table 1: Summary of Imperfections Charges over the years

3.8 INCENTIVISATION

Dispatch Balancing Costs (DBC) are a significant cost passed on to the all-island consumer and represent the vast majority of the Imperfections Charge. In the tariff year 2011-12 DBC represented 6.2% of the €2.3 billion¹ market.

In light of the above, an all-island DBC incentive mechanism was introduced by the SEM Committee with effect from 1 October 2012². The current parameters as detailed in the DBC Incentivisation Decision Paper (SEM-12-033) are detailed in Table 2 below:

€m's	Lower Bound	Dead Band	Upper Bound	Below Target	Above Target
Dispatch Balancing Costs	7.5% - 20% below baseline	7.5% below and above the baseline	7.5% - 20% above baseline	TSOs retain 10% of every 2.5% below	TSOs penalised 5% of every 2.5% above

Table 2: DBC incentive parameters

¹ EirGrid Group Annual Report 2012 <http://www.eirgrid.com/media/EirGridAnnualReport2012.pdf>

² SEM-12-033 Incentivisation of All-Island Dispatch Balancing Costs Decision Paper

In relation to tariff year 2013-14 the baseline applicable for the above incentivisation, is €165.5m. The maximum reward available is €2.1m and alternatively, the maximum penalty is €1m.

The reward/penalty will be determined following completion of the 2013-14 ex-post review due in 2015. The resultant incentive payment/penalty will be applied on a 75:25 split between ROI TUoS and NI SSS revenues respectively. This incentive mechanism will be monitored over the coming years to determine its effectiveness.

3.9 TSOS REPORTING AND TRANSPARENCY MEASURES

In order to increase transparency around DBC, the SEM Committee has introduced reporting requirements on the TSOs. The objective is the TSOs will provide regular updates on the levels of constraints, drivers behind constraints, mitigating measures being taken and other information or commentary, which the TSOs believe will aid transparency in this area.

These Quarterly Imperfections Costs Reports are available on the TSOs website. The most recent report relates to the period January – March 2013³ and included a Year-to-Date section.

4 PROVISION OF COMMENTS

The RAs request comments on the proposals set out in this consultation paper. All comments received will be published, unless the author specifically requests otherwise. Accordingly, respondents should submit any sections that they do not wish to be published in an appendix that is clearly marked “confidential”.

Comments on this paper should be forwarded, in electronic form, to Karen Shiels at Karen.Shiels@uregni.gov.uk by 17:00 on Friday 19 July 2013.

³ http://www.eirgrid.com/media/QuarterlyImperfectionsCostReportJan_to_Mar2013.pdf