Imperfections Revenue Requirement Forecast 2019/20

TSO Consultation Response

29 July 2019

Response

SONI and EirGrid, in their capacity as TSOs in Northern Ireland and Ireland, welcome the publication of the Imperfections Charge 2019/20 and Incentive Outturn 2017/18 (SEM-19-031) and the opportunity to respond to same. This response is submitted on behalf of both TSOs.

In its forecast the TSOs set out a requirement of €302.65m for the 2018/19 tariff year along with a k factor of €84.4m. The RAs have recommended a forecast allowance of €271.33m, which is a reduction of €31.32m, along with a minded-to position allowing the k factor in full; though views on potentially smoothing that aspect are invited. The RAs have also proposed to amend the actual outturn Imperfections Costs for 2017/18, resulting in the complete removal of any incentive entitlement for the TSOs during that period.

While the TSOs acknowledge the significant increase in the forecast requirement and welcome the RAs minded to position to allow the k factor in full, there are several areas of concern regarding several of the proposals set out.

One overarching concern the TSOs have is in relation to potential implications in terms of revenue risk that the overall set of changes proposed from that originally submitted may have for EirGrid plc and SONI Ltd, and more generally for market participants and end consumers. Last year the forecast was reduced by a large amount and we have ultimately seen a significant imbalance between that recovered through the Imperfections Charge and actual Imperfections Costs. Given the current financial position that has put the TSOs in; any further revenue mismatches have the potential to lead to significant issues for the continued efficient operation of the Single Electricity Market next year.

As was highlighted in last year's consultation response, EirGrid plc and SONI Ltd have in place contingent capital facilities which are drawn to cover any revenue shortfalls as a result of carrying out their TSO and MO licenced duties. It is important to understand that these facilities are finite, and not a mechanism to facilitate in built shortfalls in revenue provisions with a view to smoothing the impact of tariff increases or for any other reason.

The under-recovery of Imperfections revenues has put significant pressure on these facilities in their first year of operation, and a continued under estimation of the required revenues as forecast by the TSOs run the risk of these being exhausted in 2019/20. If such an event looked likely the TSOs would need to seek an adjustment to the Imperfections Charge Factor in order to increase the Imperfections Charge at short notice. To be clear, in such an event, the increase via the Charge Factor would be significant. Such increases at very short notice may have a detrimental impact on supply companies and ultimately consumers.

Moreover, were such a change not formalised in a timely fashion the TSOs may be forced to enter into suspend and accrue arrangements as set out in the Trading and

Settlement Code. It is therefore imperative that the appropriate forecast is provided for in full by the RAs. It is to no party's benefit to enter a tariff year with high levels of uncertainty around the scale of charges that will be applied over the course of the year, particularly supply companies who rely on timely information to allow them to plan for the year ahead.

We have set out their more detailed responses below.

Interconnector Ramp Rate

RA minded-to position: Interconnector Ramp Rate Disparity forecast, €3.2m –The RAs have not been persuaded that this effect leads to an expected loss (ie a bias in the differences during ramping) and consider this to be a non-volatility issue and recommend a €0 allowance.

The TSOs have previously stated that material imperfections volumes and costs will arise as a result of the way Euphemia interprets Interconnector Ramp Rates versus how Interconnectors ramp in reality. As part of the TSO submission, shadow settlement was carried out to investigate what exactly this cost has been since the new market arrangements went live. The Imbalance cost in both GB and SEM markets was calculated using actual imbalance volumes and prices. The results clearly showed that there has been a net charge to the TSOs because of the ramp rate disparity. Since the TSO submission in May 2019 there has continued to be a net cost position to Imperfection, with a further c. €0.35m (bringing the total to €8.5m up to 30 June 2019) of charges attributed to this ramp rate disparity for both Interconnectors. This has provided further evidence that proves exposure of the Imperfections budget to this new market feature. These charges have to be paid by the TSOs as part of Imperfections and as such they need to be recovered through the Imperfections tariff. As there is real evidence of this outturning as an actual cost to Imperfections since 1 October 2019, the TSOs would strongly recommend inclusion in the Imperfection Revenue Requirement 2019/20.

NI Gas Transportation Charges

SEMC minded decision: Provision of €18 million for the inclusion of NI Gas Transportation Charges (GTC). The RAs note that the TSOs have assumed that all large gas-fired units in NI will purchase gas transportation on the short-term market during 2019-20. The RAs do not see evidence for an increase in this element and propose to exclude from the calculation.

A number of Northern Ireland generators have been including a gas product charge in their offers in the SEM since October 2016 and have continued to do so in the first year of the new Balancing market, the result of which has increased Imperfections. The TSOs have received no evidence to suggest that this situation will change, and therefore a provision should be made on this basis.

For the 2018/19 Imperfections forecast revenue requirement, an amount of €7m was included in the TSOs' forecast for the NI gas product charge and the RAs deemed this to be a reasonable assumption. The removal of this is therefore inconsistent with the RAs' stated position one year ago and the TSOs believe that the proposed provision for NI PPB gas product charges should be included in the imperfections revenue requirement. For clarity, the €18m was for three NI gas units included in previous years, along with an additional NI gas unit forecast to begin to include these in their offers now that the GTC charge methodology in NI has been aligned to that in Ireland.

If the RAs have evidence that this additional Gas unit will not include GTC charges in their offers for the 2019/20 Tariff Year, the TSOs nonetheless strongly advise that a provision of €10m should be included as part of the Imperfections revenue requirement to cover the NI units that currently include GTC charges in their offers as outlined above.

Undo Actions

SEMC minded decision: An inclusion of €5.7 million has been requested for "Undo Actions" which are new settlement cost components, the intent of which is to ensure units are compensated for energy dispatched by the TSOs which the TSOs then decide on not taking. While the RAs accept that these costs will arise, we are proposing to make no specific allowance for it but would encourage the TSOs to minimise these occurrences in the course of near and real time operation.

In estimating this provision for the 2019/20 Imperfections Forecast revenue requirement, the TSOs used Initial Settlement results to determine the impact of "Undo Actions" on Imperfections costs to date. Following the availability of M+4 settlement results (which are currently available for the first month of the Balancing market), it was found that due to a known issue (Defect 5893 in I-SEM Known Issues Report), the Initial Settlement results were significantly higher than the M+ 4 settlement results.

In light of this, the TSOs accept the RAs decision to make no allowance for the tariff year 2019/20; however, the TSOs will closely monitor these costs as a provision may be required in the future based on further market experience.

Pumped Storage

SEMC minded decision: Provision of €14.42 million for the settlement of Pumped Storage units in the new market. While the RAs acknowledge the treatment of these units in Plexos differs from the new market, we note that the PLEXOS models already include a gap between the efficiencies, with the unconstrained and constrained set to 70% and 48% respectively. The RAs propose to retain the efficiency gap and make a reduced supplementary allowance of €10 million, and would expect the TSOs to strive to match the market position of the units in dispatch as closely as possible.

The TSOs would like to clarify that the provision of €14.42 million is requested to cover settlement costs, PREMIUMS and DISCOUNTS in particular, which have occurred to date under the new market arrangements. This is separate to the efficiency modelling, which has always been included as part of supplementary modelling in the Imperfections forecast revenue requirement. The efficiency in the model only represents unit dispatch, however the big difference under the new market arrangements is that the units submit commercial offer data and their PNs are determined by how they clear in the day ahead market. The current PLEXOS model is not set up to include these factors and therefore a separate provision is required to manage the settlement costs of these units based on how they are scheduled in the market systems.

The TSOs would like to point out that they always strive to match the market position of the units in dispatch as closely as possible. However, the scheduling software takes into account the Physical Notifications, offer prices and technical capability of each unit in its optimisation and the TSOs are bound by these parameters.

The TSOs accept the RAs decision to allow provision of €10m as part of the Imperfections revenue requirement for tariff year 2019/20, but will monitor this closely over the course of the year.

Conclusions on Imperfections Forecast

Taking account of the changes the TSOs have accepted, a table setting out a revised Imperfections Revenue Requirement for 2019/20, exclusive of the k factor, is displayed below. It is imperative for the reasons outlined above that this forecast is allowed in full.

2019/20 Imperfections Revenue Requirement Submission – 7 June 2019	€302.65m
Amendment to Undo Actions	-€5.7m
Amendment to Pumped Storage	-€4.42m
Revised 2019/20 Imperfections Revenue Requirement	**€292.53m**

Table 1: Revised 2019/20 Imperfections Revenue Requirement

View on potential k factor smoothing

SEMC minded decision: Bearing in mind the uncertainty of the revenue that may be required in future years, the RAs are minded to allow the €84.44m K factor adjustment in full in 2019-20. However, given the impact on tariffs, the RAs have considered the possibility of delaying the recovery of part of this amount until the subsequent year, in order to smooth the effects of the increases borne by suppliers and ultimately consumers. The RAs would invite respondents to comment on the merit of this and on the quantum of any amount to be delayed for recovery until the subsequent tariff year.

The TSOs welcome the minded to position to allow the €84.44m k factor in full. However, we do have significant concerns around the invitation for views on the merit of delaying recovery of part of the k factor in order to smooth the effects of the increases borne by suppliers and ultimately consumers. The k factor is broken down into an actual under recovery of €4.44m in 2017/18 and a projected under recovery of €80m in 2018/19 based on actual outturn for the year to date.

As noted by the TSOs when making the k factor submission, the projected €80m under recovery was lower than the expected outturn for the year to date. However, given the significant increase to the forecast requirement, the TSOs deemed it reasonable to seek the €84.4m provision for the k factor, thus in effect the k factor has already had a degree of smoothing applied. This was done with the expectation that the required revenue would be allowed in full.

While the TSOs acknowledge that there are significant increases which will inevitably have an impact on suppliers and ultimately consumers, it is critical to understand that to seek to include in built under recoveries may have a detrimental impact on the market and market participants and on the ability of EirGrid and SONI to carry out their duties as licenced TSOs and MOs. For one, if recovery of the forecast k factor is delayed, despite the expectation that it will actually outturn higher than forecast, alongside a provision for a lower than forecast revenue requirement, it is likely to lead to an even larger k factor in future years, increasing costs for market participants down the line.

Additionally, there is the issue of the pressure the previously mentioned current financial position vis-à-vis Imperfections is having on the contingent capital facilities. If these are not alleviated through the provision of the €84.4m k factor in full, along with the forecast sought, as per Table 1 above, it is very possible that the facilities will be exhausted and the EirGrid and SONI business will need to adjust the Imperfections Charge Factor at very short notice leading to increased costs.

As mentioned previously this adds a high level of uncertainty as to what the actual Imperfections Charge will turn out to be over the course of the year, which could be detrimental to suppliers and ultimately end consumers. If the Charge Factor adjustment is not formalised in a timely manner the business may be forced to enter into suspend and accrue arrangements across their collection agent services compounding uncertainty in the regulatory framework and the market.

For the reasons set out above it is critical that the RAs do not seek to smooth the k factor across multiple years.

Amendment to incentive outturn 2017/18

SEMC minded decision: The RAs are minded to endorse the analysis by the TSOs with the exception of the deductions made for RoCoF GPI payments under Other System Charges. This is a substantial element of the process however, and would reduce the apparent savings made by the TSOs, resulting still in a net savings in DBC made against forecast, but with resulting incentive payment of €0.

The proposal to change the DBC incentive framework fundamentally affects regulatory certainty. It effectively renders the incentive framework meaningless, through proposals to amend the rules ex post on an ad hoc basis. The TSO's would urge the RAs to give further consideration to what it is they are proposing before nullifying the underlying incentive framework.

To seek to exclude RoCoF GPIs would be outside of the DBC incentive framework both as specified and as has been previously practiced and approved and which has included all OSC and GPIs within its calculation, notwithstanding there is, in a number of instances, less than perfect correlation between these and the associated impact to Imperfections.

We do recognise that the incentive framework may require a review, and would expect it to be reviewed in the context of the forthcoming EirGrid and SONI price controls and this may precipitate a number of changes. Any incentive can only operate, and operate effectively, to the extent that the arrangements as to its application are both consistent and understood up front and it would be of significant concern to the TSOs were any ad hoc changes to be proposed as part of this year's process.

The TSOs have fully adhered to the rules of the Incentive process as set out in SEM-12-033, and deem it appropriate that the RAs should be mindful of these too. Due to the increasing complexity of the network a lot of day to day TSO efficiencies are not captured in the current Incentive process, and the TSOs would welcome a review of the process, which is especially appropriate as the Incentive process moves into I-SEM. For the 2017/18 Tariff Year however, the TSOs feel that one-sided post calculation deviations demonstrate an unfair approach to a process that has been approved by the RAs and fully adhered to by the TSOs.

Based on the continued efforts of the TSOs to minimise costs through the incentive process, which amount to €115m over the last 5 years, it would seem an unreasonable approach to remove all of the Incentive payment for 2017/18 based on an ad-hoc decision made post calculation. The TSOs feel this does not constitute fair warning, nor fair consideration, for the process that has driven large consumer savings to date, and would certainly negatively impact the TSOs trust in the process.

Imperfections Charge Factor

In the Revenue Requirement submission the TSOs sought approval that the Imperfections Charge Factor be set to 1. In the absence of any mention of this in the consultation paper, the TSOs will proceed on the basis that the factor is set to 1 unless informed otherwise and would request that the RAs confirm this. The Charge Factor is the means by which the tariffs may be adjusted mid-year. This change will be triggered if there is too large a shortfall of revenues collected to carry until it can be recovered through the k factor.