

PrePayPower Response to SEM-22-038: SEM Imperfections Charge Reforecast Report

10th August 2022

Dear Gavin and Leigh,

PrepayPower welcomes the opportunity to respond to this Consultation Paper.

We note that there have been substantial increases in Imperfection costs since the start of ISEM and we expect that Eirgrid and the Regulatory Authorities will continue to work together to manage these costs downwards.

When imperfections cost increases are taken together with the recently announced TSO request for a €478m increase in transmission revenue to pay for contracts for emergency generation capacity, it becomes clear the energy consumer is being asked to foot the bill for an additional Billion Euros in energy costs over and above already extremely high wholesale energy costs.

Allowing for the increases in commodity costs which are largely outside of the control of the TSO and Regulatory authorities, it becomes incumbent on the Regulatory Authorities to examine why costs are so much higher. One reason is that the TSO has not been successful in building high-capacity onshore transmission projects to any extent and now the end consumer is being asked to foot the bill. The TSO appears to have also focused their future development plans on offshore transmission assets which will provide no relief from imperfections costs which are driven by the inefficiencies of the Grid onshore on the Island. It is reasonable to question how much more of the cost of this transmission inefficiency must consumers endure in future?

Another reason why the cost is so high is because of the behaviour of market participants especially those generating energy. The structure of the balancing market is such that generators have the ability to submit offers and bids to the market for energy without any form of price control. It is evident from balancing market and imbalance pricing data that generators offer energy at and are accepted at prices up to the strike price. The strike price has varied in recent months between €500/MWh and €1,000 / MWh with a generators cost of production generally substantially below these levels. The market structure and resultant bidding behaviour from generator participants to these levels means that consumers are paying far higher prices to generators than is necessary. The TSO imperfections submission identifies approx. €134m of these costs which are directly related to simple bids and offers, and it is likely the total is actually higher.

Furthermore the TSO submission identifies an alarming tendency for generators to remove portions of their capacity from the Day Ahead market. This behaviour was identified in the summary of a 3rd party consultants report which is shown in Appendix 8 of the TSO submission. In particular on page 3 of appendix 8, the consultants identified that

“The review identified an enduring tendency for CCGT capacity outside the Dublin Locational Capacity Constraint (LCC) to sell around 90% of its available capacity into the DAM. While the model mostly scheduled such plant to its full available capacity, actual executed bids tended to be around 10% lower. In

turn, this increased scheduling reduced overall costs in the unconstrained model compared to actual DAM outcome. This bidding behavior was anecdotally confirmed by inspection of sample individual PQ curves. Whereas model SRMC assumptions were broadly in line with executed bids in the DAM, some CCGT participants priced the top-end of their capacity well above this level (which typically did not get executed in the DAM) or did not offer this capacity into the DAM at all"

There are 7 CCGT located outside the Dublin Locational Capacity Constraint, amounting to more than 2,600 MW of installed capacity. The consultants report appears to suggest that some participants priced the top 10% of their capacity, some 260 MW in total, sufficiently high that they did not run in the Day Ahead Market. The report further suggests that some participants simply did not offer some of their capacity into the market at all.

Perhaps there has been some information omitted from the report that would clarify the situation but the consultant's description of this behaviour appears strikingly similar to the definition of withholding under REMIT regulations.

In advance of the new tariff year, we would call on the TSO and Regulatory authorities to first evaluate what is the impact of this behaviour on imperfections cost and to secondly investigate the nature of the bidding behaviour identified.

Managing consumer costs should be of the utmost importance and all forms of downward pressure should be considered to apply to those who are most able to influence the imperfections costs. Given the unprecedented market pressures and rising consumer costs we believe that we are in an *Emergency situation* and any interventions in the balancing market should be considered in that light.

We note that the RAs have reviewed the TSO's report and requested stakeholder's views on 5 specific areas. We have structured our response to this paper addressing each aspect and included some additional observations for your consideration.

1. TSO costs and assumptions for Tariff year 2022/23

We have reviewed the costs and assumptions for the Tariff year 2022/23. We are broadly in agreement that the majority of the increase in costs is due to continued upward movements in commodity prices. However it is important to note that there are hundreds of millions of euros worth of costs that could be reduced outside of this with improvements to the market and transmission grid.

Reluctantly, we support using the forecast from May 9th and the calculated tariff of €22.80/MWh, as commodity prices on the curve for the periods in question have further doubled between May 9th and early August. We note that SEMO have flagged a financial shortfall should a lower forecast be passed through to the customers and we feel it is best that the market operator is financially resourced appropriately.

We note that the existing Balancing Market rules have resulted in additional costs of €99.23m for the CDISCOUNT and CPREMIUM component with a further €35.17m included in the supplementary modelling for CDISCOUNT and CPREMIUM payments for pumped storage. This total €134.4m in additional costs (which we feel is an underestimate) arises solely from balancing market rules and the ability of generators to price energy in an uncontrolled fashion not bound by any market rules or reason. We believe these costs could be mitigated by temporary changes to the Balancing market rules.



2. Actions that could minimise Imperfections Charges

We would call upon the RAs to examine a *temporary* rule change to be enacted for a limited time period covering the period of where very high imperfections costs such as these persist. This rule change would limit participants to making complex bids and offers and prevent simple commercial offer data (COD) being submitted or participants would be limited to simple COD set at a small margin in excess of their complex COD. Using the data from the Eirgrid submission we believe this rule change could save at least €134.4m in imperfection costs in the forthcoming tariff year or €3.55 / MWh. We would call on RA's to give serious consideration to this temporary change given its potential to significantly reduce costs.

3. Forecast calculation methodology using 12-month average prices or k-factor for Imperfections Charge

We note that the TSOs took their commodity cost inputs on the 9th May 2022. Given the recent extreme volatility we acknowledge the difficulty in using either point in time prices and/or average prices. We note the consultation paper has recalculated the imperfection charges using a 12-month average. This reduces the charges from €22.80 to €17.22. However, given that the forward curve has since doubled for the period in question we would be of the view that the current commodity costs included in this year's report are under-estimating the true costs for the year 2022-23. Any measures which will further underestimate these costs is likely to result in a significant under recovery of costs and a very difficult situation for the TSO and MO.

On a market fundamental's basis, taking the last 12 months is not a sound approach – and doesn't reflect the volatility we have seen in prices. Similarly taking a single day is also problematic if prices change dramatically after this date as is the case since May 9th. We would favour a methodology which uses a 30-day median of prices rather than a single day however we again acknowledge the difficulty in getting this correct.

4. K-factor single or multiyear

We would support the immediate application of multiyear k-factor but only in the situation where the k-factor represents an under recovery for the previous year. Over recoveries should be paid back immediately. We would propose that the multi year period should be between 3-5 years.

The table below shows how spreading the cost of k-factor over 5 years could reduce imperfections price for the year 2022/23 by almost €3.00 to €19.86 /MWh

Table 1: Imperfections recalculated with a multi-year k-factor

€m	Original costs (€m)	2022/23 (3-year k) (€m)	2022/23 (4-year k) (€m)	2022/23 (5-year k) (€m)
Dispatch Balancing Costs	730.45	730.45	730.45	730.45
K-factor adjustment	140.36	46.79	35.09	28.07
Total Imperfections	870.81	777.24	765.54	758.52
Forecast Demand ('000 MWh)	38,200	38,200	38,200	38,200
Imperfections Price €/MWh	22.80	20.35	20.04	19.86



5. Biannual review of Imperfections Charges

We would be in favour of a mid-year review of imperfections with any actions to change the rate levied outside of a variation of +/- 10% subject to a mini consultation.

6. Additional observations:

We note that the PSO Charges were changed this year to give a payment of €89 to each customer. If the imperfections costs of €22.81 goes ahead as planned this will be an increase of €57 for the average customer. As a consequence the net benefit of the PSO change for average customers will be only €32.

7. Summary

If the proposed changes to the Balancing market rules and the changes to a multiyear k-factor are applied this could reduce the imperfections tariff from €22.80/MWh to €16.34/MWh. This would bring the imperfections charge closer to last years tariff of €9.19/MWh and would represent an annual increase of €30.03 for an average residential customer as opposed to the proposed tariff which would result in an annual increase of €57.16.

Table 2: Imperfections recalculated reducing BM costs by €134.4m

€m	Adjusted BM Rules costs	2022/23 (3-year K)	2022/23 (4-year K)	2022/23 (5-year K)
Dispatch Balancing Costs - €134.4m	596.05	596.05	596.05	596.05
K-factor adjustment	140.36	46.79	35.09	28.07
Total Imperfections	736.41	642.84	631.14	624.12
Forecast Demand ('000 MWh)	38,200	38,200	38,200	38,200
Imperfections Price €/MWh	19.28	16.83	16.52	16.34

Best Regards,

Colm mac Oireachtaigh,

Head of Forward Trading,
PrePayPower



