

FERA Response to
SEM Committee consultation on
Imperfections Charge
October 2022 – September 2023

FERA's members operate in the Demand Side Response sector of the electricity industry and perform a significant role in supporting the operation of the balancing market and facilitating the continuous introduction of renewables.

The following comments are in relation to the published SEMC consultation and the TSOs papers.

The TSOs have submitted a proposal of an Imperfections Charge for €870.81m. The SEMC have stated that the equivalent Imperfections Price is €22.80 per MWh. This appears to be derived from the total consumption of 38,2000,000 MWh for the year. A better way of showing the true cost would be to divide by the 'constrained MWh' as this would show the value of alternative dispatch, rather than spreading the cost over the whole annual consumed MWh.

It is understandable that the TSOs used a fixed point in time to identify the commodity prices for their modelling. There is a need to be realistic in what the future fuel and carbon costs are going to be. The K factor suggests under recovery from previous year - why was that? The use of smoothing shall underestimate possible costs and again under recover, placing future K factor obligations. It does not appear that the smoothing of commodity prices over the previous 12 months shall produce a suitable figure for the future years, given that all energy and commodity experts are pointing to increases in prices.

Whilst the SEMC would like to identify a lower imperfections charge, so that the consumer shall pay less, it is unlikely to be reflective of the true nature of future years commodity costs.

The SEMC also suggest looking at the last year actual outturn and extrapolating that. Shall the shortfall profile from previous year reflect the future? Was the shortfall reflective of pricing or MWh volume through specific times of the year? If MWh shortfall was profiled across the year, then maybe specific commodity monthly forecasts could be used to predict the shortfall. If money shortfall was to be used, then than may not be reflective of future expectations.

Section 3.2 refers to PLEXOS modelling producing costs in Euros. It should also be able to produce 'constrained MWh' and thus a cost per 'constrained' MWh. This would be a useful analytical tool in



assessing where the true cost resides and where the Regulators/TSOs need to concentrate on to alleviate those additional costs.

Section 5.1 asks for comments on the TSOs forecasts and assumptions. We would state that the shortfall from previous year is not in doubt and has to be covered. The analysis for next year is reflective of significant global price increases and utilise May 2022 values. These have not reduced, and energy experts suggest these shall continue, or maybe increase, through the winter of 2022/23 and into the rest of the year. There is no reason to underestimate the TSOs forecasted values, nor should we utilise alternative costs, such as using a smoothing of costs over a historic period of time.

The Imperfections charge is somewhat understated when it is spread over the larger annual consumption MWh for the whole market. The true value of such actions would be better viewed when attributed only against the MWh derived from the TSOs actions. The total cost for the year in Euros should be divided by the calculated 'constrained' MWh. This figure would show the true value of TSOs actions when prioritising certain generation over others.

Section 5.2.1 mentions utilisation of average prices for Q4 2022 to Q3 2023, that would have been stated prior to 9 May 2022. Forecast prices during May21 would severely understate the actual resultant prices of May22 and thus the other monthly forecasts would equally be as inaccurate. This approach would raise significant concern that inappropriate values were being used for the forecasting.

Section 5.2.2 introduces a Run Rate approach. It would appear that the RAs are suggesting that the future year shall have costs that shall exceed the allowance by the same amount as previous year - €150m. It is important to see which months this may have been incurred and if it is during the higher fuel price months. Since it is the forecasted higher fuel prices that are the important item then looking at previous month losses, that have low fuel prices, does not provide a suitable comparison.

Section 5.3 makes reference to a possible deferral of K factor recovery.

Depending on the cash flow arrangements of the market, and how any under recovery is funded then it may be useful to spread the K factor over a number of years. This would reduce the impact of the current global fuel price spikes until a time when they may settle. However, if the global fuel prices do not stabilise and continue to rise then any initial deferral shall place an increased burden on future cost recovery which may have significant implications on consumers.

The table 5 shows that in 2021/22 there was an allowance of €341m and the under recovery was €140.36. That is -41% on the allowance. Most of the previous years there was a small % of over recovery - except for 2018-19 which also had an under recovery. Note that 2018/19 had a marked gas price increase which is similar to the global fuel price rises that are being witnessed recently. It



is valid to assume that such fuel price increases shall result in under recovery when such price rises are unforeseen. The TSOs have indicated that they are aware of fuel price forecasts, and they have correctly included these in the modelling and predictions.

Whilst the current energy crisis has placed an unforeseen burden on the consumer and there is a strong willingness not to increase such a burden, it must be understood that not addressing the actual true costs shall have consequences in the future.

Section 5.4 attempts to highlight an issue with the rules in the Trading & Settlement Code, insofar as it was constructed to handle a single K factor per year and would only handle a further K factor should under recovery occur. This indicates that a modification to the T&SC wording should take place in order to cover all scenarios.

It is a suitable approach to check if there is over recovery of costs and to pass possible saving through to the consumer, where possible. Given the volatility in global pricing of fuel then it may be prudent to introduce a biannual review, so as to capture a decrease in the costs. This news would be better accepted rather than having to mention an increase, should the imperfection charge be set too low at the start and then needed to be increased. Note that there is already a positive K factor from last year to be paid for.

Conclusion

It would appear that the TSOs have identified from historic data that fuel price rises result in under recovery and therefore it is prudent to ensure fuel price predictions are taken into account, such that the true cost of System Operations is covered by the consumer. It may also be wise to assess these values part way through the year to make sure that there is a correct recovery and no significant over or under recovery. Biannual review would allow for the consumer to properly cover the actual ongoing costs and to reduce any K factor for the following year.

The suggestion of using a lower K factor than suggested by the TSOs means that there is doubt in the fuel price forecasting and/or a drive to delay such impacts on the consumer till later years. Deliberately delaying the costs to the future introduces further risk of financial burden on the consumers in those future years.