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5th August 2022

RE: SEM-22-038 - Consultation Paper on Imperfections Charge October 2022 – September 2023 and Reforecast Report October 2020 – September 2021 (the “Consultation”)

Dear Gavin and Leigh,

Bord Gáis Energy (“BGE”) welcomes the opportunity to respond to this consultation on the Imperfections Charge proposed for the tariff year 2022/23.

1. Introduction and Summary

The current volatility in the energy markets and commodity prices is unprecedented and it is reflected in the Imperfections Charge for 2022/23 proposed by the TSO which is more than doubling the current tariff. The scale of this increase, and the impact it will have on the consumer should in our view be addressed and mitigated in a manner that is resilient to future market pricing levels, is sustainable in approach, and predictable to stakeholders. Any changes to the Imperfections Charge calculation methodology needs to draw out immediate and future impacts to all stakeholders (TSO, suppliers, and the consumers). It is with this in mind that we comment on the alternatives set out in the consultation paper.

- BGE supports amending the methodology used to calculate the level of the proposed annual increase of the Imperfections Charge to avoid tariff distortions due to extremely high commodity prices at a reference date.
- We ask that increases to the Imperfections Charge for 2022/23 are recovered over a 3-year period to reduce the impact on consumers. Furthermore, we support the proposal by the RAs that the annual K-factor is recouped over a number of years (we suggest 3) to smooth the impact of any extreme tariff events in any one year.
- We propose a 3-year forecast of the Imperfections Charge levels is introduced to give stakeholders a forward view of the level of tariffs expected, and the impact of the K-factor recovery in each year. We support a biannual review process of the Imperfections Charge tariff to help inform this 3-year forecast but we do not agree with any within year tariff changes as these can lead to unnecessary increases in supplier billing workloads, sudden increases on consumer charges, and potential customer confusion on the tariff levels on bills.
- Lastly we believe that any cash-flow risk introduced to the TSO operations by the changes proposed in the level and recovery of the Imperfections Charge can be borne by the TSO in the short-term (e.g., 12-18 months) with the understanding that the TSO will be returned to a cash neutral position in the longer period (e.g., ~3 years depending on the tariff smearing time period). We ask that any funding shortfall to the TSO does not impact Dispatch Balancing Cost (DBC) payments to market participants or ad-hoc adjustments to charges on consumer bills. Mitigating DBC cost impacts to consumers and participants would be ensured for example by putting in place additional non-market funds to support the continuation of these DBC payments.

We explore each of these items in the following sections and evaluate how each can spread the increases in the Imperfections Charge across a number of years to lessen the annual impact on the consumer.

2. Imperfections Charge level 2022/23 – methodology

We agree with the position of the Regulatory Authorities (RAs) that the TSO's modelling methodology is capturing unprecedentedly high commodity prices on foot of using a single data reference point (9th May) which does not fully account for the volatility in the commodities futures markets. We support the second alternative approach ('run-rate approach') proposed by the RAs as a way to incorporate current market, performance, and assumption conditions into the forecast for 2022/23, rather than the TSO approach of a single point in time as a data reference on commodity pricing. We ask that should this 'run-rate' approach be adopted, then the current 7-month period of actual outturn in the current tariff year is expanded as much as possible within the modelling deadline to include as much actual outturn data as possible in the calculation.

In our view, the other option proposed¹ in the consultation paper is not a suitable basis for forecasting the tariff level for the 2022/23 Imperfections Charge, despite using a tried approach of historical average pricing to smooth out short periods of volatility. Although it is based on known market-related pricing of commodities, the weighting of the last 12 months is reflective of a stable market with lower prices. The current market volatility is driving commodity prices at unprecedented levels and cannot be correlated to historic pricing levels. Our preference (as set-out above) for the "run-rate approach" is on the basis of realistic estimates for consumers which can possibly mitigate the extent of K-factors that may arise in the future.

3. Distributed recovery of increases to Imperfections Charge, and K-factor recovery

We ask the CRU to distribute across a 3-year period the recovery of the increases in the Imperfections Charge for 2022/23 (compared to 2021/22) due to commodity price volatility. This, in our view, will smooth out the significant impact this cost increase can have on consumers in any one year and allow a more manageable impact in future years where the impact to the tariff rate should be mitigated to an extent by increasing demand levels.

Commodity price volatility is also distorting the level of within year K-factor correction required by the TSO given the proposed level for the 2021/22 K-factor is the highest in eight years². We support the proposal by the RAs to recover this cost over a number of years rather than all in one year (2022/23) as proposed by the TSOs, and we support spreading the recovery of the K-factor evenly over a 3-year period also.

We recognise these deferred recovery requests will introduce a cost-recovery delay for the TSO but we believe that any cash-flow risk introduced to the TSO operations by the changes proposed must be borne by the TSO in the short-term (e.g., 12-18 months) without impacting Market Participants as highlighted by the TSO in their Imperfections Revenue Requirement 2022/23 report³. This is on the understanding that the TSO will be returned to a cash neutral position in the longer period (e.g., 3 years). We ask that all efforts are made to secure additional non-market monies to support the continuation of DBC payments so not affecting market participants payments or introducing ad-hoc negative changes to consumer bills.

In our view, the 3-year recovery of the K-factor and 3-year recovery of cost increases should work together with a 3-year forecast on Imperfection Charges to give a forward view on the level of costs and tariffs expected.

4. Future forecasting of Imperfections Charge, and a biannual review

We propose that a 3-year forecast of the Imperfections Charge is developed using the 'run-rate approach' as set out in the consultation paper, recognising that commodity prices further into the future will vary more from the eventual prices used on the actual tariff year. However, there can be a benefit to stakeholders to see the

¹ "To apply average prices for Q4 2022 to Q3 2023, taken daily for the 12 months preceding the data freeze, that is from 10 May 2021 to 9 May 2022" – SEM-22-038 (pg 11)

² SEM-22-038 – Table 5 (p18)

³ Annex 1 to SEM-22-038 (pg 35) - "Available market cash has largely been expended and the TSOs expect to imminently begin drawing on Contingent Capital to fund any imperfections under recoveries until the end of the current tariff year. The TSOs note that the ultimate risk here is to Market Participants. As set out in Section 5, in the event the charge is insufficient to correct the under recovery and fund imperfections in 2022/23, once the contingent arrangements are fully drawn, the market will be shorted via the payment deferral mechanism under F.22.3 of the Trading and Settlement Code until additional money are available."

direction that tariffs are expected to move and the scale of the potential tariff that may result. We believe that stakeholders (including RAs, suppliers, and consumers) can benefit from:

- having a forward view of the level of Imperfection Charge and tariffs expected in the coming 3 years,
- the impact of the K-factors in each of those years if spread over 3-year periods (as proposed above),

as affected stakeholders can consider what mitigating actions can be taken ahead of forth-coming tariff years to smooth out any forecast impacts to consumers from unprecedented volatility in the energy markets and commodity prices.

In our view a biannual review process of the within year Imperfections Charge should work in tandem with this 3-year forecast only as a method to validate and test the data and assumptions in the forecast. We do not support however any change to the Imperfections Charge tariff within the year as a result of the review. Biannual tariff changes will result in increases to supplier billing workloads to a level that is complex and unnecessary when trying to implement twice yearly tariff changes. This will potentially increase the risk of billing error by the supplier, and lead to a reduction in consumer clarity of the charges on their bill, so creating the potential for an associated increase in billing complaints to suppliers and the RAs. It also introduces additional uncertainty in potential charge increase during a tariff year which does not bode well for consumers. The output of any biannual review will be a useful validation checkpoint for the 3-year forecast but we do not see it as the basis of updating the Imperfections Charge tariff to consumers within the tariff year.

Given that the majority of the imperfections charges is driven by shortcomings in the grid infrastructure and by grid constraints, higher transparency around the drivers and mitigation actions for these costs is required in our view. We ask the TSO to clearly demonstrate to participants the work they are doing to remove existing constraints from the grid, and the effectiveness this work is having in reducing future Imperfections Charge tariffs for consumers, given recent tariff years have shown that Imperfections Costs are mostly due to constraints⁴. EirGrid's constraint abatement plan should also have a forward-looking aspect to include any expected increase in constraints to the grid from large project connections such as the Greenlink and Celtic interconnectors and the forecast growth in wind generation (both offshore and onshore) to meet the 2030 targets, as well as the grid works needed to accommodate these projects. These forward views on expected constraints must feed into the forward-looking forecasting of Imperfections Charges as BGE has suggested above.

I hope you find the above comments and suggestions helpful. If you have any queries thereon please do not hesitate to contact me.

Yours sincerely,

Ian Mullins
Regulatory Affairs – Commercial
Bord Gáis Energy

{By email}

⁴ SEM-22-038 (pg2) – “For 2022/23, and in common with recent Tariff Years, Imperfections Costs are mostly due to Constraints.”