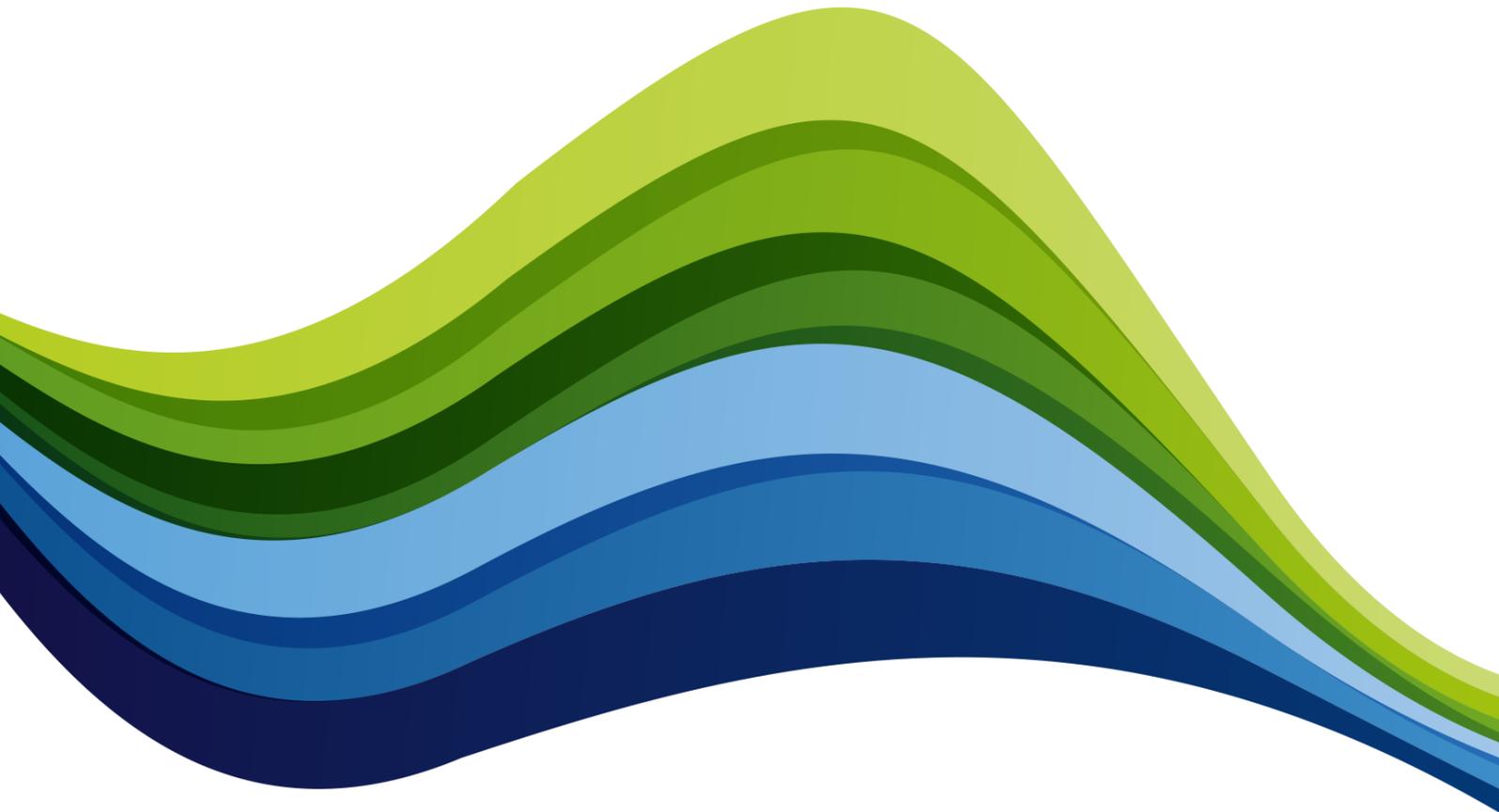


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# **Imperfections Charges 2019/20 & Incentive Outturn 2017/18**

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SEM 19-031



## Introduction

SSE welcomes the opportunity to comment on the “*Imperfections Charge 2019/20 and Incentive Outturn 2017/18*” consultation. For the avoidance of doubt, this is a non-confidential response.

As both a registered Supplier and Generator we have provided comments with regard to market and settlement impacts of this consultation.

We note the interaction that this consultation has with the SEMO Trading and Settlement Code market audit consultation, (insofar as the complementary discussion on the possible non-compliance and overall audit impacts of system defects) and with the Balancing Market Options paper, (with regard to the possible option of Simple NIV tagging being applied to the market).

## SSE Response

We consider that the proposed value of €10.40/MWh for 2019-20 indicates a trend towards higher Imperfections Charges following the establishment of the new market, and in response to the costs of continuing volumes of issues in market systems, (which we consider have been partly remedied in the time from original go-live in May, and final go-live in October). We would expect that this value for imperfections will remain at the same magnitude for the following tariff year reflecting an anticipated 12-18-month lag following resettlement, intended repricing<sup>1</sup> and continuing system defects; (requiring subsequent resettlement on the previous tariff year). Therefore, we would strongly urge the SEM Committee to consider the impact of system defects as part of their considerations under the above related consultations.

Given that the increased value of the Imperfections Charge suggests a step change going forward, we would not see any value in staggering the recovery of this new tariff across multiple years. To do so, would effectively compound the cost over other future years of anticipated higher Imperfections Charges.

We have provided specific comments below under the following headings:

1. K factor uplift
2. Demand forecast
3. Imperfections charges input
4. Incentive outturn 2017-18

### K factor uplift

In principle, the K factor should seek to provide an under-recovery mechanism driven primarily by commodity cost volatility and should be a mechanism applied by exception, for known but difficult to estimate costs that will then need to be reconciled through an under-recovery mechanism. We note the large increase for 2019-20 is rather due to high under-recovery

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<sup>1</sup> We have provided separate correspondence regarding repricing. In summary, we are not in favour of actioning the repricing of the market at this time when there is a never-ending cycle of resettlement and potential repricing being required as a result of the high volume of system defects. Furthermore, we are not supportive of a 0% materiality being applied, which will reopen settled prices and potentially any upheld pricing disputes in the preceding months. This will be hugely damaging to market confidence and there will likely not be the resources to manage a parallel process of reopening disputes and new disputes.

associated with system defects that have arisen following Go-Live. We would like to note that the TSOs were given significant allowances to provide for the new market with regard to new systems. There was also satisfaction that the mapping of requirements from the TSC was appropriately done and allowances associated with these were provided through SEMO's price control. Given that there is currently no indication as to when significant system defects will cease to be found and Code Releases will cease to be required with such frequency, the inclusion of these costs in the K factor could persist and crucially, could be underestimated. This places significant uncertainty on customer tariffs for future years.

We would point to the most recent MOUG meeting, 17 July and the known issues log, 19 July. There is no specific indication that all significant defects have been found. Furthermore, given the implications of repricing on the current project for resettlement, outside of new known issues (which may then require a following resettlement and repricing event), this could drive unexpected increases in this value.

Finally, we would note the optics of these costs is that they suggest that the current working of the new market is becoming costlier than originally anticipated. We would consider that the current ongoing costs should be attributed to the level of defects in the system procured. It is unclear whether there is a mechanism for the TSO to claw back some of these costs from the vendors given their ongoing nature since go live. If not, it is unclear why the market is carrying all of these costs. There does not seem to have been any incentive put in place to deliver a system that is fit for purpose. Furthermore, the continuing level of significant system defects and additional defects borne out of Code Releases suggests incomplete testing, development or mapping from design requirements to IT structures or tools.

### Demand forecast

We note that the demand forecast has been reduced due to embedded generation transferred to being DSU registered. We refer to the Generation Capacity Statement 2018-2027 and consider that the proposed reduction indicates a likely low demand scenario is being envisaged. We are concerned by this, given the known increased demand due to data centres and the general view that demand should be rising in the future following population increase and the aspirations under the Climate Action Plan (i.e. increased levels of EVs). By this logic, we would have expected the demand forecast to have remained static or to have increased. Any reduction we would have expected to be attributed to the likely impact of Brexit, rather than a transfer of registration to activities designed to displace demand on a short-term contractual basis.

The burden of the increased Imperfections Charge would also be reduced if the demand forecast were increased to more realistic levels. This would be of benefit to consumers. The reduction in demand instead succeeds in suggesting that a greater proportion of costs can be extracted from the market for activities that we consider the TSO should be bearing or seeking to reduce through proactive efficiency.

### Imperfections Charges inputs

We are supportive of the SEM Committee disallowing a large amount of the new costs submitted by the TSOs arising from the new market arrangements. In particular, we are not supportive of the TSOs' proposal that gas transportation costs anticipated to be booked by NI gas-fired plant should be borne by electricity customers (i.e. NI GTC). However, we note that this approach may not flow through to the allowed provision for Pumped Storage Units. We

would appreciate clarification that the reduction to €10m is reflective of gas transportation costs appropriately being extracted from the total electricity system revenue requirement.

In addition, we note the new provision of €19m for imbalance pricing CDISCOUNT and CPREMIUM. We consider that this is a cost that should be borne by the TSOs, since this cost could have been reduced by TSO dispatch and balancing actions and management of volatile cashouts and pricing. Furthermore, given the continued system defects, most recently relating to CDISCOUNT (Issue 6044<sup>2</sup>), we would again be concerned that this provision is underestimated and will be the subject of future under-recovery.

Finally, the other specific input is a provision for fixed cost charges. We are concerned that this estimated figure could well increase given continued fixes needed for fixed charges defects (i.e. Code Release D). We would suggest a cap on this charge to ensure that this cannot escalate and result in a higher than proposed charge per MWh being recovered via the K factor, in subsequent years. However, in principle as above, we are concerned about the degree of I-SEM costs being recovered through the Imperfections Charge mechanism.

Related to the inputs is the fact that the possible scenario of Simple NIV tagging in the market would result in lower Imperfections Charge, and therefore may represent a wide-reaching benefit to the market. We consider that the current system separates cashout from system conditions, which gives rise to some perverse incentives. The System Operator can incur Dispatch Balancing Costs that are substantially more expensive than the prevailing energy cost of balancing the system<sup>3</sup>. For example, if the imbalance price is substantially negative during a period in which the system is relatively balanced, the TSO will be incurring a cost to bid back a unit that is more expensive than the decremental component of their complex offer data. While some additional cost should be expected, (i.e. that generators should earn IMR by providing flexibility during periods where the system is 'stressed'), outturn costs are exacerbated by three features of the current imbalance pricing regime. These are: a) the Net Imbalance Volume is relatively poorly correlated with the system price; b) simple bid/offer prices are rarely paid in settlement and work more as a tool to reflect scheduling preferences; and c) uncompetitive simple prices mean that 'stress' pricing is generated frequently. These features mean that there are limited incentives to re-optimize generation in ex-ante markets because cashout is often constraint-driven. Rather, there are strong incentives for constrained generation to primarily participate in the Balancing Market as opposed to ex-ante markets.

### Incentive outturn 2017-18

We are supportive of the fact that the TSOs receive no incentive against the baseline for the 2017-18 tariff year. We note the incentives had remained near zero in previous years, but no penalties appear to have been levied. We would welcome consideration of whether the controls on this mechanism should be tightened, to ensure greater efficiency by the TSOs in reducing and bearing certain costs, rather than including them under Imperfections Charges, to be borne through customer tariff increases.

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<sup>2</sup> Issue 6044 relates to the systems being unable to shadow the CDISCOUNT charge component for wind units correctly. This would have an impact on REFIT top-up for wind farms, which includes a notional provision for CDISCOUNT. <https://www.sem-o.com/documents/general-publications/I-SEM-Known-Issues-Report-19-Jul-2019.pdf>

<sup>3</sup> The TSO will incur an imbalance cost by reference to an imbalance settlement period price that is potentially fairly far removed from the settlement price of the actual actions (either simple or complex) that were required to balance the Net Imbalance Volume by making units whole to the better of PIMB and their bid/offer prices.