



Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

TOP UP PRICES IN 2003

**A DECISION BY THE COMMISSION FOR ENERGY
REGULATION**

4th February 2003

CER/03/021

Introduction

The Minister for Public Enterprise issued a Policy Direction to the Commission on 26th July 1999, which provided the framework for trading in the balancing market. The Direction sets out the features of trading arrangements based on a bilateral contracts market supported by a top up and spill regime. Under these arrangements, the independent sector is able to purchase power shortfalls (top up) and sell surpluses (spill) to ESB Power Generation whenever the production of the independent sector does not exactly match the aggregate demand of their customers.

Paragraph 5 of the Minister's Direction indicates a method for the calculation of the top up price. It states that the level of prices should:

“average out over the year to the established full cost of a best new entrant (BNE). These prices will be profiled according to published ex ante estimates of ESB's avoidable fuel cost, plus an extra capacity element weighed according to the expected loss of load probability (LOLP), at the appropriate time of day, week and season.”

The estimation of the full cost of the BNE, to which the Minister's direction refers, is outlined in a separate document published by the Commission following public consultation.¹ That document estimates the average annual cost of the BNE operating at base-load to be **€47/MWh** on a sent-out basis.

This price needs to be grossed up using the average loss factor on the transmission network to arrive at trading prices. This loss factor is estimated to be 2.513% for 2003. The average price at the trading location is therefore calculated as €47/MWh multiplied by 1.02513, which equals **€48.18/MWh** at the trading point.

The Commission, in its decision paper on Best New Entrant Pricing in 2003 stated that it may, in exceptional circumstances, review the BNE's price during the year. In this case the Commission will also review the level of top up prices.

This document describes the methodology for calculating the top up prices that will apply in the energy balancing market during the year 2003. The components and profile of these prices are in the attached table, which provides prices in euro/MWh on a loss-adjusted basis.

Background

On 10th January 2003 the Commission published proposed prices for top up to apply in 2003. The Commission requested responses to the proposed prices by Wednesday 15th January. The Commission received many negative comments in relation to the proposed top up prices from participants in the market. In particular the increase in the level of top

¹ Best New Entrant Price 2003, CER/02/242, 31st December 2002.

up in the summer months was of concern. Suppliers had not anticipated such high increases in top up and had already entered into contracts on the basis of assumed increases, which were much lower. Suppliers would therefore be placed in a very serious situation financially if these prices were approved.

Generators were also concerned with the high top up prices in summer and the fact that the top up price in the period January/February 2003 was less than the summer price. It was suggested that this would result in perverse incentives for generators to carry out maintenance in this the peak demand period.

Based on these representations the Commission has reviewed the methodology and the model used for calculating top up and secondary top up prices for 2003. This review included discussions with market players and in particular discussions with the TSO. The Commission concludes that the methodology used was sound and top up figures produced by the model reflect the scenarios presented.

The higher top up prices in summer reflect the increased maintenance requirement of ESB plant and the fact that there are now two new large units requiring 10 weeks maintenance in the year. The CREEP programme scheduled these outages in the summer. The Commission notes that if these prices were implemented participants would alter their behaviour resulting in lower LOLPs than those projected, and thus the top up prices would not be reflective of the actual situation. This shows that there is a difficulty with setting top up prices in advance.

The TSO confirmed that the studies used to calculate ESB's avoidable fuel costs assumed a decline in fuel prices but that since those studies were carried out fuel prices have risen. They have indicated that, therefore, avoidable fuel costs may have increased since the last study. The effect of lower avoidable fuel costs is that there is too high a weighting on the capacity element of the top up prices. This has the effect of pushing the summer top up prices higher.

The LOLPs generated for January/February 2003 are low relative to figures for the November/December period. This reflects the fact that prior to 2003, the previous time that the peak occurred in January was 1997. Thus, the CREEP programme weights the November/December period higher. This resulted in indicative top up prices for January / February which are considerably lower than November / December and also lower, in some instances, than the summer periods.

Commission's Decision

The Commission is satisfied that while the methodology used to calculate top up is sound, the results are not reflective of what would happen in reality. The Commission also notes that there have been changes in fuel prices since the models referred to above were run, the trend now being towards higher prices. The Commission accepts that the top up prices as

proposed on 10th January provide perverse incentives and may present financial difficulty for market participants.

Accordingly, the Commission has altered the top up calculation produced by the models by increasing the estimated 2003 ESB avoidable fuel costs by 16% to provide an annual average price similar to that applying in 2002. This figure represents the percentage difference between the ESB's average estimated avoidable fuel costs for 2002 and those for 2003.

ESBNG studies indicate significant difference in prices between January/February 2003 and November/December 2003. On this basis, the Commission has decided to present two streams of top up prices for the "traditional" Winter period – one for January/February 2003 and another for November/December 2003. In addition, the Easter period, Good Friday to Easter Monday inclusive (18th April to 21st April 2003) and the Christmas period from 24th December 2003 to 31st December 2003 will be treated as a public holiday in terms of price setting. This is similar to the structure adopted in 2002 for top up pricing.

The Commission notes that in its revised calculations, peak signals for both winter seasons have been preserved, and winter prices are higher than those of summer. The Commission deems this a reasonable reflection of market realities. The Commission considers that the important issue is to ensure that the peak signal is maintained. It is noted that currently there may not be an incentive for customers of independent suppliers to reduce consumption during peak demand periods during the winter months. The Commission is investigating incentive measures which would do so and will be going to consultation on this in the coming months with a view to implementation for the months of November and December of 2003.

The results of these alterations are shown in Table 1 below. This table details the elements that make up the profile of top up prices, the ESB's avoidable costs and the weighted capacity element at the trading point (the interface between the transmission and distribution systems). It also shows the resulting top up prices in €/MWh at the trading point. These prices shall apply from 1st January, 2003.

While the average top up price (time weighted) is derived from an average Best New Entrant Price, time of day/season top up prices vary depending upon the input assumptions, for example, demand projections and generator outage schedules and this impacts on the Loss of Load Probability and thus the value ascribed to capacity in the top up price calculation. The Commission will monitor these assumptions and may review the time of day profile of top up prices if appropriate.