Chapter 9: Difference Payment Socialisation Charge and Socialisation Fund

Difference Payment Socialisation Charge and Socialisation Fund – 1/9

- Money in through Difference Charges may not equal money out for Difference Payments, resulting in a phenomenon which has been called the “hole in the hedge” where there is insufficient money available for the payment to enact the hedge for suppliers. This can happen for a number of reasons:
  - Stop-Loss Limits (in the absence of these limits non-performance difference charges at the imbalance price would be received to help pay imbalance difference payments at the imbalance price, but the charges element of this is limited after a certain point);
  - Multiple markets as the market reference price (Capacity Market Units could meet their obligation in a certain market, e.g. the Day-ahead Market with a price lower than the strike price, which meant they did not need to make a difference charge, while difference payments in other markets for suppliers who did not trade in that same ex-ante market, for example an imbalance with a price greater than the strike price, may still be required in order to enact the hedge);
  - Different treatment of some units (interconnectors, DSUs) so that they may not have difference charges levied in situations where other units would;
  - Possible that less capacity than the amount required to meet peak demand is procured through the capacity auction, or the peak demand used in the auction has been under-forecast, so there is insufficient capacity making difference charges to cover the supply which requires difference payments;
  - Exclusion of non-bidding plant from the amount of capacity to be procured in the auction – this capacity is meeting demand without being paid, and without being exposed to difference charges, while that demand is still eligible for difference payments.

Difference Payment Socialisation Charge and Socialisation Fund – 2/9

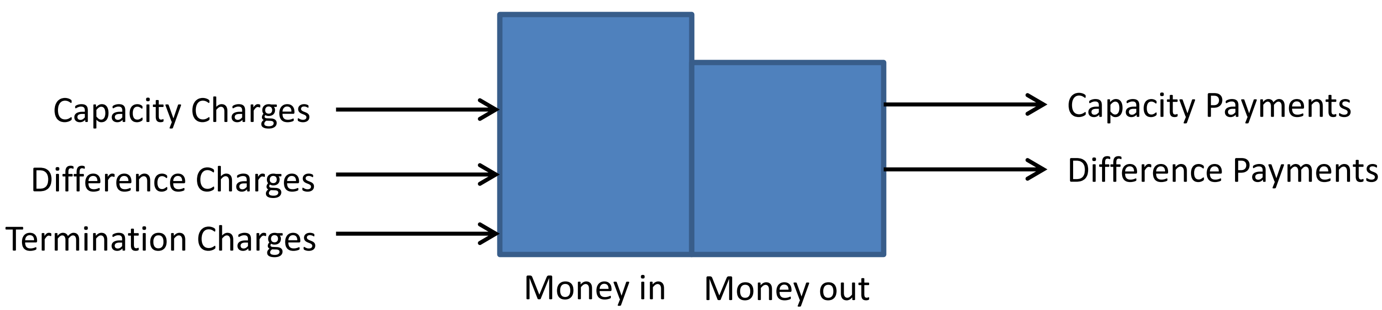
- This relates to a mismatch in the total money in and out over the course of a year. There are also other areas where there can be a mismatch between cash flow in and cash flow out within the year, such as:
  - An over-forecast of demand or demand reducing in line with the incentive resulting in less Capacity Charges being available to meet Capacity Payments; and
  - Seasonal variations in demand resulting in some times where the Capacity Charges are less than that required for Capacity Payments, and other times where the Capacity Charges are greater than that required for Capacity Payments; and
  - The design of the Capacity Charge for Suppliers creating the incentive to shift load away from periods where the charge is applied – if the incentive is successful and load was less than that forecasted in setting the price for the charge, then less funds will be available.

- The solution to all of these has been to manage all capacity market funds together, and with an additional charge on suppliers.

Difference Payment Socialisation Charge and Socialisation Fund – 3/9

There are 4 stages of managing this:

1. All cash flow in single “socialisation fund”.



The socialisation fund solution pools all of the money from payments and charges together with the expectation that the surpluses in one will offsets that deficits in another.

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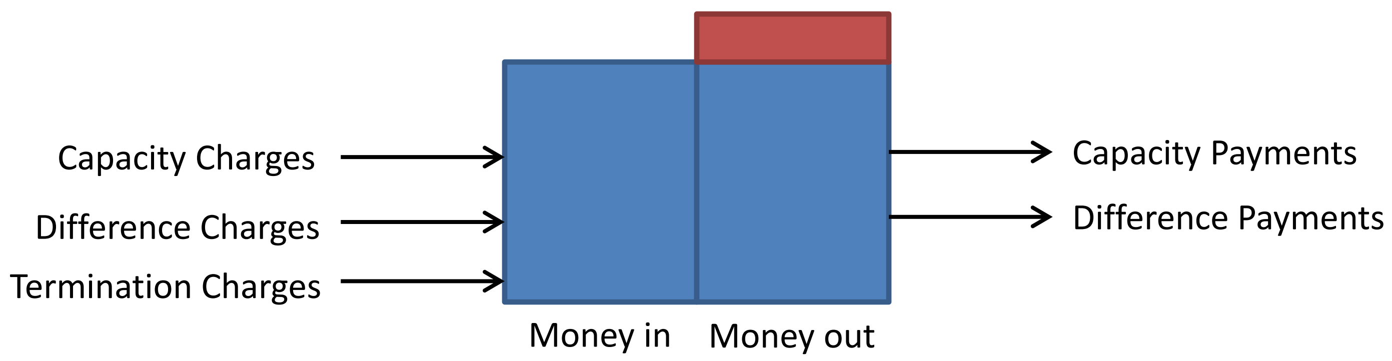
Difference Payment Socialisation Charge and Socialisation Fund – 4/9

There are 4 stages of managing this:

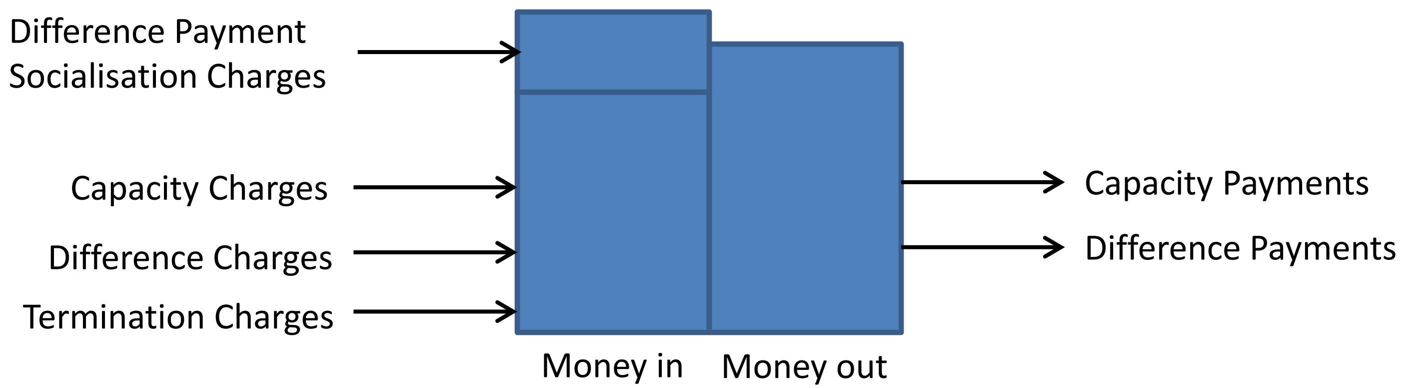
1. All cash flow in single “socialisation fund”.
2. If insufficient,



Difference Payment Socialisation Charge and Socialisation Fund – 5/9

There are 4 stages of managing this:

1. All cash flow in single “socialisation fund”.
2. If insufficient, plug gap with Difference Payment Socialisation Charge.

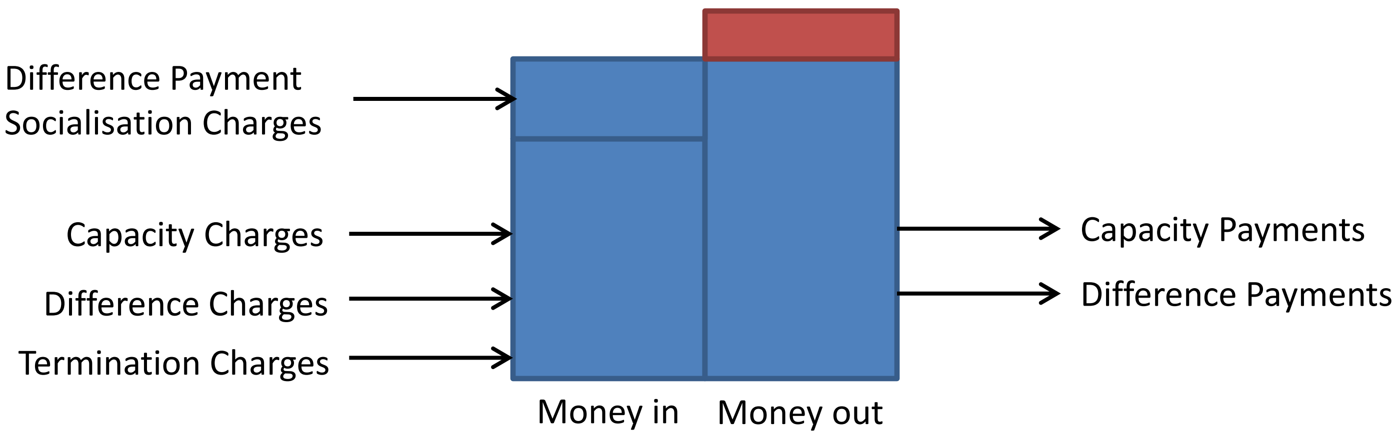


An additional charge on suppliers, known as the Difference Payment Socialisation Charge, may be required in order to ensure there is sufficient funds available. This charge is calculated as a multiplier of the Capacity Charge for each Supplier, based on the forecasted shortfall in the Difference Charges required to meet the Difference Payments. This could be thought of as all Suppliers pre-paying into the fund to ensure that payments to those owed them can happen at the correct time.

Difference Payment Socialisation Charge and Socialisation Fund – 6/9

There are 4 stages of managing this:

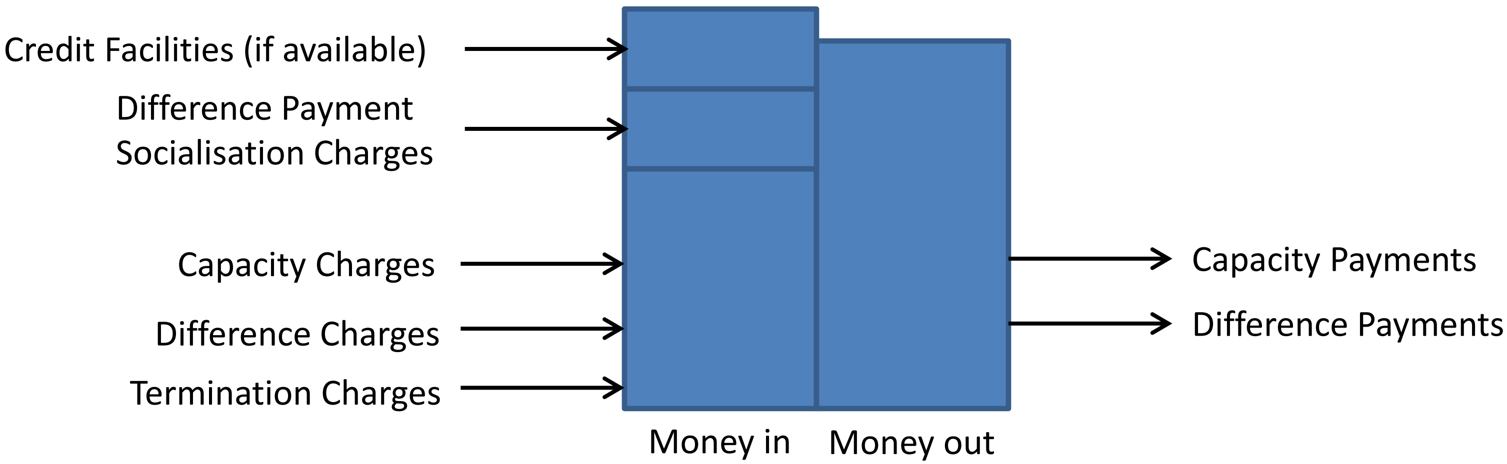
1. All cash flow in single “socialisation fund”.
2. If insufficient, plug gap with Difference Payment Socialisation Charge.
3. If insufficient,



Difference Payment Socialisation Charge and Socialisation Fund – 7/9

There are 4 stages of managing this:

1. All cash flow in single "socialisation fund".
2. If insufficient, plug gap with Difference Payment Socialisation Charge.
3. If insufficient, plug gap with credit facilities to extent possible.

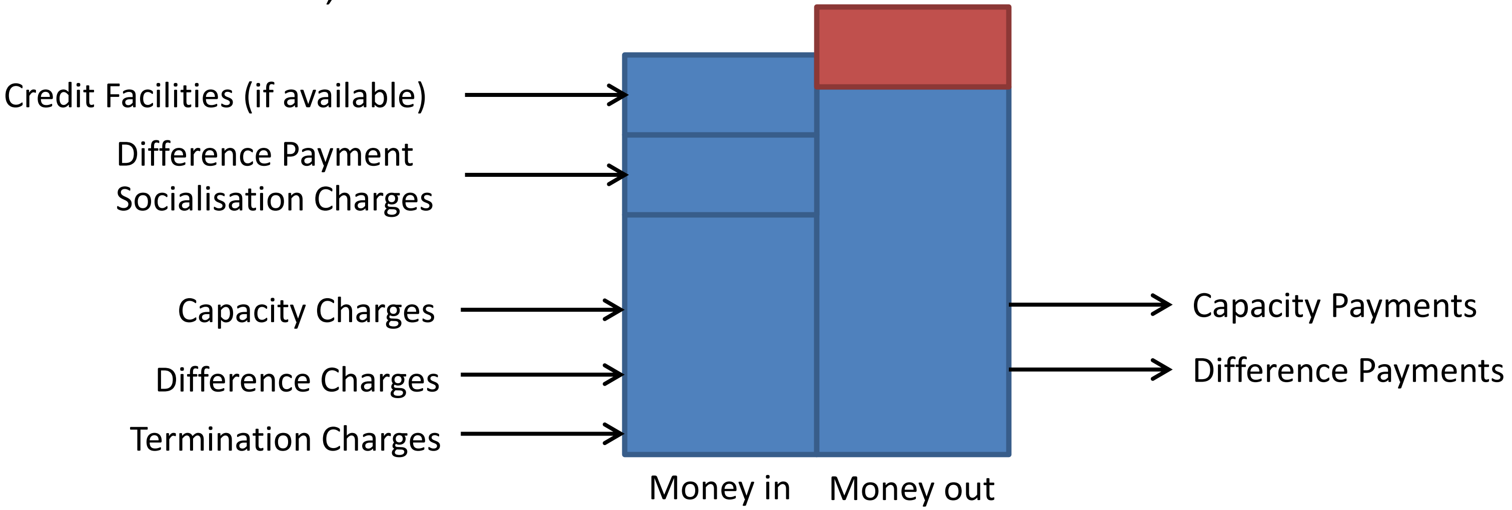


The Difference Payment Socialisation Charge may also be insufficient, for example if the forecast which was the basis of the additional charge was incorrect. If this occurs, then it is possible that the Market Operator can use credit facilities to manage the shortfall in the short term to the extent agreed with the Regulators.

Difference Payment Socialisation Charge and Socialisation Fund – 8/9

There are 4 stages of managing this:

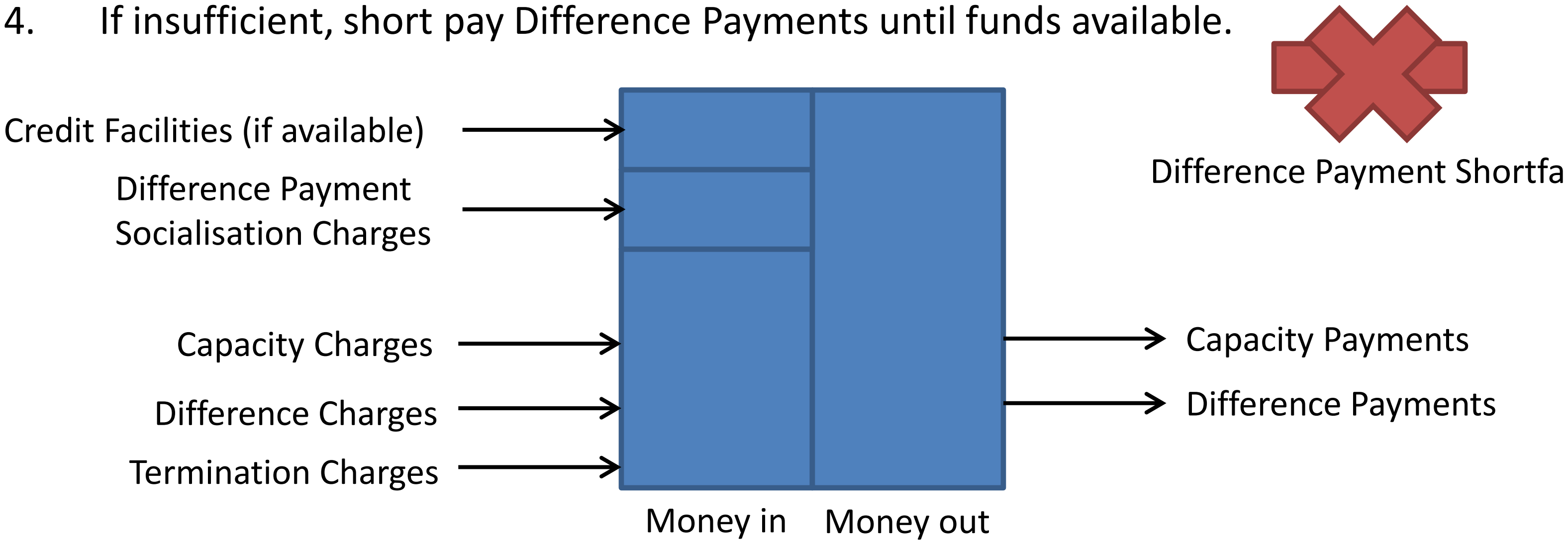
1. All cash flow in single "socialisation fund".
2. If insufficient, plug gap with Difference Payment Socialisation Charge.
3. If insufficient, plug gap with credit facilities to extent possible.
4. If insufficient,



Difference Payment Socialisation Charge and Socialisation Fund – 9/9

There are 4 stages of managing this:

1. All cash flow in single “socialisation fund”.
2. If insufficient, plug gap with Difference Payment Socialisation Charge.
3. If insufficient, plug gap with credit facilities to extent possible.
4. If insufficient, short pay Difference Payments until funds available.



If that is again insufficient to ensure that money in equals money out, then the money going out is stopped. This is done through reducing the Difference Payments to be made on this occasion pro-rata across all Suppliers owed them until the total payment can be met with the funds available. The amount on each individual Supplier that is short paid will be tracked, and Suppliers will be reimbursed when the funds are recovered (and after any credit facility payments are made).