



Ongoing tariff reform at the TSO-level in Iceland – Follow-up report

Prepared for Landsnet

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Rapport

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1 Summary of suggested changes

The following changes to existing tariff arrangements at the transmission level in Iceland are discussed in this report:

- Increase the share of the revenue cap covered by generators to 13%
- Charge generators on a combination of USD and ISK
- Charge generators based on installed capacity

In addition, the treatment of power plants below 10 MW, and the treatment of customers behind power plants are briefly touched upon. No decision related to changes to Landsnet's methodology on these aspects have been decided at the stage.

The changes are due to take place on January 1st, 2022.

2 Introduction

This report is a follow up on the previous report on the tariff reform at the transmission level in Iceland, released in November 2020¹.

Landsnet initiated a tariff reform. The aim is to contribute to utilising the existing transmission network efficiently, lead to an optimal expansion of the transmission network and keep transmission network costs down.

In a first project conducted in 2018, six areas were identified as priority for the tariff reform. In the November report, AFRY Management Consulting provided recommendations related to the:

- Share of transmission costs recovered from producers
- Customer categories
- Basis for calculating the capacity charge

In the November report, we also shared information on the reasons for suggesting changes to the current tariff model in Iceland, as well as on the process. Towards the end of November 2020, Landsnet released a statement about increased share from generators².

As explained earlier, the argumentation for increasing the share of revenues from generators include.

In this report, we present decisions made by Landsnet on a number of elements.

¹ https://www.landsnet.is/library/Skjol/Vidskipti/Netmalar/Landsnet_Report_v200.pdf

² <https://www.landsnet.is/vidskipti/vidskipti/vidskiptaumhverfi/throun-a-vidskiptaumhverfi/gjaldskrarstruktur-landsnets/>

This report is based on a close dialogue between AFRY and Landsnet. Stakeholders have been involved early on in the projects, and we have taken into account comments provided throughout the project. AFRY has provided Landsnet with suggestions. Landsnet has commented these suggestions, and conducted its own analyses, involving a large spectrum of employees with different functions into the discussion. The text below is the result of this process. This report should therefore be seen as a summary of the work, and presents decisions made by Landsnet.

3 Capacity charge for generators

The most appropriate approach for charging producers connected at the transmission level in Iceland was identified to be a tariff based on installed capacity. The tariff for producers would consist of a capacity charge for which the base level is 100% of installed capacity. The capacity charge is simple and should be easy to understand. It implies that a producer that has e.g. 10% of the installed capacity in Iceland, pays 10% of the total revenue Landsnet collects through this tariff element.

Tariffs should send efficient signals for new investment and utilization of the existing network, but should also allow for the collection of revenue to cover already incurred costs in a way that is a fair approximation of the costs each producer causes for the network. The latter part should ideally be “neutral”, meaning that it should affect the producers’ operations minimally.

As argued in our earlier report, the costs of network investment depend more on capacity than on the energy volume transmitted, and it is natural to somehow base transmission tariffs on capacity. Different variants exist, but it is mainly the installed capacity of current plants that has been considered in the dimensioning of the current network. In this regard, the base approach should be to recover systemic costs with a basis in installed capacity.

Possible future extension: in the future, there may be reasons to amend the tariff such as e.g. allowing for Landsnet and a producer to enter a long-term agreement that a plant or a collection of plants subscribe to less than 100% of installed capacity. In such an agreement the producer would pay a lower tariff, but Landsnet would be able to curtail the plant(s) freely without compensation down to the subscribed level. The basis for granting a producer a subscription of less than 100% of installed capacity should be that it will reduce Landsnet’s total system costs in the long term, chiefly through a reduced need to increase network capacity. In turn, the producer would benefit from a reduced tariff.

4 Share of revenues from generators

When identifying the share of revenues from generators, Landsnet split the regulatory asset base according to the number of circuit breakers in each substation. This methodology is approved by the Icelandic Energy Authority and

is simple, transparent and replicable. Based on this approach, the split for generators would amount to 13% of the asset base. The regulatory asset base is further based on the book value of the assets and the in-charged cost base is a share of the revenue cap model.

Today, in-feed covers 1% of the revenue cap and out-charged covers 98%. The remaining 1% is related to other revenues. When it comes to revenues from out-feed, the split is currently 64% for power intensive units and 36% for distribution system operators. With the suggested split above, in-feed will cover 12,5% and out-feed 86,5% based on assumptions in April 2021. The revenues that come from out-feed will then be around 62% for power intensive users and 38% for distribution system operators, albeit from a lower total share.

Landsnet recommends setting the in-feed charge in both ISK and USD. Today, revenues from infeed are in ISK but by charging in both ISK (DSO part) and USD (PIU part), Landsnet's revenues better represent the revenue cap and the asset base. This will decrease the currency risk since the revenue cap for DSOs is based in ISK and the revenue cap for PIUs is mostly based in USD. Furthermore, in accordance with article 12.a. in the electricity act, the tariffs should be in ISK for DSOs and in USD for PIUs.

In the beginning of each year, the split of revenues will be determined by the infeed split from the previous year. Each producer will then be charged both in ISK and USD based on that ratio.

5 Treatment of small power plants, as well as customers connected directly to a power plant

Landsnet's tariffs for small power plants will remain unchanged. The objective of the tariff reform is to assert impartiality towards producers regardless of size and to give the right signals pertaining to cost reflectivity. The distribution system operators plan to establish an in-feed tariff in line with Landsnet's changes on the in-feed charge. The treatment of small power plants proposal is aligned with the recommendations sent to the Ministry of Industries and Innovation made in a report by the National Energy Authority of Iceland regarding the business environment of small power plants.

The treatment of small power plants is suggested to be implemented by the distribution system operators. The proposal is based on the installed capacity charge for generators presented in section 3, meaning that the tariff will be based on installed capacity of each power plant. By adapting the capacity charge solution for small power plants, every producer will pay the same in-feed charge per MW regardless of size and location, and if the plant is connected to the TSO or a DSO.

In connection to the changes of the in-feed charge there is a need to lower the discount to represent the same benefit for small power plants. Furthermore,

the method of how to assess the technical and monetary benefits the small power plants bring to the transmission system will be reevaluated.

When it comes to the treatment of consumers connected directly to power plants, no changes are suggested at this stage. Landsnet is evaluating this aspect, and will review it, as well as the grid code B8 (terms for power-intensive users receiving electricity directly from power stations) in 2021.