Single Electricity Market Committee

Consultation Response (Summary Notes) from two Consultation Papers combined

a) DS3 System Services Enduring Scalar Design
&
b) DS3 System Services Enduring Tariffs

August 2017

Bord na Móna is once again pleased to have the opportunity to contribute to the ongoing design of DS3 System Services Workstreams. Bord na Móna, as a market participant with conventional and renewable assets is fully supportive of the objective behind the DS3 System Services project in achieving an SNSP rate of 75%, ensuring that national obligations and targets are realised by 2020.

With the transition to I-SEM and prospective continuing low energy prices and the introduction of CRM with reduced remuneration for capacity, and with future downward pressure on Energy revenues, Bord na Móna, in common with service providers in general, is acutely aware of the importance of being able to capture secure and adequate revenues from System Services to help underpin the business case for both existing, as well as new investments.

We are also conscious of the role and responsibilities of the TSO, the need to deliver value to the consumer, and ultimately in providing a power system which is both sustainable and secure at these high levels of non-synchronous penetration.

As you will be aware there are two consultation papers which we have been invited to comment on together, to some degree in parallel, given that the product scalar designs used for modelling in the Enduring Tariffs paper[1] are based on those set out in the Enduring Scalar Design consultation paper[2].

Given this, we see value in providing common 'Summary Notes' which accompany the template responses for the two papers. So these 'Summary Notes' cover both consultation papers together, and they essentially distill to <u>four critical comments plus a number of recommendations</u>.

Responses to the individual questions posed under both consultations are attached to, and are an integral part, of this response.

A) Whats's wrong with the Proposals (four critical comments)

- <u>1 Proposals are Risk Imbalanced</u>
  The proposals are risk imbalanced in that the commercial balance of risk against the service provider far outweighs the risks on the authorities of overspend. The 'Control Expenditure' element of the Guiding Principles appears to have become the over-arching Principle, at the expense of the 'Investment Certainty' principle.
  Our belief is that there needs to be an acceptance by the authorities that there should be a path towards achieving an optimal solution, that it is over ambitious to expect that this would be achieved from the get go and that there should be an acceptance that the roll out of ISEM will achieve substantial savings (from the CRM and likely reduced energy revenues) which are likely to be accompanied by <u>some</u> areas of overspend in pockets, which while being recognised, do not all need to be closed off at this early stage, given the negative impact on investment certainty of doing so.

- <u>2 There is an Extreme lack of Visibility of Future Payments from the DS3 revenue stream</u>
  With reduced Capacity Revenues and downward pressure on Energy Prices we are surprised that 'Secure Energy Supply' is not a stated 'Guiding Principle'. The new CRM will visibly achieve reduced capacity, as it

[1] Consultation on DS3 System Services Enduring Tariffs – DS3 System Services Implementation Project – 4th July 2017
[2] Consultation on DS3 System Services Enduring Scalar Design – DS3 System Services Implementation Project – 4th July 2017

is designed to do, however it is not our understanding that DS3 was designed with the same intent with regard to reducing existing capacity.
Given this, under the current Proposals[3] there is insufficient DS3 revenue certainty and an extreme lack of visibility of future payments such as are required to support existing and future investment.

We outline some of the more important areas of uncertainty marginalising DS3 revenues:

- There is no clear path of indexation of current payments; current proposals extend to a 5.3% increase on current rates for the Ocott'17 to April '18 period – with no visibility on further increases. This affords far from the level of certainty required for normal business practices and does not meet normal investment criteria. With the law of unintended consequences this could negatively impact 'Secure Energy Supply'.

- 'Minded to' higher levels of payments are dependent on SNSP levels in excess of 60% for FFR and for the 11 existing services. Current and future levels of SNSP are simply insufficiently visible for investors to provide a sufficiently robust business model platform. Table 6[4] clearly highlights the impact on SNSP from influence of variations in Wind, Export/Import, and enhanced/new provider models.

- This issue is exacerbated by the potential provision for a reversal of the recently increased maximum SNSP of 60% to a level below this, should the need arise. This gives small comfort to the investor notwithstanding the 65% max SNSP level used in the Plexos 2017/18 tariff year model.

- Related to this is the RoCoF constraint – increasing from 0.5Hz/s to 0.65Hz/s to 0.8Hz/s to 1Hz/s as per RoCoF project timeline. There is insufficient visibility as to the level of progress on this constraint versus what is required for the levels of expected SNSP.

- There is consideration of a potential contract term of 4 to 6 years. While this would be welcomed under balanced contract conditions the investor position is that this could represent more of a bind than a bonus given the stated isolation of the DS3 delivery programme from the CRM and Energy markets. Four to six years of a DS3 mechanism without attention to the CRM and Energy markets provides too much of a risk to the investor. We note that the 'conditional' provision does not provide investor comfort in this regard in that it is restricted solely to DS3 payments, regardless of Capacity or Energy market revenues.

- This leads to consideration of the Volume scalar and Conditional review. While we welcome the TSO's 'minded to' position NOT to implement a specific Volume Scalar for Regulated Arrangements we remain concerned, again from an investor perspective, about the provision for conditional review of the tariff and scarcity scalar structure with regard to its potential to depress 'forecast' revenues. We note also the quarterly adjustment powers of the Protocol document in this regard.

- We also note that the CRM Unit Specific Price Cap process for the upcoming T-4 Auction in Autumn 2018 will require forecast DS3 revenues four years on from then. This will require an effective

[3] In relation to the two consultations
[4] DS3 System Services Enduring Tariffs Consultation

platform to be in place which will allow this level of forecasting analysis for SEMC Framework Compliance. It appears that the current platform will not be fit for this purpose.

- Adding further to the uncertainty will be the introduction of Competitive Auctions and their impact on 'Secure Energy Supply' as well as on investor confidence.
- While we welcome much about the recent recommendations paper[5] with regard to the treatment of the data poor we remain concerned about the potential revenue depressing effects of changes in relation to Governor Droop Demanded Response on SOR & TOR1; also regarding enhanced 'success' requirements for Ramping Services which are discussed in the Interim Performance Scalar Calculation Methodology Consultation Paper[6].
- Smaller points also deserving of mention are a) the flagged likelihood of the two of the three new services being part of Grid Code requirements, thereby denying or diluting associated revenues to providers and b) the intended holding off of paying the 'higher of the Market Position or Physical Dispatch' with regard to DS3 payments. Both these provisions will depress service provider revenues.

- <u>3 Payments for the HAS services have not been maintained & Only Limited Payments for Distribution System ancillary services</u>

  1) Payment for HAS services are still too Low

     Under the proposed Tariff Rates for Enduring Regulated Arrangements the design criterion to equalise total payment for the seven existing services in the changeover from HAS contracts to the DS3 interim period will not be maintained.

     There is a missing revenue issue given that the total extrapolated payment for the seven existing services in 2017/18 (ie at the proposed increased rates) under DS3 falls well short of equalling the existing HAS budget for these services. This is evident from the table below:

[5] DS3 System Services Tariffs (1 Oct 2017 – 30 April 2018) Recommendations Paper 21st July 2017

[6] DS3 System Services Interim Performance Scalar Calculation Methodology Consultation Paper 13th April 2017

Table 1 Difference between HAS and DS3 remuneration to Service Providers

HAS Service	14/15 Cost (€)	HAS 14/15 Rates (€c/unit)	2014/15 Volume (unit)	DS3 Service	Proposed New Rates: DS3 Int Rates (€c/unit)	Cost (€)	Difference (€)	Cost DS3 vs 14/15	
POR	5,997,822	2.34	2,563,172	POR	3.09	7,920,201	1,922,379	32.1%	
SOR	8,961,140	2.24	4,000,509	SOR	1.87	7,480,952	- 1,480,188	-16.5%	
TOR1	8,941,887	1.87	4,781,758	TOR1	1.48	7,077,001	- 1,864,886	-20.9%	
TOR2	5,373,694	0.93	5,778,166	TOR2	1.18	6,818,235	1,444,541	26.9%	
RRS	2,656,983	0.20	13,284,915	RRS	0.24	3,188,380	531,397	20.0%	
RRD	5,313,966	0.54	9,840,678	RRD	0.53	5,215,559	- 98,407	-1.9%	
Reactive power	7,230,863	0.13	55,622,023	SSRP _ Lead	0.22	6,118,423	- 1,112,440	-15.4%	**
Reactive power	4,153,649	0.13	31,951,146	SSRP _ Lag	0.22	3,514,626	- 639,023	-15.4%	**
	48,630,004					**47,333,377**	**- 1,296,627**	**-2.7%**	*

* This -2.7% figure increases to -5.0% assuming 2014/15 volumes at HAS 15/16 rates

** Assuming an 0.5 RP factor multiplier for the active power range for which this reactive service is available

There are clearly very large % reductions across SOR, TOR1, and Reactive power – most notably due to the RP factor in the case of the last.

The reduction in cost across the seven 'existing' HAS services, which of course is the flip side of revenues to service providers, is estimated at -2.7% when comparing the effect of proposed new DS3 rates on 2014/15 volumes and rates. The gap increases to 5.0% when using the same volumes but at HAS 2015/16 rates.

Consequently rates need to be higher so as to compensate for this gap thereby satisfying the design criterion to equalise total payment for the seven existing services in the changeover from HAS contracts to the DS3 interim period.

2) Only Limited Payments for Distribution System Ancillary Services

Due to no fault of their own, assets which are producing services which are of value and benefit and which do not have access to the transmission system and instead are linked to the distribution network (for other than aggregators) will not be eligible to collect revenues during the interim period. This is of concern. In this regard we note the TSO's recommendations in respect of 'Principles Covering the TSO's Approach' as set out in the Report on DS3 System Services Review to the SEM Committee of May 2013[7].

This report sets out a range of core principles that the TSOs consider to be most relevant in the design of system services which can help guide the design of pragmatic arrangements:

- Value to the consumer
- Transparency
- Proportionality
- Non-discrimination
- Provision of a long-term signal consistent with electricity policy objectives

[7] DS3: System Services Review TSO Recommendations

It would be difficult to position that such a service provider who is capable of providing the services in a reliable manner is not eligible to participate and be remunerated. There needs to be a mechanism devised which would allow such Distribution System assets receive DS3 payments over the Interim period, either from the get-go or from sometime within the interim phase. There is inadequate provision for participation within the DS3 supplier framework which seems unfair and which is a concern given that this interim period could last for several years.

- 4 Insufficient engagement with Industry Service Providers
  The balance of risk is very much against the service provider within these proposals. Most fundamentally the notion of moving away from annual indexation of existing tariffs is a marked and step change departure from industry expectations.

3) Recommendations (number of recommendations)

- 1 Realise Commercial Imperatives and need for an Incremental/Staged approach
  TSO's and Authorities to recognise that there is a need for an incremental/staged approach which will be aligned with the four Guiding Principles, but which will take into account the 'missing' Guiding Principle of 'Secure Energy Supply' which is notably omitted.

  There needs to be a realisation on the part of the Authorities that this will lead to pockets of overspend which will ultimately be levelled out both within the Regulated Tariffs period as well as further in the Auction period. Any decision on DS3 overspend should be taken within the scale of CRM expected savings over coming years, where such spend may reduce from c€530m to €150m - €350m depending on source.

  The consultation papers invite industry to comment on 4 to 6 year contracts which could potentially apply to DS3 services in isolation of Capacity and Energy revenues. As mentioned – this could lead to an inappropriate bind rather than a bonus to service providers.

  The Authorities need to realise that in implementing ISEM that there simply needs to be adequate overlap in DS3 policy in recognition of the three revenues streams and that this needs to be far more reactive than 4 to 6 year periods will allow, notwithstanding the limited potential beneficial powers of the conditional tariff and scalar adjustments which, while potentially representing a benefit are more likely to represent a threat to future revenues from an investor perspective.

- 2 Give Appropriate Market Signals to Industry – specific recommendations

  For reasons outlined above there is an explicit need for:

  - Annual Indexation of existing tariffs which dilutes most of the SNSP risk out from investors' hands. BnM is aligned with the EAI's proposed modification which would involve industry being provided with a clear increasing trajectory for the DS3 base tariff rates to 2020 so as to provide greater certainty as to the total DS3 revenues that will be paid out each year, acknowledging that the application of scalars will still make up any shortfall in revenues with reference to the SEM Committee approved glidepath.

    BnM expressed the view in our response to the DS3 System Services (1 Oct 2017 – 30 April 2018) paper that this level of increase could be up to 15% and highlighted clearly that the 5.3% rate was

insufficient. We have also demonstrated that payments for 'existing' HAS services will not even be maintained under the new proposed rates – they need to be raised - and we advocate that mechanisms are put in place which will allow for remuneration of Ancillary Services from assets on the Distribution System.

- Need for a watering down/dilution of the binary nature of the 60% SNSP threshold for the FFR scalar such that there is a ramping up from a zero value for 50% SNSP towards that already proposed for 60% SNSP. All other thresholds to remain the same.

- 3 For the TSOs to bring Industry concerns to the Regulatory Authorities

Issues with regard to overspend need to be addressed between the Regulatory Authorities, the TSOs and Service Providers, in view of industry's call for the TSOs/RAs to realise Commercial Imperatives and the consequent need for an Incremental/Staged approach as set out above.

Industry would welcome further engagement with the TSOs and the Regulatory Authorities towards making effective communication and towards ensuring that the Regulatory Authorities fully take on the concerns of industry, particularly with regard to the impact of ISEM, when setting out their DS3 parameter boundaries to the TSOs.

This needs to be a three way process, which has not happened to sufficient degree.

This concludes our formal responses to the two consultation papers from a Service Provider perspective.

If there is any clarification or additional information you require, please do not hesitate to contact us.

For and on behalf of Bord na Móna

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