Response to the TSO's Consultation Paper

on

DS3 System Services Tariffs
(1 Oct 2017 – 30 April 2018)

DS3 System Services Implementation Project

from

BORD NA MÓNA

29th May 2017

BORD NA MÓNA
Naturally Driven

Response:

Bord na Móna is pleased to have the opportunity to respond to the consultation on the proposed Tariff rates for the period 1st October 2017 to 30th April 2018 as well as on the Proposed tariff methodology.

The context of our response is to firstly set out that that DS3 is an absolutely essential component of Service Provider revenues, forming one of the three key revenue legs, the others being Energy and Capacity. Bord na Móna, as a market participant with conventional and intermittent renewable assets is fully supportive of the objective behind the DS3 System Services project in facilitating an SNSP rate of 75%, ensuring that national obligations and targets are realised by 2020.

However, we see significant commercial issues relating to the low level of increased proposed tariffs of just 5.3% for the seven month period, given the lack of opportunity for adequate cost recovery across the energy, capacity and ancillary services revenue streams such as to enable a commercial return on investment for Existing assets. To explain, annual industry Capacity payments look likely to fall by between €200 and €350m[1] by 2020 (just 3.5 years away), while DS3 annualised[2] revenues might increase from current annual levels of €69-€73m[3] by c9.1%[4] or by just c. €6.5m for the first of these 3.5 years. This potential revenue gap of between *circa* €194m to €344m will be exacerbated by the regulatory exclusion of certain fixed costs 'missing revenues' which themselves have formed the contentious spine of many recent consultation responses relating to Capacity and Balancing markets.

We also recognise that it is highly likely that a significant part of this fall-off in capacity payments will be price related, meaning that even existing individual plant which successfully clears in the Reliability Option (RO) auctions will receive only a fraction of their payments to date. We already know that these RO payments will be capped[5], in some instances at no more than *circa* max. 60% of existing revenues.

Also with regard to new 'fast services' and associated new assets, we fully support that new services are anticipated to rightly take on a significant portion of the anticipated increase in DS3 revenues however we note that these services will not be commercially remunerated until August 2018 earliest[6] so the potential for such take-up, at scale, up to April 2018, is non-existent.

All of this highlights a fundamental revenue gap for Existing plant which will clear in the Capacity Auction, which will receive RO payments from as early as end May 2018 and where such plant, by clearing at auction, is signalled as being relied upon for system security. We believe that the scale

[1] Using industry commentators indicating a fall in industry capacity revenues from a) €530m to €350m and b) from €500m to €150m. We note that the more recent estimate is 'b)' which indicates a €350m fall

[2] Using a simple estimate and fully accepting that there will be a separate consultation in July 2017 to include consideration of tariffs from May 2018

[3] EAI Communication indicating actual annual spend of circa €69.3m vs anticipated spend of circa €73m

[4] By annualising the 5.3% figure for 7 months, ie 5.3%/7X12=9.1% as an approximation

[5] Assuming the Price Cap for Existing Plant at 50% of CONE – the Existing Capacity Price Cap

[6] We note that the TSOs have informed the SEM Committee of the technical need to stagger the introduction of these fast services – thereby further delaying implementation time: SEM-17-017 DS3 System Services Future Programme Approach – Information Paper, March 2017

Contd.

of this shortfall in payments, given the likely inability to recover them in the price coupled energy markets, will represent a very real commercial threat to plant which IS required to provide system security and that the rates under discussion within this consultation as well as the further consultation in July should take this into account in their 'system needs' calculation, notwithstanding SEM C's desire to limit the exposure of consumers to costs associated with system services.

Furthermore the paper does little to provide visibility to the industry of the glide path for both New and Existing service providers to a €235m DS3 System Services revenue by 2020 which was promised as part of the detailed design and implementation phase[7], notwithstanding the related previous good work[8] which now requires further development to inform the July consultation.

'*A glide path (with an annual expenditure cap) to the cap of €235m in 2020 will be established in the detailed design and implementation phase. This will be based upon the required volumes of system services* <u>*for each of the years 2016 – 2020*</u>*, which will be developed with the TSOs including public consultation and aligned to the delivery of the 75% SNSP.'* *Source: see footnote 7*

In the absence of sufficient information in the consultation paper to have a fully objective view a quick calculation shows that, should the fast services reach 38% of 'system needs'[9] by 2020 and attract pro-rata revenue to the other services, then <u>the annual average rate increase for the 11 existing services would need to be of the order of at least 15% per annum</u>, which is clearly considerably greater than the 5.3% for 7 months currently in consideration within this consultation proposal.

With this in mind, and with regard to the proposed tariff methodology, it is clear that the combined payment of services, in reflecting the 'needs of the system', should be mindful of providing the correct signals to ensure system security.

Furthermore, a significant omission to date which needs resolution is that, having received market signals to exit[10], the service provider is tied in by Grid Code requirements and prevented from exiting for a further three years, at their own cost, despite having made a decision to exit. This is not acceptable commercially and we urge speedy resolution of this issue.

There follow some bullet points which expand further on some of the points raised in the Response summary, while hopefully adding clarity.

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[7] SEM-14-108 DS3 System Services Procurement Design and Emerging Thinking Decision Paper para 76)

[8] 1) DS3: System Services Review TSO Recommendations – Report to the SEM Committee, 2012
2) SEM-14-108 DS3 System Services Procurement Design and Emerging Thinking Decision Paper
3) Consultation on Volume Calculation Methodology and Portfolio Scenarios – 14th October 2015

[9] Relative to 'system needs' as expressed in Table 2, p29 of DS3 System Services Interim Tariffs Decision Paper – 24th August 2016; also Appendix 1 (for reference)

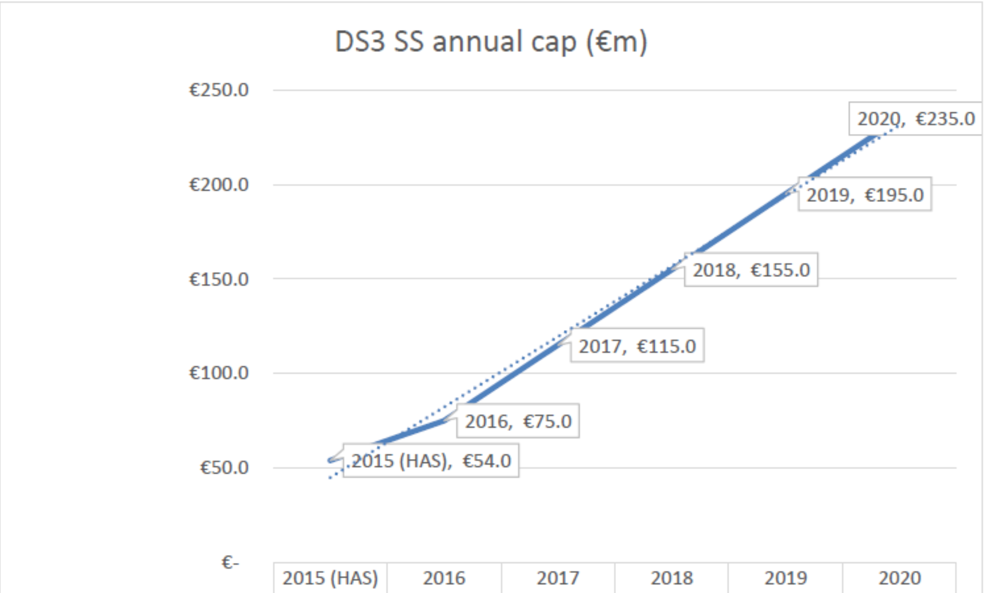
[10] Could be due to DS3 and/or Capacity payments

In Summary:

1) The introduction of CRM Reliability Option payments from May 2018, which could be 60% or less than current payments for Existing plants[11] will either force Existing plant to try to recover these lost revenues in the Energy markets or withdraw from the market[12]. By virtue of clearing in the RO auction these plants are clearly needed for System Security, therefore their withdrawal may impact security, provide blunt investment signals and damage confidence in the market, far from optimal outcomes. We believe that, because there will only be very limited opportunity to recover such costs from the price coupled Energy market that the DS3 budget will need to factor these into the 'system needs' calculation. We further note that service providers which receive a market signal to exit[13] are unfairly required by Grid Code provisions to provide three years notice, at their own cost. This inequity needs to be addressed.

2) The 5.3% proposed increase in DS3 rates for the 7 month period appears insufficient by a large margin, but there is inadequate information within the paper on which to make detailed comment. In this regard we highlight the need for a portfolio/scenario set of glide-paths which will give some direction to both Existing service providers, as well as to New investment. These would be very helpful, and indeed a requirement, towards guiding effectively the July 2017 consultation for DS3 Tariff setting for the period from May 2018 onwards.

3) Specifically, in relation to the 5.3% proposed increase, and knowing that the staggered introduction of New fast services will only commence in August 2018, we refer to Figure 3 of the recent Information paper[14].



	2015 (HAS)	2016	2017	2018	2019	2020
DS3 SS budget (€m)	€54.0	€75.0	€115.0	€155.0	€195.0	€235.0

Figure 3: DS3 System Services Glide-Path

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[11] For clarity – a 40% reduction or more
[12] The 3 Year notice for exit within the Grid Code Requirement remains a very serious industry issue which we wish to highlight again as requiring resolution
[13] Could be from an Ancillary Service or CRM market signal, etc
[14] SEM-17-017 DS3 System Services Future Programme Approach – Information Paper, March 2017

The capped increase between 2017 and 2016 is 53% (ie €115m/€75m), and this is without budgetary provisions to pay for fast services. This would objectively suggest that the 5.3% proposed increase for 7 months, equating to 9.1% for 12 months, is extremely low and totally out of kilter with the aforementioned 53% increase for 2017 vs 2016 or for the 35% increase (ie €155m/€115m) for 2018 vs 2017. In this context and mindful of tariffs being set within the 'system needs' constraint we refer to the over-arching system need for system security.

4) New industry – while we welcome the plans to remunerate the fast services we are disappointed that introduction of their remuneration will be staggered and that the earliest remuneration timing will be as far out as August 2018.

5) While we welcome many of the proposals within the recent Consultation on DS3 Scalar methodology[15] , and in the context that there has been an underspend on DS3 payments to date, we remain concerned about the revenue depressing effect on provider revenues from potential plans to 'tighten' existing scalars and what the effect on provider revenues of the new scalars, yet to be introduced, will be. In our response to this paper we also expressed our concerns particularly about potential future 'minded to' positions reducing the inertia credit allowance and the introduction of more demanding criteria for ramping. We also expressed concern about the costs of performance testing within the data-poor proposed solution. This is of particular concern where a providing unit delivers relatively low volumes and the associated cost of 'proofing' performance significantly cannibalises the earned revenue. In such instances, a sensible approach should be taken which would assuage the concerns of the TSO and still fairly reward the service provider. We expressed our recommendation that the TSOs would take on such performance testing costs.

6) Finally we look forward to the opportunity for Industry participants to make more informed representation in response to the upcoming July Consultation concerning tariff pricing for 1 May 2018 onwards. It would be our hope that this would follow receipt of relevant analyses as part of the consultation.

This concludes our immediate views. Finally, we thank you for this important consultation and are available to discuss the contents of this submission with the TSO if deemed useful.

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[15] DS3 System Services Interim Performance Scalar Calculation Methodology Consultation Paper DS3 System Services Implementation Project; 13th April 2017

Appendix 1 Relative Importance of DS3 System Services

Service Name	Unit of Payment	Current Payments	2020 System Needs	2016 System Needs	Commentary
Synchronous Inertial Response (SIR)	MWs^2h		2%	6%	2020 values assume that changes to the RoCoF standard have been implemented. This service may be of higher importance in the short term.
Fast Frequency Response (FFR)	MWh		12%	6%	The importance of this service directly relates to the outcome of the RoCoF project. Until the outcomes are known, we propose balancing payments between SIR and FFR.
Primary Operating Reserve (POR)	MWh	15%	11%	13%	POR, SOR and TOR remain important in the short term, with actual payments approximately equivalent between years. Lower total percentage reflects larger total payments across all services.
Secondary Operating Reserve (SOR)	MWh	18%	7%	11%	
Tertiary Operating Reserve 1 (TOR1)	MWh	21%	8%	10%	
Tertiary Operating Reserve 2 (TOR2)	MWh	12%	8%	10%	
Replacement Reserve – Synchronised (RRS)	MWh	13%	1%	2%	
Replacement Reserve – Desynchronised (RRD)	MWh		1%	7%	
Ramping Margin 1 (RM1)	MWh		3%	3%	More valuable with increased presence of wind, solar and demand side units.
Ramping Margin 3 (RM3)	MWh		5%	5%	
Ramping Margin 8 (RM8)	MWh		5%	5%	
Fast Post Fault Active Power Recovery (FPFAPR)	MWh		17%	5%	A scarcity scalar is required to control the scale of payments. This is not implementable in the timeline for the interim arrangements.
Steady State Reactive Power (SSRP)	MVArh	21%	11%	15%	
Dynamic Reactive Response (DRR)	MWh		10%	2%	A scarcity scalar is required to control the scale of payments. This is not implementable in the timeline for the interim arrangements.

38%
Sum

Table 2: Relative importance of DS3 System Services

Source: DS3 System Services Interim Tariffs Decision Paper – 24th August 2016