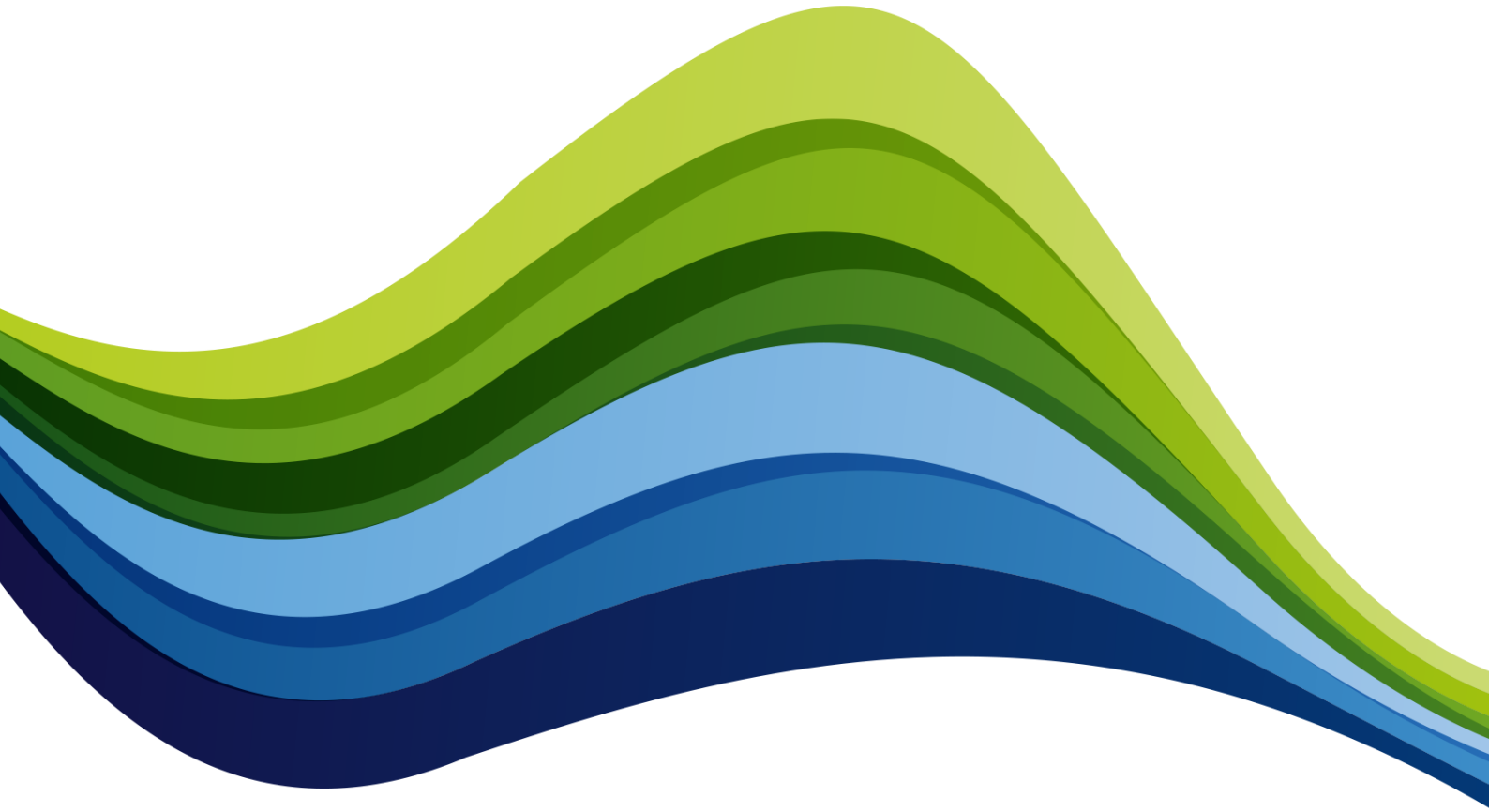
DS3

System Services Enduring Tariffs and Scalar Design

If you have any questions in relation to our response, please don't hesitate to contact Connor Powell (connor.powell@sse.com)



Response/**August 2017**

Summary

Thank you for giving SSE the opportunity to comment on the EirGrid's consultation on enduring tariffs and scalars for the system services established under the DS3 programme.

EirGrid has made a great deal of progress towards introducing a design that gives clear signals to service providers in real-time and investors over the medium term. We believe that the arrangements for enduring regulated tariff arrangements proposed are more practical, implementable and desirable than a number of the previous design papers on market mechanisms issued by the SEM Committee.

However, we would note that the 2017 to 2018 procurement process has been less than ideal for providers of both the 11 existing services and the 3 further services. The mechanism chosen to procure these hasn't been able to offer the flexibility to adjust or reallocate volumes in the event that units are enhanced or new units are commissioned.

In addition, the limited (and piecemeal) increase in the proposed tariffs over the interim period has not reassured potential service providers that they have a stable platform for investment. We hope that the parameters chosen can lock in the trajectory for expenditure and give investors reasonable comfort that enhancements and investments will be rewarded.

In addition to these general comments, we have provided some comments on both the DS3 Enduring Tariff and DS3 Enduring Scalar papers in areas where we can add value – we have not provided comments on the scalars not proposed for introduction.

Tariffs

Have you any comments on the proposed tariff rates for the Enduring Regulated Tariff arrangements?

We are comfortable with the retention of the proposed rates, assuming that all of the product scalars are fully applied and fully functioning.

Have you any comments on the TSOs' recommendation that the regulated arrangements be put in place for a minimum defined time duration until such a time as there is greater information available on the timeline for implementing a long-term market mechanism for System Services?

We think that a longer minimum defined time duration would be very helpful – the long-term market mechanisms for System Services defined to date have not been practical or investable. Putting in place a commitment to the panel framework for a defined period in line with a regulatory price control (i.e. 8 years in line with RIIO) could facilitate enhancement and projects with shorter lead-times being brought forward.

With respect to contract certainty, are there other considerations which we should take account of or other options that we should explore further?

The paper states that:

"Based on experience in other jurisdictions and the lower investment certainty in these arrangements relative to those elsewhere, the TSOs are minded to recommend a minimum of six year contract certainty for these products."

We'd agree – six year contact certainty is in line with other markets. 10 year contracts are available under the I-SEM capacity mechanism which would need to underpin most investment decisions anyway.

However, it should be noted that some older plant that is investing to enhance service provision may not want to be tied to a contract of this length of various reasons:

1. Plant revenues are linked to 1 year capacity contracts – early retirement may be required
2. Contracts may prevent plant configurations from being changed during the contract
3. Older plant performance may degrade

There should be an option to contract for a shorter period of time or change/terminate your contract at set intervals, freeing up volumes for other service providers. This could allow new better performing plant to replace retiring plant sooner and improve overall system performance.

Have you any comments on the TSOs recommendation to replace an annual tariff review with a conditional tariff review, or are there alternative approaches that you think are better?

We'd agree – the conditions need to be clearly defined and understood by the TSO, RAs and service providers at the outset. A process where investors have to wait till a defined annual tariff review point (with no corresponding guarantee) is not going to fix price uncertainty.

Are there other considerations on the conditions under which a conditional review would be triggered?

No – but these should be clearly defined to avoid unnecessary intervention.

Have you any comments on the proposal to exclude a high annual wind capacity factor as a consideration for triggering a conditional tariff review?

We agree with the TSO proposal – service volumes should track service requirements – high wind imposes high system service requirements.

Have you any comments on the TSOs recommendation to use the 'Stepped' scarcity scalar design rather than the 'Linear' scarcity scalar design

Should we decide to use a 'Stepped' scarcity scalar, are there other considerations which we should consider in its design?

We would favour a linear scarcity scalar but if a 'stepped' approach is favoured, we would suggest that the SNSP 'watermark' is brought down slightly to 50% in proportion with the scalars to provide a less volatile stream of service payment revenues.

Do you agree with the TSOs recommendation on the method by which to mitigate over-expenditure as a result of potential overinvestment by high availability technologies?

Have you any comments on a preferred method to implement a procurement-based volume limit on the level of high availability technologies to obtain system service contracts?

We agree with EirGrid's approach.

Do you agree with the TSOs recommendation to delay the implementation of taking the higher of a service providers market position or physical dispatch, to determine the available volume of a service, for a minimum of 12 months post I-SEM go-live?

Do you have any comments on the method by which a resettlement between market and physical dispatch could occur following the 12 month delay?

We would agree with EirGrid's approach, albeit with a materiality threshold applied to ensure that the resettlement exercise does not impose a substantial administrative burden on service providers.

Scalars

Do you agree with our proposal to include in the performance assessment methodology to determine the value of the Performance Scalar an additional measure to incentivise a unit to supply to the TSOs an accurate forecast of its availability to provide Reserve and Ramping Margin Services? If not, please specify why or identify what element of the proposal you believe requires amendment?

This proposal is not practical for both conventional and other BMUs:

- The TSO already has a central view of service capability provided by Physical Notifications and VTOD data for all conventional units that will be more accurate than individual notifications from service providers
- Variable units have been defined as controllable but not dispatchable by the TSO and SEMO. They will not be providing Physical Notifications because they cannot provide Balancing Market Offers. They will also not be providing individual traded positions outside of the Day Ahead auction.
- Service capability for these units will be entirely dependent on central TSO forecasts for things like constraints and curtailments which will free up reserve provision – it is difficult to see how any of these providers would know what
- Producing an accurate service availability forecast would require investment in IT system development and ongoing operational resource[1] that would not be justified by the scalar itself.

We would urge the TSO to remove these proposals – it is difficult to see how the provision of *'certainty of service availability'* could be justified by service providers as a reasonable cost – the data received by the TSO is therefore likely to be manually produced, error prone and contradict clearer data sources such as physical notifications.

Do you agree with our proposal to implement a Product Scalar for the Faster Response of FFR? If not, please specify why or identify what element of the scalar design you believe requires amendment?

We support this proposal.

Do you agree with our proposal to implement a Product Scalar for the Enhanced Delivery of FFR, POR, SOR and TOR1? If not, please specify why or identify what element of the scalar design you believe requires amendment?

[1] Particularly in the case of variable units, which are centrally controlled – managing a portfolio of availability forecasts.

We would support this proposal.

Do you agree with our proposal to implement a Product Scalar for the Continuous Provision of Reserve from FFR to TOR1? If not, please specify why or identify what element of the scalar design you believe requires amendment?

We would support this proposal.

Do you agree with our proposal to implement a Product Scalar for Enhanced Delivery of SSRP with an AVR? If not, please specify why or identify what element of the scalar design you believe requires amendment?

We support this proposal and we would welcome continuity from the Interim Arrangements to Regulated Arrangements.

Do you agree with our proposal to implement a Product Scalar for SSRP with Watt-less VArs? If not, please specify why or identify what element of the scalar design you believe requires amendment?

SSE welcome that EirGrid's recognition that Watt-less VArs provide a valuable system service and needs to be incentivised by a product scalar. However, there is insufficient support in this scalar to allow convertor technology (wind, solar, battery technology etc) to contract for this service.

There are inherent energy losses associated with using convertors for Watt-less VArs and these costs are still multiples of the current revenue streams from this product scalar. Eirgrid have acknowledged in this consultation that there is an energy cost but are unwilling to compensate for this through DS3 System Service contracts. Unfortunately these technologies have no other mechanism for recouping the energy cost – as non-dispatchable BM units, they cannot reflect these costs in other markets.

Do you agree with our proposal to implement a Temporal Scarcity Scalar for DRR and FPFAPR? If not, please specify why or identify what element of the scalar design you believe requires amendment?

While we think a temporal scarcity scalar creates the correct signal, we do not think the proposed binary scalar step at 70% SNSP is appropriate. We would suggest that FPFAPR and DRR scalars are introduced at a linear rate from 50% to 70% SNSP. Uncertainty around revenues will be too high for service providers to justify expenditure on provision.

Do you agree with our proposal to implement a Temporal Scarcity Scalar for FFR? If not, please specify why or identify what element of the scalar design you believe requires amendment?

In line with our previous comments, while the EirGrid proposals create a strong signal, we do not think the proposed scalar steps at 60% and 70% SNSP are appropriate. We would suggest that FFR scalars are introduced at steps from 50% to 70% SNSP and that the scalar is lifted to 1.0 from a much earlier point. Fast Frequency Response will improve the performance of the overall system at these levels, even if the absolute requirement isn't as great.

Without this modification, uncertainty around revenues will be too high for service providers to justify expenditure on provision – the bulk of their revenue will be linked to wind load factors and interconnector flows. The resulting volatility for service revenues will not underpin investment in new provision.

Do you agree with our proposal to implement a Temporal Scarcity Scalar for 11 Existing System Services? If not, please specify why or identify what element of the scalar design you believe requires amendment?

In line with our previous comments, the EirGrid proposals create too strong a signal. They are sacrificing long-term investability and practicality for sharp real-time signals. We would suggest that scalars are introduced at steps from 50% to 70% SNSP. Without this modification, uncertainty around revenues will be too high for service providers to justify expenditure on their provision.

Do you agree with our proposal to implement a Locational Scarcity Scalar for All System Services? If not, please specify why or identify what element of the scalar design you believe requires amendment?

The locational scalar and its allocation must be clearly defined in advance of its application through consultation. We do not believe that the locational scalar should be an important factor in revenue distribution given that system services contracts will always be a marginal revenue stream for a typical unit.

The heavy lifting for locational investment signals should come from other market segments unless there is a very specific service requirement. In that case, a bilateral contract may be more appropriate than a scalar.

As an alternative proposal, we would suggest that Locational Scarcity Scalars are applied only to the relevant services – i.e. voltage services.