127 Baggot Street Lower,
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Ireland.

DATE: 21st of August 2017
RE: DS3 System Services Enduring Tariffs and Scalar Design Consultation
TO: DS3@eirgrid.com and DS3@soni.ltd.uk.

Dear sir/madam,

On behalf of our dedicated working group on I-SEM, EAI welcomes the opportunity to respond to this consultation on the proposed DS3 ancillary services regime which is due to replace the current Interim DS3 regime from I-SEM go live on 23rd May 2017. Our concerns, outlined in further detail below, relate primarily to (1) Process/Timelines and (2) Incentives/Investment Signals.

(1) Process and Timelines:

In March 2017, the SEM Committee published an Information Paper (SEM-17-017) setting out how the implementation of the DS3 System Services programme would be progressed through 2017 and beyond. As part of its determination the committee decided that the Interim Arrangements would be extended from September'17 to April'18.

This decision was taken without consultation with the providers who are contracted under these arrangements and as a result the service providers were left with no option to challenge this decision other than to withdraw from the interim contracts. However, for many others withdrawal was not an option due to, for example, the obligation to comply with Grid Code requirements resulting in acceptance of the extension of the interim DS3 contract This is not considered conducive to creating an environment where new and existing providers are likely to invest to increase the level of DS3 service provision that the TSOs have previously stated is required.

Following on from SEM-17-017 the TSOs issued a consultation on the 2nd of May 2017 concerning the tariff rates to be applied during the interim roll-over period (Oct'17 – April'18) where an increase of 5.3% on the prevailing tariff rates was proposed. The justification for this level of increase was to align total payment levels, based on experience to date under the interim arrangements, with those initially anticipated. EAI notes the lack of reference to indexation or to the DS3 expenditure glide path to 2020 as set out by SEMC in the TSO proposal. Whilst the concerns raised by respondents, such as the interaction of DS3 with other markets and the impact of the performance scalar were noted by the TSOs, they remained unresolved in the TSO recommendations which were ultimately adopted by the SEMC. The EAI believes that the failure to address these concerns demonstrates an insufficient engagement with the industry to determine the framework for an income stream which is necessary to not only encourage investment in much needed flexibility given the new energy market arrangements and increase in renewables, and also to retain existing service provision.

The Enduring DS3 Tariff and Scalar consultations published in July'17 proposed to introduce a range of measures, the most impactful of which is to introduce a scarcity scalar to dynamically link the level of payment for DS3 system services to the System Non-Synchronous Penetration (SNSP) level on the system. The scarcity scalar is intended to substantially account for the increase in DS3 expenditure over the period to 2020. This, along with the other proposed scalars, represents a significant development in the nature of the system services market and comes at a critical and challenging time when market participants are preparing for participation in the ISEM market and in particular the first CRM RO auction process. While EAI welcomes a move towards increasing the DS3 expenditure towards 2020 if investments are to be made, given the time that will be required to complete the consultation and decision process the introduction of such a significant development will challenge market participants' already strained ability to participate effectively in the CRM RO auction and prepare for ISEM go-live.

In addition, when the TSOs issued their consultation on the rollover tariff it was considered that these tariffs would apply for a period of seven months. However, in the Enduring Tariff consultation it is now proposed that these rates will apply as base rate for the period to at least the end of 2019. This represents a significant change to the value reflected in the original 2nd May 2017 consultation and again undermines the investment case for much needed flexibility.

On the basis of the above synopsis of the process to date, while EAI supports the ambition to incentivise greater investment in the provision of the required DS3 services by rewarding potential providers for the value that they deliver, the persistent change to the DS3 framework continues to prove a challenge to market participants. The consequent uncertainty unnecessarily adds to workload and undermines the value of the revenue stream under DS3 for investment cases. EAI thus requests earlier and ongoing engagement with industry in advance of consultations being issued, thus affording sufficient time to those affected to provide opinion, thereby improving the quality of the consultation process and progressively improving the level of confidence market participants can have in the DS3 revenue stream.

(2) Incentives and Investment Signals:

The DS3 consultation papers issued by the TSOs on 4th July 2017 outline an ancillary services payment regime whereby it is proposed that the base Tariff Rates will remain unchanged between 2017 and 2020, but additional payments will be made for DS3 services at times of high SNSP through the application of multipliers ("Scalars") to the base tariff rates at these times. In the consultation papers the TSOs advocate longer term contracts (up to 4 or even 6 years) for DS3 services, and the TSOs argue that this along with the fixed unchanging base Tariff Rates, will provide the appropriate certainty of DS3 payments to potential DS3 service providers.

The EAI disagrees with the TSOs' apparent assumption that this certainty will provide the appropriate incentives for participants to make investments in order to provide DS3 services. The EAI strongly believes that the proposed DS3 regime does not provide sufficient DS3 revenue certainty to participants, and thus will not provide the appropriate incentives to encourage investment in DS3 services. The EAI have formed this view due to a number of reasons, including:

(1) it is extremely difficult to accurately forecast on a consistent basis when, and to what extent, wind will blow at the various wind generation locations on the island of Ireland (and indeed anywhere). Furthermore, participants do not know when, or how much, additional non-synchronous generation will definitively connect to the All-Island system or indeed how the Interconnectors will impact the SNSP level, e.g. if Euphemia should increase energy costs on the island of Ireland and the Interconnectors are then importing thus increasing SNSP considerably. Given these realities, it is extremely difficult to accurately forecast when SNSP in I-SEM will exceed 60% (or 70%), and thus extremely difficult to accurately forecast when, and how often, the TSO will apply DS3 Scalars as proposed in this consultation. As a result market participants face a difficult task in forecasting or budgeting DS3 revenues to the required degree of accuracy to give comfort surrounding potential investment cases.

(2) the proposed DS3 regime reflects a marked departure from how many market participants had expected the I-SEM DS3 market to operate, with many expecting it to operate on the basis of regulated tariffs which increased over time along the SEMC proposed glide path. Such a material change as now proposed, along with the nature of other decisions made on how various aspects of I-SEM may operate, raises real concerns for current and potential market participants to consider regulatory uncertainty as a real risk to potential revenues and investments. Specifically participants may question the revenue certainty related to any four to six year DS3 services contract with the TSO, where it is unclear if the contract term, the regulated tariff rates, or the type and value of the scalars, which might be assumed by participants to be fixed for the contract term, but may in fact be subject to change over the lifetime of any contract depending on what issues arise in the I-SEM market once it is live.

(3) the achievement of high SNSP values up to 75% is highly dependent on the achievement of RoCoF (Rate of Change of Frequency) values in excess of the current 0.5 Hz/s, which is expected to increase on a phased basis firstly to 0.65 Hz/s, then 0.80 Hz/s and finally 1.00 Hz/s by 2019/20[1]. No reference to this dependency has been clearly outlined in these DS3 consultation documents, and no update has been provided as to what progress has, or has not, been made to achieve a higher RoCoF given the initial 36-month timeframe initially referenced for this work. Given the lack of an update on the progress towards achieving higher levels of RoCoF, participants may view there to be a real risk that the required levels of RoCoF will not be achieved, resulting in the levels of SNSP outlined in the consultation papers not being attained and Scalars not being applied in

[1] Section 6.1.3 (Page 61) of the Consultation on DS3 System Services Enduring Tariffs

line with TSO forecasts[2]. Such uncertainty will not incentivise investments. Going forward the EAI requests that more regular updates on the progress of RoCoF is provided to industry.

(4) The TSOs state in the consultation that if unforeseen circumstances arise which challenge their perceived understanding of the operation of the system under I-SEM, they may operate the system at levels of SNSP below 60% for periods[3]. Such a move would result in Scalars not being applied in periods where they had been expected, thereby potentially dramatically reducing the value of DS3 revenues being paid to participants. Such a risk further undermines incentives and the degree of confidence in DS3 investment decisions. It is worth noting that the SNSP levels in SEM have been increased to 55% in March 2016 and 60% in March 2017 without consultation with industry and recognition of the extra value of current ancillary services due to such higher SNSP levels through the application of any scalars or otherwise. At a minimum, we believe the TSOs need to be transparent with regards to the conditions the system needs to experience in order to apply such a restriction to the SNSP level.

(5) The SEM Committee has decided (SEM-14-108) that DS3 payments should be made on the basis of the higher volumes arising from a unit's Market Position and their Physical Dispatch. The TSOs propose to delay the implementation of this decision by 12 months[4] due to their view of the risk of over-expenditure as a result of forecast error relating to this. However, the TSOs also suggest deducting €15m from the total potential DS3 payment of €235m to deal with this issue[5]. The seemingly arbitrary proposed delay and deduction undermine potential forecasts of DS3 revenues by participants as other such delays or deductions may occur unexpectedly in the future. We strongly urge implementation of this SEMC decision on day 1 of I-SEM, assuming the higher revenue is what the participant receives.

(6) The TSOs suggest in the consultation papers that in the longer term there may be merit to exploring whether the provision of two DS3 services, namely FPFAPR and DRR, should become grid code requirements[6]. Such a possibility would undermine the incentive to invest in the provision of such services given the impact this might have on expected revenues from the provision of such services. It also creates the concern that such a consideration may be given to making the provision of other DS3 services also grid code requirements, with resultant revenue uncertainty. This concern is enhanced given the example that today FFR is being utilised by the

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[2] Table 6 (page 34) Percentage of time at high SNSP levels - Consultation on DS3 System Services Enduring Tariffs.

[3] Section 4.3 (page 41) Consultation on DS3 System Services Enduring Tariffs.

[4] Section 4.4.2 (page 47) Consultation on DS3 System Services Enduring Tariffs

[5] Section 2.4 Consultation on DS3 System Services Enduring Tariffs

[6] Section 2.4 (page 21) Consultation on DS3 System Services Enduring Tariffs

TSOs, but not actually being paid for. Market participants need to be remunerated for provision of services critical for reaching 75% SNSP and meeting 2020 national requirements.

Conclusion:

It is hoped the detail that has been provided gives sufficient detail to the RAs to enable them to appreciate the concerns EAI members feel in relation to the DS3 process and timelines to date, and in relation to the lack of revenue certainty that the current proposed DS3 regime provides to existing and potential investors. The EAI would like to suggest that modifications to the TSOs' proposed regime could go a long way to providing greater certainty that the required DS3 investment will occur. These modifications are summarised as the following:

1. Provide industry with a clear increasing trajectory for the DS3 base tariff rates to 2020 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;
2. Provide more frequent updates on RoCoF progress as a way of providing industry with greater certainty that DS3 is developing;
3. Provide a coherent list of circumstances under which the TSOs can restrict the level of SNSP; and
4. Maintain the RAs' decision to pay a market participant based on the higher of their Market Position and Physical Dispatch.

We are available to discuss this submission and look forward to a response and further discussion of the concerns raised herein.

Yours sincerely,

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Electricity Association of Ireland.