

DS3 System Services Consultation – Interim Tariffs

This questionnaire has been prepared to facilitate responses to the consultation. Respondents are not restricted to this template and can provide supplementary material if desired.

Please send responses in electronic format to DS3@eirgrid.com or DS3@soni.ltd.uk

Respondent Name	<i>William Carr</i>
Contact telephone number	<i>1702 9423</i>
Respondent Company	<i>ESB</i>

Note: It is the TSOs' intention to publish all responses. If your response is confidential, please indicate this by marking the following box with an "x". Please note that, in any event, all responses will be shared with the Regulatory Authorities.

Response ☐ confidential

The closing date for responses is Friday, 20 May 2016.

General Comments

ESB Generation and Wholesale Markets (GWM) welcomes the opportunity to submit a response to the Consultation Paper on the DS3 System Services Interim Tariffs. We have provided answers to each question in the template provided, and summarise our key issues below:

Key Issues

- The tariffs for SOR, TOR1, RRS and Reactive Power have been reduced significantly compared to the HAS rates and will impact on the revenues of all service providers. This should be explained and justified before making such material changes.
- If these tariffs were implemented, we estimate that the overall payments for the existing services will reduce by €8.7m (18%) compared to 2014/15, before taking account of inflation. This is not consistent with the stated principle that *“The total payments for the existing seven HAS services should at least be the same as in the HAS arrangements”*, and is therefore not acceptable.
- We agree there is merit in adjusting tariffs for existing services to better reflect relative service value, but our preference would be to retain current HAS rates rather than adopt the proposed tariffs and see revenues reduced as a result.
- Although contacted volumes may increase through the current procurement process, the real-time service volumes (on which payments will be based) are not expected to materially change under the existing market arrangements in 2016/17. Actual service volumes over the previous 12 months should therefore be used as a forecast for real-time service volumes in 2016/17 rather than those derived from a model.
- The proposed interim tariffs for the new services are significantly below the value they deliver and are unlikely to be investable. Even if the enduring tariffs are increased from these levels to better reflect value, this would be a year lost in attracting new investment. In our view, the tariffs for these services should be based on the value they deliver in 2020 to help attract the investment needed in these services. Over time, competition in the provision of these services should deliver value back to consumers by driving down these costs.
- In the spirit of revenue neutrality, tariffs should be adjusted to take account of the effect of the Performance Scalars. Tariffs should be adjusted upwards where the industry average Performance Scalar is forecast < 1 . Without increasing overall costs, this approach will reward those providers with performance above the industry average, and penalise those below, thus creating

a balanced incentive for all participants to improve their reliability over time. Additionally the resulting tariffs should be indexed to reflect inflation as per the process that has been applied in previous years to the HAS rates.

<i>Question</i>	<i>Response</i>
Consultation on Interim Tariffs	
<p><u>Question 1</u>: Should we take any other factors into account when determining the relative importance of each service during the interim period?</p>	<p>The tariffs for DS3 System Services should ultimately reflect the relative value of each service in allowing the TSOs to operate a secure, economic and efficient transmission system, and in allowing consumers to access a greater proportion of their electricity needs from renewable sources.</p> <p><u>Existing Services</u></p> <p>We agree that there is merit in adjusting the existing tariffs to better reflect the relative value these services and to provide a transition towards value based regulated tariffs under the enduring regime. However, as the proposed tariffs would result in a significant reduction in the revenue for existing service providers we propose that the current HAS rates be retained as the basis for the tariffs for the final year of SEM.</p> <p>Also, we feel that the absolute value of the services is highly relevant and the incremental analysis does not give this view sufficient recognition. The current products provide significant quality services and as enhanced products are needed</p>

	<p>the absolute costs will increase, but the value of existing products should not be lessened given that these remain essential for system security.</p> <p><u>New Services</u></p> <p>We recognise that as the level of non-synchronous generation increases, so the relative value of system services needed to support a higher SNSP will change. This should provide greater emphasis on the faster response services to deal with incidents when system inertia is low, whilst continuing to recognise the value of the existing services.</p> <p>It therefore seems counterintuitive that the relative value of SIR reduces so dramatically (6% to 2% from 2016 to 2020 – a 66% reduction) as inertia becomes increasingly scarce and necessary to maintain system integrity. Investors will be reluctant to invest in a service where the TSOs suggest the relative value of this service will reduce by two thirds even though the need for inertia is growing.</p> <p>Also, the relative value of FFR, FPFAPR, DRR are shown to increase significantly by 2020. The interim tariffs for these new services may be better set to reflect that future value now, thus stimulating investment in these important new services, albeit for a limited volume of service providers selected for the technology trials.</p>
<p><u>Question 2:</u> Have you any comments on the methodology used to calculate the rates?</p>	<p><u>Issues with the Proposed Methodology</u></p> <p>The intention of the proposed methodology is to set tariffs based on the relative</p>

value of each service and to maintain current payments associated with the existing services. The first key principle of the methodology states that *“The total payments for the existing seven HAS services should at least be the same as in the HAS arrangements”*.

However, the proposed interim tariffs do not appear to be consistent with this methodology. Our analysis suggests an 18% reduction in payments for existing services when using these tariffs, before taking account of further reductions due to the introduction of Performance Scalars. Rather than these being cost neutral, the interim arrangements appear to be a cost reduction exercise, which is not acceptable.

The reduction in payments is a direct result of the significant tariff reductions for SOR, TOR1, RRS and in translating Reactive Power rates to SSRP rates.

Service	HAS Rates	DS3 Rates	Change
POR	2.34	2.47	+5.6%
SOR	2.24	1.37	-38.8%
TOR1	1.87	1.19	-36.4%
TOR2	0.93	0.99	+6.5%
RRS	0.20	0.13	-35.0%
RRD	0.54	0.64	+18.5%
Reactive Power Lagging	0.13	0.20 ¹	-23.1%
Reactive Power Leading	0.13		

¹ Based on a notional RP Factor of 0.5

The tariff reductions for these services are significant, but are neither explained or justified in the consultation. Much more explanation and transparency is needed if such drastic reductions are to be applied.

Analysis of Payment Reductions for Existing Services

If the 2014/15 HAS payment rates are applied to the ancillary services payments for 2014/15 published by the TSOs we can derive an implied volume for each service. This calculation is set out in the table below:

HAS Service	2014/15 HAS		
	Reported Payments (€)	Published Tariffs (€/Unit)	2014/15 Implied Service Volume
POR	5,997,822	2.34	2,563,172
SOR	8,961,140	2.24	4,000,509
TOR1	8,941,887	1.87	4,781,758
TOR2	5,373,694	0.93	5,778,166
RRS*	2,656,983	0.2	13,284,915
RRD*	5,313,966	0.54	9,840,678
Reactive Power Lagging	7,230,863	0.13	55,622,023
Reactive Power Leading	4,153,649	0.13	31,951,146
Total	48,630,004		

*RRS/RRD payments assumed split 1/3 RRS, 2/3 RRD

It has been proposed that the basis for payment is not changing for the reserve services in the interim period therefore actual service volumes for 2014/15 should provide a reasonable estimate of the volumes of service that which will be required in 2016/17. Even if additional volumes sign up via the current procurement process, these are likely to be small and will not impact on these real-time service volumes dispatched by the TSOs which form the basis for payment.

SSRP will be different, but assuming an RP factor (the proportion of the MW range over which the contracted MVar range can be provided) of 0.5, as Minimum

Generation levels for a CCGT is typically half the MW capacity. This translates to an SSRP volume requirement for 2016/17 of 43,786,585MVarh.

DS3 Service	2016/17 Service Volume	DS3 Rates (€/Unit)	Cost (€)	Difference (€) compared to HAS Rates	Difference (%) compared to HAS Rates
POR	2,563,172	2.47	6,331,034	333,212	5.6%
SOR	4,000,509	1.37	5,480,697	-3,480,443	-38.8%
TOR1	4,781,758	1.19	5,690,292	-3,251,595	-36.4%
TOR2	5,778,166	0.99	5,720,384	346,690	6.5%
RRS	13,284,915	0.13	1,727,039	-929,944	0.7%
RRD	9,840,678	0.64	6,298,034	984,068	
SSRP	43,786,585	0.2	8,757,317	-2,627,195	-36.3%
Total			40,004,797	-8,625,207	-17.7%

The table above uses the implied 2014/15 service volumes as an estimate for the real-time volumes required in 2016/17, and applies the proposed DS3 interim tariffs to derive a cost for each service. This cost is compared to the actual costs incurred in 2014/15.

Payments for SOR, TOR, and SSRP reduce significantly, giving a €8.6m (17.7% reduction in overall expenditure, even before taking account of inflation. This is not consistent with the principle that *“The total payments for the existing seven HAS services should at least be the same as in the HAS arrangements”* and is therefore

not acceptable.

Volume Forecasts for 2016/17

We suspect that the shortfall is a result of using higher forecast volumes from the modelling. Section 3.2 of the consultation suggests that the modelled volumes for 2015/16 would be verified against the 2015/16 budget for these services – we suggest these should be validated against actual volumes used over the past 12 months, rather than a budget that itself is likely to have been based on a model.

Ideally, using actual 2015/16 service volumes would provide a more accurate proxy than 2014/15, but we are only half way through the service year. However when comparing the published payments in the first 5 months of 2015/16 to those for the same period in 2014/15 as shown in the table below, these are very stable for all but reactive power.

HAS Service	HAS Payments (€)		
	Oct 2014 – Feb 2015	Oct 2014 – Feb 2015	Change (%)
POR	2,601,555	2,632,460	+1.2%
SOR	3,873,929	3,917,376	+1.1%
TOR1	3,854,372	3,812,585	-1.1%
TOR2	2,323,256	2,262,289	-2.6%
RR	3,324,576	3,318,045	-0.2%
Reactive Power Lagging	3,072,604	3,539,660	+15.2%
Reactive Power Leading	1,752,136	2,024,156	+15.5%

With inflation applied to the rates, the volumes of POR and SOR used do not appear to have materially changed between 2014/15 and 2015/16, while the volumes of TOR and Replacement Reserves have fallen slightly. Whilst there was an increased requirement for reactive power, this may be due to a temporary voltage constraint. Tariffs should not be reduced because of an increased requirement for this service. We therefore conclude that it is reasonable to use the implied 2014/15 service volumes as indicative volumes for 2016/17.

New Services

In the table below we compare the proposed interim tariffs for the new DS3 System Services with the value based tariffs published back in 2014 (based on the total benefit of €355m per year by 2020 from the procurement of DS3 System Services). We see these interim tariffs as indicative of the enduring tariffs for the new services, given that there is no lost inframarginal rent associated with providing these services under I-SEM to factor in. This does not instil confidence in the investability of these new services – they neither reflect the value of the services provided nor the additional risks associated with service commitment and the Performance Scalars.

New DS3 Service	Value* based price (€/Unit)	Interim DS3 tariff (€/Unit)	Difference
SIR	0.0018	0.004	+117.94%
FFR	17.4976	1.96	-88.80%
RM1	0.4912	0.08	-83.71%
RM3	1.0115	0.13	-87.15%
RM8	0.6186	0.1	-83.83%
FRFAPR	1.3990	0.13	-90.71%
DRR	0.6913	0.03	-95.66%

The SIR price is higher than the original value based estimate. We welcome this as recognition that the original tariff was not sufficient to justify investment in reducing

MinGen to provide additional SIR. However, if investments can be justified against this revised price, the reduction in the relative value of SIR from 6% to 2% by 2020 as shown in Table 3 of the consultation will create uncertainty for potential investors in this service.

For the other 'new services', tariffs are significantly below the value they deliver and are unlikely to attract the investment needed in these services. Even if the enduring tariffs are increased from these levels to better reflect value, this would be a year lost in attracting new investment.

In our view, the tariffs for these services should be based on the original value based tariffs shown in the table above. This will help attract the necessary investment in these services. Over time, competition in the provision of these services should deliver value back to consumers by driving down these costs. Overall costs for FFR, FPFAPR and DRR will be managed in the interim period by limiting service volumes to a small number of trials,

Impact of Performance Scalars

The proposals to set a performance scalar based on a reliability target of 90% will reduce payments if the industry average performance is below this level. In the spirit of maintaining payments for existing services to at least current levels, the proposed tariffs should be adjusted to take account of this effect.

For example, if the industry average reliability of a service is 80%, and the

	<p>performance target is set to 90%, the Performance Scalar will be 0.75. The associated tariff should therefore be adjusted upwards by $1/0.75 = 1.33$ to maintain revenue neutrality. Otherwise the introduction of Performance Scalars would simply be another cost reduction exercise. This approach will reward those with performance above the industry average, and penalise those below, creating the incentive to improve reliability over time.</p> <p><u>Exchange Rate Methodology</u></p> <p>We agree with the proposed exchange rate methodology – i.e. to use the same methodology as used under the HAS arrangements.</p>
<p><u>Question 3</u>: Are there any other benefits from the interim arrangements that should be considered?</p>	<p>The benefits from the interim arrangements should be:</p> <ul style="list-style-type: none"> • To implement the 14 DS3 System Services • To stimulate investment in the new services critical to delivering renewable targets under I-SEM and reducing the level of wind curtailment below 5% • To create opportunities for new service providers to offer these services • To develop a performance monitoring regime for the new services • To create incentives to improve the performance of existing services <p>The actual benefits realised from the interim arrangements will be limited if the interim tariffs put in place are too low, increasing the risk that targets for the DS3 programme will be missed as a result.</p>

<p><u>Question 4:</u> Have we set out the relevant impacts on service providers over this interim period?</p>	<p>The reduction in income for the provision of existing services has neither been justified nor highlighted in the consultation. If tariffs for SOR, TOR, RRS and SSRP are to be reduced significantly relative to current levels, the impact on service providers should be highlighted.</p> <p>Also, the DS3 System Services programme has so far attracted a great deal of interest in the provision of these services. The tariffs published will have a bearing on the sentiment of these potential investors, and this impact should be explored. Is there a risk that interest will wain with investors turning away from I-SEM to more attractive markets for the provision of system services?</p>
---	--