

Single Electricity Market

DS3 System Services Third Consultation

SEM Committee Cover Note

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Introduction

The TSOs formally commenced the “Delivering a Secure Sustainable System” (DS3) Project in September 2011, following review by the Regulatory Authorities (RAs) of the Transmission System Operators (TSOs) Report on Ensuring a Secure, Reliable and Efficient Power System in July 2011. This followed a request by the SEM Committee for the TSOs to put in place a programme of work to solve the challenges which would occur with operating the electricity system in a secure manner as levels of wind penetration increase

One of the key workstreams in the DS3 programme is the Review of System Services (previously referred to as Ancillary Services). The aim of the system services review is to put in place the correct structure, level and type of service in order to ensure that the system can operate securely with higher levels of wind penetration. The review also includes the appropriate valuation and costing of these services. The TSOs have statutory responsibilities in Ireland and Northern Ireland to procure the required services necessary to support the secure operation of the system. The SEM Committee at present approves the rates and overall all-island “pot” for harmonised ancillary services as the cost is included in transmission charges. Therefore it is important that all charges which are passed onto the customer are justifiable and deliver value for money for the all island customer.

Two TSO consultation papers have now been published on the System Services Review. The first was published in late 2012 and was a “fact-finding” consultation accompanied by a questionnaire¹. The TSOs also published a report carried out by KEMA into system services in a selection of international markets. A series of bi-lateral meetings with interested stakeholders was held while the TSOs also hosted an industry forum.

The second consultation (June 2012) proposed a number of new system services which the TSOs had proposed are required in order to continue to ensure the safe and secure operation of the system as levels of instantaneous penetration of wind increase². This consultation focused primarily on the design and technical aspects of these new services, identifying operational challenges and an enhanced focus on reliability. The second consultation paper was published in June 2012 and was accompanied by a SEM Committee cover note which highlighted the key issues which the SEM Committee believed (at that time) needed to be resolved throughout the course of the review. An Industry forum was held in July 2012. 26 responses were received; most of the responses were from Generators or Generator affiliations. The remainder were from demand affiliations and academia. EirGrid and SONI also held a DS3 Industry Forum on the 5th of November 2012 in the Alexander Hotel, Dublin. The forum provided a general update on the programme and an update on progress in the System Services and Grid Code workstreams.

¹ <http://www.eirgrid.com/media/System%20Services%20Review%20Preliminary%20Consultation%20Paper.pdf>

² http://www.eirgrid.com/media/System_Services_Consultation_Products.pdf

The TSOs have now produced a third consultation paper; this paper looks at valuing the required System Services, financial modelling and analysis, revenue allocation, possible approaches to service remuneration, contractual arrangements and the TSOs proposed final product designs. The SEM Committee has sanctioned the TSOs to carry out this third consultation but has not itself, at this point, taken a view on the issues outlined in the TSO's consultation paper.

The TSOs third consultation paper seeks views on a proposed methodology for determining the cumulative benefit of the required new system services to the electricity industry on the island of Ireland. It provides an indication of capital costs which may be incurred to provide these new services. The TSOs have also published an independent report from KEMA on the likely costs of providing the new system services which the TSOs require.

Views are also sought on four methods, identified by the TSOs in their consultation paper, by which the proposed System Services revenue might be allocated between each of the proposed system services products. As well as considering the benefit/saving, it is also necessary to consider the 'cost' to Generators for providing these additional services.

An eight week consultation period is planned by the TSOs, with the TSOs offering bilateral meetings to respondents during the consultation window. Following on from this, the TSOs plan to review the responses and then prepare a suite of recommendations (a recommendations paper on System Services based on the outcome of the three consultation phases) for the SEM Committee to consider. The SEM Committee in this note outlines some of the issues which it believes full and detailed recommendations (and supporting information) from the TSOs are required prior to the SEM Committee coming to a final position on the System Services review. This consultation paper remains solely the TSOs views and proposals.

KEY TSO PROPOSALS HIGHLIGHTED

It should be noted that this paper does not address proposed levels of individual product rates for existing and new system services. It asks for respondents to respond on;

- How do you determine the benefit of provision of the necessary system services in an electricity industry context?
- What incremental costs are potentially incurred in delivering the necessary system services?
- What is the appropriate approach to determining the allocation of this benefit between consumers and revenue for System Services Providers?
- How do you determine the allocation of this revenue between various products?

The TSO consultation paper highlights a number of proposals in relation to the financial aspects of the DS3 System Services review. These proposals include the following.

- **The Benefit:** the value of system services in 2020 is made up of the calculated benefit of the new system services of €295m per annum in addition to the existing €60m for Harmonised Ancillary Services. The benefit is derived from a reduction in total SEM production costs and dispatch balancing costs as a result of facilitating high levels of wind on the system. Is this an appropriate way of determining the benefit derived from system services?;
- **The Cost:** the potential costs that may be incurred in these system services have been broken into two scenarios – the generation investment scenario which indicates incremental capital costs of €535m in total (important to note that this is not a per annum figure) and the alternative investment scenario which indicates costs of €1.212bn in total (again not a per annum figure). Is this an appropriate way of determining the costs of system service provision?;
- **Type of Payment:** dispatch-dependent payments (combined with rates fixed over a number of years), as opposed to capability or availability type payments, are recommended by the TSOs for most of the system service products. Is this an appropriate approach?;
- **Contract Structure:** the TSOs also confirm that they will be recommending Bilateral Contracts to the SEM Committee for the new services, broadly similar to the existing Harmonised Ancillary Services contracts, with payments for new System Services based on Regulatory-approved rates. Is this an appropriate approach?

The SEM Committee is eager to hear the views of SEM market participants, potential service providers and other interested parties on the approach being taken/proposed by the TSOs and other alternatives which could be considered.

TSO's RECOMMENDATIONS PAPER

The SEM Committee has requested that the TSOs will provide a suite of recommendations on the system services review as the next step following on from the conclusion of this consultation. This recommendations paper and its accompanying analysis/ supporting information should cover the following issues:

Estimated benefits of system services

Further information on the modelling to derive the estimated benefits will be required. The TSOs should provide the models to the RAs for understanding and analysis. It has been stated in the paper that network limitations and localised constraints have not been modelled in any of the scenarios; this needs to be further investigated and justified given the level of constraints on the island.

The All-island network is not a perfect network and therefore the constraints issue on the island could lead to localisation of the services which need to be modelled to determine how the services get distributed on the island. The TSOs should justify why their approach does not include the network limitations and also provide a view on the likely impact of including this in any recommendations.

High Level Costs

The TSOs have employed their own independent consultants, KEMA, to produce a costing report.

The TSOs have provided some high-level potential costs that may be incurred in these system services scenarios but further detail is required. The RAs will discuss this further with the TSOs in order to understand the models being used. All assumptions used within the modelling should be clearly defined and defensible.

To understand further the true value of these costs there is a need to provide a clear defined Cost Benefit Analysis (CBA) with a detailed methodology which will have to be carried out to determine if the costs associated with these new services will benefit the consumer. While the paper includes costs and benefits, it is suggested that in its final recommendations to the SEM Committee, that TSOs would include a separate report and analysis on a CBA of the proposed system services, which should include an analysis of the appropriate distribution of risks associated with the cost of the provision of system services. The impact of system services costs on transmission tariffs in Ireland and Northern Ireland should be included.

Valuation of each service

The consultation paper provides an indication of capital costs which may be incurred to provide these new services, but does not indicate the value of each of the new services or the level of payment which will be proposed against each service. The TSOs state in their paper that while the TSOs can propose and recommend a methodology which results in a system services valuation figure; determination of how much of this valuation should be paid to the service providers is a SEM Committee matter. The SEM Committee believes that it is appropriate that the TSOs would propose (and justify) a particular methodology and level of value for each service; the SEM Committee will make the final decision on whether the TSOs proposed methodology and its resulting value is appropriate.

Timing of Reviews

The TSOs have recommended the rates be reviewed on a 3 to 5 year basis, but as this is a relative new procedure with new products, it is thought that they should be closely monitored and reviewed for the first number of years to ensure that the consumer is getting value for money. Arguments in favour and against shorter and longer term reviews should be explored by the TSOs and included in their recommendations.

The TSO's suite of recommendations should also include the following:

- The level of each system service required between now (the commencement date) and 2020. This should take account of most recent (2013) forecasts for renewable penetration bearing in mind difficulties being experienced in financing windfarms, developing transmission infrastructure etc.;
- Performance monitoring of system service delivery;
- The approach to remuneration;
- The approach to reviewing system services.

NEXT STEPS

The SEM Committee has reviewed the TSO's third consultation on the System Services Review. The paper represents the views of the TSOs and there are areas within the project which the SEM Committee believe needs to be enhanced or finalized for the TSOs recommendation paper. These include further details around the total system services value, the approach taken for remuneration and an evaluation of the effectiveness of the costs through a Cost Benefit Analysis.

The SEM Committee continues to believe that the following areas are key issues to be covered in System Services Review;

- Types and levels of services required,
- Effect on the System Services requirement,
- Effect on the Capacity Payments Mechanism (CPM),
- Net benefit to the all-island consumer (Cost Benefit Analysis),
- Performance monitoring,
- The procurement of System services.

The closing date for responses of the consultation paper (System Services third consultation) is Friday 13th February 2013.

The views suggested in this paper are not the views of the SEM Committee in terms of implied policy decisions, After the review of responses to the System Services third consultation by both the TSOs and RAs, a recommendation paper will be prepared by the TSOs by end Q1 2013. A final SEM Committee decision on the new System Services structures, products and remuneration is expected later in 2013.