

SCOPING PAPER SYSTEM SERVICES FUTURE ARRANGEMENTS

Scoping Paper
SSE Response

INTRODUCTION

SSE welcomes the opportunity to comment on the SEM Committee's Scoping Paper for System Services Future Arrangements. For the avoidance of doubt, this is a non-confidential response.

SSE is a large generator and supplier operating circa 2,000MW of generation in the all-island. We currently provide System Services under the existing DS3 arrangements.

We have also contributed to and are supportive of the key points raised in the EAI and IWEA responses to this consultation.

SSE RESPONSE

SSE welcomes this initial scoping paper that seeks to implement the stated objective of the SEM Committee (SEMC) to transition towards a competitive market-based approach for System Services. DS3 has played an important role in moving towards the 2020 renewable targets in both Ireland and Northern Ireland. The Irish government has set out its objectives for 2030 in relation to carbon reductions and both the Ireland and the UK aim to be carbon neutral by 2050. Northern Ireland is developing its energy policy which will set out how it will contribute to the UK targets with a target of at least 70% renewables by 2030¹. System Services has and will continue to play a huge role in the delivery of these targets whilst ensuring that the TSOs can continue to maintain system security.

With the current arrangements due to come to an end in 2023 SSE is of the view that a market-based solution is not sufficiently advanced at this current stage to enable such a transition to take place in time. It is SSE's opinion that the SEMC should take the time to deliver a workable solution rather than deliver a sub-optimal solution in a rushed timeframe. Therefore, consideration will need to be given to how to transition from the existing arrangements to a competitive framework. It does not seem appropriate to extend the existing arrangements that were designed for 40% renewables to a system that could be delivering greater value to consumers in those interim years.

Considering the substantial changes to the wholesale energy market over the last number of years there may be significant further work to ensure that the new proposed market mechanism is compatible with the overall I-SEM market design. As already highlighted in the scoping paper this work needs to ensure that the SEM is capable of being compliant with the Electricity Balancing Guidelines (EBGL), or where this cannot be achieved the necessary derogations have been obtained.

Our key concerns with the proposed approach are:

- Timelines set out in scoping paper

The proposed timelines indicate that a detailed design will be developed by Q1 next year; this timeline would appear overly optimistic. Trying to condense the timelines too much increases the risk of failure to deliver a solution that works for investors and consumers alike.

The proposed timelines as set out in the scoping paper do not allow any space for a transition period between the current arrangements and the new arrangements, i.e. a gradual step change which could avoid the perceived "cliff edge" that industry has raised as a concern.

¹ <https://www.newsletter.co.uk/news/environment/my-vision-renewable-energy-sector-northern-ireland-2984852>

It would be preferable for the SEMC to set out in advance an achievable timeline and establish any necessary changes to the existing arrangements to allow a transition period to competitive arrangements, otherwise there is a risk of introducing more uncertainty to a market that is trying to deliver record levels of renewable investment in the system, potentially to the detriment of consumers.

SSE would encourage the SEMC to ensure they are realistic in developing a timeline for delivery of a detailed market design and work programme for delivery. It is worth learning from the experience of developing and delivering the high-level design of the existing DS3 arrangements as well as the I-SEM high-level design. This should illustrate challenges this project may face.

- Ability to deliver investment

SSE is of the view that the market needs clarity with respect to the investment that is needed to facilitate the high levels of renewable generation that will be needed to meet the ambitious national targets. To that end delivery of investment has been overlooked as one of the key criteria being set to assess any proposed framework.

Whilst there is a drive from EBGL to deliver a competitive framework for balancing capacity, the SEM Committee needs to consider what this means for the SEM. In order to establish the market mechanism, we first need to understand what competitive forces can flourish i.e. are there enough providers of the relevant System Services? This will require a step change in the level of transparency currently available to the market.

The TSOs should be looking to adopt best practice in relation to transparency of data and provide all relevant information to the market in a timely fashion. Take for example the procurement of FFR in GB and the data provided to the market, this provides a useful reference to what can be achieved. In order to allow market forces to innovate and invest to deliver a workable solution, the TSOs must be required to significantly increase the level of transparency around current and future needs for System Services.

SSE considers that the existing tariff regime does not provide a sufficient long-term pricing signal beyond the scope of the existing arrangements. The TSOs have recently signalled a potential overheating of the reserve market which could result in change to tariffs and/or scalars. This potential change in tariff rates introduces uncontrollable price risk onto the part of the investor, given the tariff rates can be adjusted after the investment decision has been made. Therefore, any future arrangements must be able to address a price volatility risk if there is a need for future investment.

Efficient investment works when there is a clear understanding of the risks, along with an ability to manage those risks. Therefore, it is necessary to set out a clear route to market that understands the needs of the investor as well as ensuring the consumer gets value for money.

It is our view that the design of System Services will require significantly more work to be able to ensure that a market mechanism can be delivered such that it can unlock sustainable investment.

- Purpose of the scoping paper

In relation to a competitive market there needs to be an efficient price derived that will deliver for consumers and provide the necessary market signals for existing and future service providers. SSE is not convinced that this proposed approach is yet detailed enough to consider the ability of market participants to reasonably finance their activities. A thorough review of all of the revenue streams available will be required in order to advance this appropriately.

It is SSE's opinion that a key objective should be having in place a market for System Services that will ensure that the national renewable targets for Ireland and Northern Ireland can be delivered. System Services is complementary to the energy market particularly in a market with very high levels of renewable penetration.

CONCLUSION

As set out in this response SSE considers the timelines presented in the scoping paper underestimate the challenges involved in delivering a new market and would urge the SEMC to ensure that sufficient time is given to deliver a workable and sustainable solution. It is important to get this right to ensure that Ireland and Northern Ireland can meet its policy commitments for increased renewables and decarbonisation as well as meeting any legislative requirements.

If there is a need to deliver future investment, then the framework needs to ensure that that investment can be facilitated. The success of System Services will be dependent on having a market that is clear and understandable. To do that, further work will be necessary to understand the interaction with other market timeframes, as well as the revenue streams that are necessary to ensure that investors can finance their activities. Currently, none of this is clear in this paper and notably, future investment needs do not feature in the criteria of the proposed framework.

The desire to implement a complete market should be based on clear measurable objectives. There is a requirement to increase transparency in relation to current and future needs for System Services. This will facilitate an assessment of what services can be procured competitively. The proposals to assess the framework have been set out but this does not necessarily establish what the objectives are or what success looks like.

SSE is of the view that the SEM Committee should ensure that introducing new arrangements for the procurement of System Services does not result in increasingly uncertain revenue streams. The relationship between System Services, capacity and energy markets should enable market participants to finance their activities. Intervention in each of these revenue streams separately could have unintended consequences to the detriment of any policy objectives.

System Services are integral to the design of the wholesale energy market and, as a result, SSE is concerned that this scoping paper does not sufficiently consider the potential impact on the ex-ante and capacity markets. It should also be acknowledged that the industry has experienced significant market changes recently, with the implementation of I-SEM and the existing DS3 arrangements. It is, therefore, essential to ensure that any competitive arrangements developed for System Services are compatible with those arrangements.

RESPONSES TO SPECIFIC QUESTIONS

1. Are there additional requirements in EU legislation or national policy that should be considered as key guidance for the project?

SSE considers that the EBGL goes beyond just creating a competitive framework for procurement of System Services. There is no reference made in this scoping paper to standard products or how the 14 System Services products that we have today align with those standard products. It is also important that in doing so this work aligns with the associated frameworks written in accordance with EBGL (e.g. rules of pricing), developed by all TSOs and approved by all NRAs. If there is no intent to align with these standard products, then there is considerable further work required to demonstrate that the specific products for Ireland fulfil the requirements set out in article 26 of the EBGL.

Government policy in Ireland and Northern Ireland is constantly evolving with respect to increasing renewables and decarbonisation, Taking for example the latest statement from the Minister for the Economy in Northern Ireland in respect of a minimum 70% renewable target for 2030, and the Programme for Government in Ireland. Any future System Services arrangements need to consider the ability for the all-island system to facilitate these evolving targets.

2. What should the role of DSOs be in development of the new arrangements?

It is clear from the development of DS3 that System Services cannot advance without the support and engagement of the DSOs. This is particularly relevant for the potential impact of embedded generation and its impact on system security. We would reference the gap analysis and other work being undertaken by Eurelectric in this regard.

3. Should any further assessment criteria be included in this workstream?

The focus on this paper fails to address the needs of investors. To do this there is a requirement to understand the risks faced, and identifying the party best placed to manage or absorb those risks.

The issue of market power is important but identifying the need for regulatory intervention is required as part of the design, and any such intervention should be to deal with identified market failure, as well as being capable of being relaxed where the market failure no longer exists. To set out to design a market that incorporates market power mitigation tools as part of its design risks undermining confidence in such a market, i.e. there is always an underlying assumption towards market power rather than designing a system that removes or reduces market power.

Section 2 sets this out in a little more detail and it is encouraging that the SEMC is looking at learning from the existing arrangements and are considering incentives on the demand/purchaser side, as market power must look at both the buy and sell sides of the equation. Taking all the above into consideration it may be worth considering market power mitigation tools should be develop in addition to rather than as part of the market design.

There is little information provided to show that there will be enough transparency within the market to ensure that an efficient price can be derived.

4. **Is the general approach to the Project appropriate and complete?**
5. **For which products is a market based approach appropriate? What sort of market based approach is most appropriate?**
6. **For which products is a market based approach not appropriate? Why is a market based approach not appropriate for these products? Will an alternative approach be more economically efficient? What sort of alternative approach should be considered?**

These three questions are closely related and therefore provide a single answer for all three questions. It is SSEs view that a market-based mechanism should be limited to services that can be delivered from any part of the system. Where location is an issue this is likely to hamper the ability to have a competitive market. This will require a greater understanding of the products that are utilised by the TSOs for operating the system on a daily basis.

The overall approach would be enhanced by setting out a clear understanding of what is to be achieved. The market would be better served by understanding this. When DS3 was being designed there was a requirement to carry out a cost benefit analysis to determine the value of providing the 14 System Services and delivering increased renewables on the system.

Where there is an intention to deviate from the standard products required under the EBGL there are clear article 26 sets a number of tests that would need to be fulfilled to ensure that the SEM remains compliant with that guideline. It does not appear that that work has been carried out as yet and therefore must be considered as part of this general approach.

Meeting the 2030 targets will require a revision of the benefits to be derived by consumers from increasing renewable penetration further. This will have an impact on the wholesale energy price. Therefore, careful consideration needs to be given as to how to ensure any necessary investment can occur, but also ensure that existing thermal generation can continue to finance its activities.

Further work is required to ascertain the level of investment required. It is likely that the option to have some form of long-term support contracts may be required. As the market matures predictable market prices should help to help ensure that sustainable investment for System Services can be achieved and may reduce the need for long-term support contracts.

The requirements for System Services are also likely to change over time, so the incentives on the demand side are going to be key as identified in the scoping paper. There has been no work as yet to attempt to understand the risks associated with moving to a market-based system or the impact on other revenue streams. It is therefore impossible to comment at this stage on whether or not this approach and its apportionment of risks is appropriate.

With respect to the questions regarding which products should be procured on a market-based approach it is not clear why the products selected exclude FFR or the ramping margin products. It is also not clear what will happen to these excluded products, e.g. will they continue to be provided under existing arrangements.

Without further rationale at this stage it is not possible to comment any further.

7. Do stakeholders believe the current qualification process, is the most efficient approach? Do stakeholders have any alternative proposals?

SSE is of the view that the existing qualification process has worked well to ensure that technologies and providers are able to demonstrate capability. This has also been carried out respecting the relevant requirements as set out in the System Operation Guidelines.

The approach to market entry will need to adapt under a market-based approach to facilitate new entry into the market on a rolling basis rather than implementing contracting windows.

8. What are stakeholder views on the overall current governance arrangements including the contractual principles, the Protocol Document and the market ruleset? Should these be modified into an overall protocol document which captures all of the rules for providing and procuring System Services with increased regulatory oversight?

SSE would support the creation of a single protocol document that covers all of the rules of participating in System Services. Investment comes from certainty, transparency and strong governance. If System Services seek to drive investment there must be a clear understandable framework, with its own governance arrangements.

SSE considers that greater engagement from market participants would enhance the current governance arrangements and would support the introduction of some form of modifications committee to oversee changes to contractual/market arrangements. It does not seem appropriate to have one party in control of all aspects of the contractual arrangements that govern the market.

9. Should System Services continue to be funded through network tariffs? Are there views on any alternative arrangements?

SSE has no specific view on this at this stage. It is too early in the process to indicate potential changes in funding when the procurement mechanism has not been fully defined.

10. Should all services be procured through a single daily auction framework or should bespoke arrangements be developed for the separate products?

Further work is required on understanding what is being procured in order to be able to comment on whether a single auction would be appropriate. However, SSE would add that a full review of the GPI process needs to be conducted to ensure that an auction is meaningful and workable.

It is likely that where new investment has been identified that a separate mechanism may be required to deliver a long-term pricing signal.

11. What are stakeholders' views on the timing of auctions?

SSE is of the view that the timing of daily auctions needs to be considered carefully as this may impact on trading strategies. We can see merit in having the daily auctions for System Services after the day-ahead market for energy has been completed. This could reduce the burden on market participants.

Understanding the energy position before entering in to a System Services auction may have the advantage of providing the necessary information required to ensure System Services volumes can be provided.

12. Do stakeholders have any proposals on how best to ensure commitment obligations are met?

SSE is of the view that further consideration needs to be given to how grid code obligations will relate to market positions for System Services. The current GPI regime for provision of System Services may no longer be appropriate. Currently the TSO is able to oblige any System Services provider to meet its grid code obligation. It seems obvious that if the TSO is able to require a service provider to move away from a market position to deliver the grid code requirement then the auction results will be undermined.

A solution will need to be developed to ensure that the market-based outcome will not be undermined by grid code requirements without sufficient compensation to the System Services provider.

A review of the scalars, particularly the performance scalar, should also be undertaken to ensure that they remain fit for purpose in a market-based solution.

13. What are the significant interactions within potential System Services product markets and between System Services markets and the energy and capacity markets? How should issues arising be addressed?

SSE is of the view that these questions cannot be answered adequately at this time. The interactions between all three markets are considerable and careful consideration will be required from the SEMC and TSOs. Previous work by the SEMC has demonstrated how complex this issue is, and the potential interactions between capacity and the energy market presented significant obstacles to delivering a workable auction design. It is therefore unlikely that an answer can be solved at this early stage in the process. Therefore, this will also require significant industry engagement to ensure a workable approach can be delivered.

14. Do stakeholders have further views or proposals in relation to auction design?

The scoping paper does not set out what would happen if a daily contract is not awarded for a specific service. This is particularly relevant for ensuring that the outcome of an auction is not undermined by any other incentives e.g. GPI regime for grid code compliance.

The SEMC will need to consider how they will deal with a situation where the TSO uses grid code obligations to move units away from a contracted position. Processes and payment regimes will need to be developed to ensure all of this is compatible.

There is considerable further work to be done on the procurement mechanism for those products that are not being procured under a competitive framework. How will they be procured and how with the value of those services be determined?

Nothing to date has been set out in relation to who will develop and administer the auctions. This could present a risk to the overall delivery timeline.

15. Do stakeholders believe there would be benefit in maintaining the Fixed Contract Arrangements for future procurement runs?

SSE is of the view that there is merit in having some form of fixed contract arrangements with set tariffs in order to transition from the existing DS3 framework to the proposed market-based solution.

The tariffs that are currently in place were set to ensure that the 2020 targets could be met. This is not representative of the value consumers will derive from the additional renewables on the system between now and when a competitive framework is in place. Therefore, SSE is of the view that the current tariff arrangement and cap on expenditure would need to be reviewed to ensure that they meet the needs of further renewable development, and not risk undermining progress in this respect.

With respect to the volume capped mechanism that has been implemented in the past these arrangements were designed to deal with a specific risk. It would need to be demonstrated that these arrangements are still necessary and are fit for purpose.

16. Do stakeholders have views on the list of additional considerations above? Are there any further issues to consider?

The SEMC should assess all of the services that are currently required by the TSO including those that are not considered as part of the DS3 framework to evaluate if they should be procured through any new arrangements.

17. What are stakeholders' views on the potential existence of, and options for mitigation of, market power?

There is insufficient information in the public domain to be able to answer this question effectively. In order to understand market power, the market has to be clearly defined and sufficiently transparent in relation to current and potential future needs. In relation to the potential existence of market power we are not in a position to answer this without the transparency around the volumes that are required to be procured for the relevant System Services. Without this level of understanding it is not possible to quantify how concentrated the market currently is or how that level of concentration can be reduced, this would require quite granular detail to be able to make any informed assessment. It would be useful to look at other markets across Europe and beyond to understand the level of transparency there and incentivise the TSO's accordingly to move towards best practice.

With respect to the mitigation of market power the issue of transparency needs to be addressed first. Any market power mitigation measures need to identify a market failure, the measures employed need to be sufficiently targeted so as to address the impact to consumers of that market failure.

Regulatory intervention needs to be target such that there is no unnecessary intervention in the price making mechanism, successful markets benefit from a clear understanding and predictability. Therefore, unnecessary or unjustified intervention can result in increased risk. This risk cannot be solely absorbed by the market participant and can impact the efficiency of the price signal.

It is also worth reconsidering having market power mitigation as part of the assessment criteria for consumer value. If the market power mitigation measures cannot be relaxed or removed to account for structural changes in the market in the future, then there is a risk the market will not work. It is SSE's view that market power mitigation measures should be complimentary to the market design not part of it.