ESB International Ltd
Stephen Court, 18/21 St Stephen's Green, Dublin 2, Ireland
Telephone +353-1-703 8000 **Fax** +353-1-703-7097
www.esbi.ie

28 January 2009

Conor Kavanagh,
Eirgrid
160 Shelbourne Rd,
Ballsbridge,
Dublin 4

Leslie Burns
SONI
Castlereagh House
12 Manse Road
Belfast BT6 9RT.

Ref: AIP/SEM Consultation paper AIP-SEM-08-128 entitled "Harmonised Ancillary Services, Other System Payments & System Charges" dated 23rd September 2008.

Dear Conor and Leslie,

I attach ESB International (ESBI) response to the above consultation.

Kind regards

Derek Russell

_____

Derek Russell
Commercial Manager, SEM
Independent Generation, ESB International

ESBI RESPONSE

AIP/SEM Consultation paper AIP-SEM-08-128 entitled "Harmonised Ancillary Services, Other System Payments & System Charges" dated 23rd September 2008.

Introduction

This response is submitted by ESB International on behalf of Coolkeeragh ESB Ltd. ESBI appreciates the opportunity to comment on these important regulatory parameters and we have no objection to all or part of it being published by the Regulatory Authorities (RAs).

We have outlined a summary of comments in our response with specific comments in relation to specific clauses or sections.

Summary of Comments :

- **Incentives focused on penalties as opposed to payments**: The focus of the proposed structure for ancillary services, rather than being weighted towards creating payments and "incentives" for generators to perform, appears to be very much weighted towards creating charges and penalties for non-performance. The island of Ireland needs new generation plant to be built in order to meet increased demand and to replace older less efficient plant. To do this the correct regimes to create an environment to encourage appropriate investment need to be in place, however the initial proposed structure for the ancillary services regime outlined in this consultation paper does not appear to promote such an environment. A more structured approach which focuses less on penalties and more on incentives, while still achieving a reasonable mix of both, is required, and in this vein SONI and Eirgrid are requested to restructure their proposal. There is the potential of discouraging generators from offering ancillary services to the TSOs for fear of the punitive penalties, and this it is argued is not in the best interest of users of the system nor of the TSOs.
- **Model Ancillary Services on the NI model:** In section 1 "Summary" of the paper dealing with "Generator Performance Incentives" it states that "In essence, it is envisaged that the arrangements currently in operation in Northern Ireland will continue". What has appeared in the paper does not reflect this statement as many of the incentives in the SSSA arrangements have been removed, and most of the charges in the SSSA arrangements have been substantially increased. Such a regime is not one which ESBI could support.
- **Charges and Payments cannot be linked to true value to system**: Under ASP.6 of the "Ancilliary Services Principles & Design Framework" it states "In general it would be inappropriate to base payments on their system value as, being essential for the operation of the system; their value would almost invariably be disproportionate to the costs involved in their provision". This assumption has been reflected in the proposed payments for services provided by generators. However the reverse is also true in that it would be inappropriate to base charges for non-performance on the value of the potential effect on the system as, being essential for the operation of the system; their value would almost invariably be disproportionate to the charges proposed for non-provision. Indeed Eirgrid made this comment at the conference in Dundalk and yet Slide 83 of the presentation given by SONI/Eirgrid in Dundalk on 1st October (given by

Conor Kavanagh) states “The Charges are proportionate to the costs that the underperformance imposes on the TSOs and, consequently, on other users of the transmission system”. There appears to be some differences in what generators are being told in this regard.

The key issue here is that logically the value to the system of a service being provided is directly related and directly similar to the value to the system of the service not being available. This should be a guiding principle for the services proposed in this paper.

However many of the charges for the non-provision of services are disproportionately higher than the equivalent payments for the provision of such services. This disproportion in charging, despite not reflecting more closely the payments for provision of the services, is not conducive to encouraging private investment in generation on the island of Ireland. DG.3 of the Ancillary Services Design Guidelines states “Both rates and charges will be set at adequately high levels in order to reward consistently high performing service providers and to incentivise poor service providers to either improve performance or declare realistic service levels” which appears to support a more balanced view between of payments and charges than that which has appeared in this consultation paper.

- **Predictability of generator financial performance**: The paper proposes that the design guidelines will bring about a situation whereby “service providers will have certainty and hence increased predictability of income, provided they met the contracted service levels. This should increase the focus on delivery. ” While it may be the case that generators can predict with some accuracy the income they are likely to receive each year from the provision of ancillary services, this is only half of the story in relation to the generators real performance in the year. Further given the material negative difference between charges compared to payments, the truth of the matter is that generators are in an a worse position in estimating their actual financial outcome each year as even a small non-performance in anticipated services will have a material negative effect on their yearly financial performance. Hence the proposed structure as outlined in this paper actually makes predictability of actual financial performance (which is real performance indicator for a generator) much harder and less certain. This uncertainty is further enhanced by the fact that some payments vary year on year and this does not lend itself to accurate prediction of performance by generators over reasonable time periods.
- **Cost Neutral principle**: To ensure that all generators who can provide an Ancillary Service to the system, there should be an overriding principle that the extent of the charges that can be imposed on a generator for under-performance should never exceed the value of the payments received by the generator for the provision of such services, in any contract year i.e. the worst position for a generator is that he doesn’t earn anything from the provision of any particular ancillary service (net neutral position).
- **Double Charging**: When a particular event occurs for a generator which brings about a performance standard below contracted/expected, the generator will normally be incurring significant consequential costs related to this regardless of any penalties the TSOs may decide to impose. The consequential costs are themselves usually sufficient incentive for generators to take all actions possible to prevent under-performance, and as such having the TSO impose more than one penalty charge for the same instance (e.g. an SND charge plus a Trip charge in the event of a

trip) will not create a greater incentive for generators. While one might argue some form of incentive should be imposed by the TSOs given their obligations to operate the system safely and reliably, regardless of the lack of actual effect this is may have to incentivise, having a second such charge is considered purely a penalty charge. ESBI propose that the model currently used in NI where only the larger of the two charges will be imposed should be employed.

Specific Comments:

Clause 3.2: SONI and Eirgrid are asked to advise how the "AS allowance" for each jurisdiction is calculated i.e. how is the size of the "ancillary services pot" calculated? This question was raised at the conference in Dundalk but a clear answer was not provided. It is assumed that there is some methodology that calculates this from first principles based on the values attributed to each service by the operator, but from the response provided at the conference it appears it may simply be something which is based on what has been done historically with a lack of clarity as to how it was calculated in the first place. Clarification in this regard is essential.

Clause 3.2.3: The final paragraph of this clause states "*Any monies collected by the TSOs as charges will be used to contribute to the funding of the next years AS expenditure*". However slide 83 of the presentation given by Connor Kavanagh at the SONI/Eirgrid workshop in Dundalk on 1st October 2008 states that "Monies collected through these charges are used to reduce constraints" – the "charges" being referred to being "*Generator Performance Incentives – Charges*". Clarity is requested as to how it is proposed such monies will be utilised by the TSOs.

To act as a true incentive, it is suggested that monies collected through ancillary services charges should be used to reward good service providers, thereby acting as a true incentive for generators and thus assist in meeting the required performance. As an example the Disbursement Accounts principle utilised under the BGE Code of Operations follows such a principle and has proved extremely effective over the years.

Clause 3.2.5: It is stated that there will be "*a performance review of each TSO with respect to AS*". The key objective of this review has not been stated and hence there is concern that the RAs will seek to incentivise the TSOs to reduce AS costs leading to greater uncertainty for generators in estimating performance. Methods of reducing costs include reducing payments, increasing charges or deciding not to use AS services provided by generators. None of these options are desirable from a generators point of view. Indeed it appears not to be in the interests of any user of the system to have a TSO conflicted in its primary objective to operate the system in a safe and reliable manner. Clarity is requested as to what this review will be looking at and looking for?

Clause 3.2.6: It is stated that "*Annual rates and contracts with existing service providers will not change within year unless there is repeated underperformance*". It is noted that there is no details given as to what is meant by "repeated underperformance", however regardless of this it is suggested that given the penalties for failing to provide a contracted ancillary service it is never in any generators interest to fail to provide the required service level. Hence if such an event occurs, or occurs on a few occasions, the generator will already have incurred material losses without adding to this hardship the threat of varying the contract or the rates, or even terminating the contract (as nothing is stated in the paper as to potential actions for repeated underperformance, termination is assumed a potential outcome). A contract for a period of time (e.g. a year) should be left in place for that contracted period. One of the aims of this harmonisation

process is stated to be making prediction of financials more accurate – changing, and even the threat of potentially changing, a contract within term is not conducive to achieving this aim.

Clause 3.2.9 – Confirmation is sought in relation to the proposed "start" and "end" dates for each contracted service to ensure that the proposed period between these dates will be 12 months or multiples thereof? Yearly contracts are considered as achieving the best balance between the generators desire for longer contracts and the TSOs desire to have flexibility to contract as they deem best for the system.

Clause 3.2.11 – It is suggested that from a cash flow point of view, for both the TSO and any generator, it is more desirable to allow the netting of invoices, and thus this is requested to be allowed to occur.

Clause 3.3.2 – The charge for underperformance during low frequency events (being the underperformance multiplied by the payment rate multiplied by 30 days) is excessively penal compared to the payment for the reserve (which is the realisable availability multiplied by the scaled payment rate). While it is acceptable to have the charge for non-performance of a service being greater than the payment for the performance of the service, the extend contemplated in this paper is thought to act more as a disincentive to generators to offer ancillary services to the TSO, than it is to act as an incentive to encourage generators to behave in a particular desired manner. A more balanced view is needed here.

Clause 3.3.3 –

The TSOs have requested parties to comment on the practicality of implementing a complementary monitoring system where service providers hard wire the signal showing their frequency response control settings to the relevant TSO. ESBI do not view this as a viable option and see many issues with this.

Clause 3.3.3 and 3.4.3 – In relation to the design of the payments for both reserve and reactive power the paper states that the "*budget constraint limits the number of effective signals that the design can successfully deploy*". Creating effective signals for desired activities must be a desirable objective for the TSOs and yet it appears the TSOs are not able to create all the signals, and the appropriate signals, they require or would like. This does not appear ideal. The TSOs are requested to advise, if there is assumed to be no budgetary constraints, what signal they would like to have in place. It is suggested that this information from the TSOs should then form the basis for a second consultation paper on the make-up of the Ancillary services.

Clause 3.4.2 – clarification is sought that the payment for Reactive Power is made to generators who are both (i) running and thus synchronised to the grid (ii) have contracted to provide reactive power? Thus no payment will be made to generators who (i) have contracted for reactive power but (ii) are not running and synchronised, for the time they are not synchronised?

Clause 3.4.3 – Commentary - states "*payment for the provision of Reactive Power is intended to incentivise service providers to maintain the capability of providing Reactive Power and automatic voltage regulation*". It is contended that the aforementioned intention may well fail to be achieved given the penal nature of the charges for non-performance relative to the payments for performance, as there is a genuine risk that generators will not be incentivised to provide reactive power or AVR services and may opt not to provide such services for fear of potential charges.

At a minimum, for each Ancillary Service, there should be an overriding principle that the extent of the charges that can be imposed on a generator for under-performance should never exceed the value of the payments received by the generator for the provision of such services, in any contract year i.e. the worst position for a generator is that he doesn't earn anything from the provision of any particular ancillary service (net neutral position).

Clause 3.4.3 – Commentary on the Proposed Design Features –

(A) The TSOs have asked for specific comment on the proposal to have the status of both (i) the AVR and (ii) every power system stabiliser, hard-wired to the relevant TSO. As stated previously in our response ESBI do not believe that hard wiring signals from generators to a TSO is practical.

(B) states that there is "*a reasonable tolerance*" to be applied in "assessing performance" the quantum of this tolerance is queried and the basis for its value?

Clause 3.5.2 –

It is not clear that payments will be made to generators who perform type Tests 1 i.e. Black Start tests planned and scheduled by the service provider as opposed to the TSO. Clarification is requested here as without payment generators are not incentivised to perform such tests, which is argued to be not in the best interest of the system.

A 90 days penalty is suggested to be excessively penal for an outright failure to Black Start. 60 days is thought more reasonable and more likely to achieve the desired outcome related to performance desired by the TSOs.

As mentioned previously at a minimum, for each Ancillary Service, there should be an overriding principle that the extent of the charges that can be imposed on a generator for under-performance should never exceed the value of the payments received by the generator for the provision of such services, in any contract year i.e. the worst position for a generator is that he doesn't earn anything from the provision of any particular ancillary service (net neutral position). If this principle is adopted then perhaps a period in excess of a 60 days penalty might then be considered acceptable.

Clause 3.5.3 – While contracts for Black Start can vary in period duration, it is suggested wise to set a maximum period of 5 to 10 years.

Setting the minimum rate of return at 5% is considered too restrictive given that (i) potential Black start providers are generally not going to be transmission systems owners/operators who enjoy favourable guaranteed rates of returns from their assets in a regulated environment, and thus generally will not be able to achieve the same attractive rates for financial offers from financial markets (ii) financial

markets are volatile by their nature and stating a fixed rate at one moment in time for a decision which will be made at a different time is not considered appropriate.

A more practical solution is suggested to state a certain % above some pre-defined base e.g. 2% above the average ECB rate over the contract term.

Clause 3.5.3 – Procurement Process – Clarity is sought to ensure that where a TSO performs a system study to assess if a particular site is suitable for black start the party requesting the study (the generator/developer) will pay the costs (if any) associated with this work?

Clause 3.6.2 – if the main aim of TSOs is to get rapid response from some generators in the event of a trip/wind down of another plant, the objective should be to achieve this in the most cost effective and system efficient method possible. Thus there is a direct link between Warming contract plants, multimode operation CCGTs and peaker/OCGT plants as these can all effectively do the same thing. It is suggested that having to keep a unit warm on an on-going basis for the occasional time it may be needed is likely to be substantially more expensive over a year period than having a contract in place for a peaking plant/OCGT.

Clause 3.6.4 – pre-emptive response – TSOs want to incentivise generators via a pre-emptive payment to provide a pre-emptive response in the event the generator predicts a trip might occur. Given the severity of the charges generators will incur in the event of a trip, and given the fact a payment will be received for a pre-emptive response, in the event that a generator views the potential of a trip as likely but is not 100% sure or not, he is incentivised to give the pre-emptive response. In such a scenario there will be occasions where false alarms will occur. How do the TSOs envisage dealing with such circumstances?

Clause 4.1.1 – ESBI strongly supports the proposal to (i) have a provision within the SEM to allow for change of fuel within day (ii) have a compensation payment reflecting the incremental cost of running on the secondary fuel, paid to the generator when instructed to run on an alternative fuel.

Clause 4.1.2 – AF.2 – While it is accepted that the TSO would schedule the tests for each eligible unit, this can only be done in consultation with, and with agreement from, the generator.

Clause 5.1.3 – ESBI does not support the notion of having two charges potentially applied to a generator in the event of a trip i.e. both a trip charge and a SND charge. The reason for this is that, regardless of the existence of the trip and SND charges, a generator will already be doing everything it can to avoid a trip, due to the significant consequential costs (e.g. being exposed to the pool to make up contracts, exposure to fuel costs (e.g. gas contracted for), imbalance charges (in electricity and gas systems), etc) but also more significantly the extra wear and tear on the machine due to a trip and the significant costs related thereto. In relation to the latter most GT providers/service providers will apply a multiple of hours to the calculated used life of a machine in the event of a trip (sometimes referred to as “Equivalent Operating Hours” or “EOH”), thereby reducing the period between maintenance shutdowns, thereby increasing the costs on the generator (increased cost per MW produced). Hence having 2 “incentive” charges

applied by TSOs in the event of a trip will not add any greater incentive to generators to avoid a trip than a single charge will. As such in the interests of fairness and reasonableness, it is suggested that the model that is currently in use in NI should be used, whereby in such an event, only the greater of the Trip or SND charge should apply.

Clause 5.2.2 – TR.4 states that the TSOs monitor generator units as they run and so can identify that a trip has occurred through SCADA. If this is the case it is queried why is it so critical for the TSOs to receive a re-declaration from the generator in the event of a trip and the related highly penal charges for not providing such re-declaration?

TR.5 states that a charge will apply for partial trips for MW losses of 100 MW and greater whereas in Clause 5.1.3 (4th paragraph) it states there is a 10MW threshold. Please confirm what level of MW losses for partial trips will charges be applied – is it 10 MW or 100MW?

Clause 5.2.3 – ESBI supports the decisions to (i) not make trip charges fully reflective of the overall cost that the trip causes (ii) not impose differing charges according to system state. (iii) not include the unit start up cost in the trip charge.

However as stated previously ESBI does not support the notion of applying BOTH an SND charge and a Trip charge in the event of a trip, given that "a level of generator unit tripping is inevitable" (as stated by the TSOs in Clause 5.2.3) and this is regardless of the most extreme measures a generator might already have taken to prevent this, and given the significant consequential, and wear and tear, costs that will be incurred by generators. As suggested previously, the current regime in NI should be used in the all island context whereby only the greater of the SND charge or the Trip charge is applied, and not both.

Clause 5.3 – The facts appear to point towards the island of Ireland requiring more generation in order to cope with both the growth in demand and the variability in, or unpredictability of, future supplies. Thus it would appear logical for all efforts to be made to encourage and facilitate new generation onto the system. Creating a new charge aimed at new generation units could not be viewed as a signal of encouragement for new generators and as such should be reconsidered.

One of the stated purposes of the test charges is "to encourage generator units to finish testing in a timely manner". This appears to imply that generators are not sufficiently incentivised to limit testing times today – this is simply not true. A generator performing testing is not making the revenue per unit time it can and is thus losing money – this is not a desirable situation for any generator. A generator is sufficiently incentivised by this to complete testing as quickly as possible and should not be penalised further in the event of difficulties.

Further a consideration for the TSOs must be to have generators that are reliable and functioning correctly on the system. To achieve this ideal it may be necessary, and may be in the interest of the greater good of the users of the system, for the generator to complete some tests. However the proposed charges may conflict this aim – this is a concern.

Clause 5.3.2 – CC.1 – the notion of "an assessment of the risk of trip" could be very subjective unless there is in place some agreed process related to calculating

this on some clear, transparent, and independently verifiable basis. Can the TSOs advise how they propose to calculate this?

Clause 5.3.3 – Having the assumption that a number of trips will take place during commissioning, and factoring the trip costs of this into the commissioning tariff, will unduly penalise generators whose plants do not trip as much as the TSOs predicted, and unduly reward generators whose plants trip more than the TSOs predicted. This appears to be an incorrect mechanism, with it appearing more logical and fair to charge in accordance with the number of trips actually occurring, rather than the number the TSOs predict may occur. This will also then reflect changes in technology going forward where TSOs will be unable to accurately predict trips given lack of information in the field.

Section 6 - of the document is described as "*Generator Performance Incentives*" which implies incentives for generators to act in a particular manner. The document then describes charges to be applied for under-performance, with no payments. GD.4 describes that monies collected in charges will be used to reduce Dispatch Balancing Costs. To act as an actual "incentive" a more effective use of these monies collected from these charges is suggested to be to reward generators for good performance. This would then be a true incentive to perform, and more likely to achieve the desired outcome from generators.

Clause 6.3 – confirmation is requested that unit specific charges are not published to be generally available but only published for each specific generator individually and given to them alone?

****