



Gaelectric Holdings Plc.

Response Paper to:

DS3 System Services Auction Design Consultation

Gaelectric Holdings Plc. Response

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Public

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1 EXECUTIVE SUMMARY

Gaelectric Holdings Plc. ("Gaelectric") welcomes the opportunity to respond to the SEM Committee's consultation on DS3 Auction Design. The design of the auction process is fundamental to informing the commercial opportunity for participants in the market, particularly new entrants, and subsequently acting as a key driver to an effective programme. As one of the largest independent developers of renewables on the island, we are concerned at the potential impact of curtailment on our projects, both those in operation and for the business case of future developments. We believe the DS3 programme can deliver considerable value in this context and indeed should be the primary driver for investment into fast acting flexible assets on the island of Ireland over the next decade. Considering the challenges facing the DS3 programme and the investment signal it should create, we believe the programme to be the single most important development of the all-island electricity system. For this reason it is imperative that the SEM Committee ensure that the final auction design is one which achieves the adequate level of investment. This is achieved by providing for long term, stable and predictable revenues for investment which is not subject to regulatory risk nor confused through undue complication or risk on participants.

Gaelectric have previously outlined our concern that the auction designs were becoming cumbersome which inherently enhances the probability of a failed auction. In this context whilst we believe the DotEcon proposals contain some semblance of commercial rationale in respect of the auction design, we are concerned that metrics have been introduced which increase complexity and creates an inappropriate allocation of risk on contract holders. This will negatively affect investment.

The analysis presented in the DotEcon indicates some very clear challenges and proposals. We request that the SEM Committee recognise these and immediately take a clear and unequivocal stance that supports investment in enabling technologies and enhanced service provision such that 2020 renewable targets will be achieved. The DS3 programme should be developed as an incentive for new entrants with flexible and high performing technologies to enter the market. The way to achieve this is through clear investment signals, unambiguous commercial structures and a transparent auction process which is not unduly complex.

The proposals contained in the DotEcon report address some key issues such as the need to separate long term and short term auctions, something that Gaelectric have repeatedly called for over the last 12 months, in addition to addressing the challenges created by unsuccessful auction participants. However, the report equally attempts to address the perceived risks placed on the TSO by inappropriately transferring this risk to auction participants. We do not support that participants should be forced to identify their technically realisable availability given that this is largely a risk which they cannot control. This is particularly challenging for new entrants forecasting over a long term contract. Rather, a tolerance band is appropriate within which, a participant's revenue is not eroded.

Further in relation to the proposals to remove the minimum revenue guarantee, we reject any assertion that this is not a requirement, or that this may be addressed within the DotEcon bidding proposals. It is abundantly clear to us that regulated tariffs are not going to be investable, nor were they designed to be. However, where a requirement is established for investment in some services, it

is possible that others will be procured on a regulated tariff- this materially impacts the investment case for a new entrant and for this reason we believe it is imperative that the minimum revenue guarantee is retained and essentially that it covers the entire service range, irrespective of which services are procured on a regulated tariff. Absent this, where any subset of services are procured by regulated tariff, a new entrant will not be in a position to raise finance given their contractual position faces partial price risk in each year.

We reject the view that the TSO should be in a position to subjectively reject a new entrant bid on the basis of the potential for further competition in subsequent auctions or potential future clearing prices. To do so would open up considerable risk of litigation and further will conflict EirGrid further given their requirements to not discriminate and also given their interest in the auctions with respect to interconnectors.

We do not view that an opinion from EirGrid should drive the need for new entrant auctions but rather promote a separate auction with separate budget for new entrants in the DS3 auction. We welcome further engagement with the SEM Committee on this point.

2 GENERAL COMMENTS

This section provides comment on areas that are not specifically addressed in the consultation paper questions but remain worthy of discussion;

Treatment of New Entrant Bidders

Gaelectric were disappointed to see that despite DotEcon dedicating 1 chapter and 15 pages to an in-depth consideration of how to treat new entrants, the SEM Committee have seemingly not agreed that this warrants extensive discussion given the lack of questions on this.

Gaelectric have previously strongly advocated for a new entrant auction and we are encouraged to see that the DotEcon findings support this proposal. Whilst we welcome the proposals to treat new entrants separately in the context of ensuring that limits on procurement volumes should not be represented as a maximum, but rather a minimum. Furthermore, clearing prices for new entrants should not impact upon the clearing price of existing participants.

We do not under any circumstances support the idea of TSO subjectivity in respect of deciding to accept new entrant offers. The TSO is obliged to act independently and we believe that their decision making would come under intense scrutiny and leave the TSO open to litigation. The TSO decision would ultimately come down to an opinion of clearing prices or competition. The TSO is also involved in bids for the interconnector and is therefore conflicted.

For the avoidance of doubt, Gaelectric support auctions for new participants, the revenues for which are underpinned by a minimum revenue guarantee (to include regulated tariff procured services) and further for the parallel procurement of capacity for new entrants also. All new entrants should be able to identify their lead time which should be up to 5 years from contract execution. There should be no subjectivity in relation to procuring new entrant volumes, but rather a minimum volume of services would be procured each year.

The minimum revenue guarantee is not covered off by the DotEcon proposals which features implicit risk regarding availability and uniform pricing for participants. We recommend that these are re-established by the SEM Committee and for the avoidance of doubt that they are established to cover those services which are procured via regulated tariff. We wish to highlight that the minimum revenue guarantee was never intended to act as a tool for 'profiteering' but rather to ensure the minimum level of investment certainty required to progress an investment. This should not be relied upon where a new entrant clears a subsequent auction for those services for the remainder of its contract tenor. We also recommend an annual price cap which would ensure that the risk (to the consumer) of making extra-normal profits from DS3 are ruled out.

Allocation of Risk

There is a clear transfer of risk away from the TSO and onto the participant. We have referred to this throughout our response, however we wish to highlight at a high level that the allocation of risk across the DS3 contract should be placed on those who are in an appropriate position to manage that risk.

Given that the ability to be technically realisable is largely dependent on the market or TSO as outlined throughout this response.

3 CONSULTATION QUESTIONS

Q1: What are your views on the proposals to try to ensure a level of consistency between CRM and DS3 System processes?

Gaelectric have been consistent in our request for ensuring that both the CRM and DS3 processes are aligned both in terms of the auction execution, prequalification criteria (where possible) and bonding arrangements.

It is important that the SEM Committee understand that from a new entrant perspective, such projects will require certainty in respect of both revenue streams before a project can proceed with financial close and substantial capital investment.

We have proposed that new entrants will be procured in parallel to avoid the risk of litigation and delay to both auctions, and further to ensure that there is no undue complexity in relation to implementation agreements for both auctions given they will either need to be a single agreement or separate agreements which speak to one another.

Q2: Do you consider that the SEM Committee should consider facilitating a link (where participants require) to only proceed with participation in the DS3 System Services auction subject to a successful outcome in the CRM auction or (vice versa) i.e. create an interdependency that as much as possible mitigates the need for auction re-runs.

It is an absolute requirement that new entrant projects should not be subject to penalty claims whereby they have cleared one auction but not the subsequent auction (in this case we assume DS3 is proposed to be held first and CRM second).

Any DS3 bid bonds would therefore need to reflect the interdependency of contract execution with the clearing of the CRM competition.

In regard to the suggestion that building in an interdependency that “as much as possible mitigates the need for auction re-runs”, we believe the only way this is possible is via a combined auction.

We echo the comments from DotEcon relating to the risk of litigation proceedings and the impact these would have on the market. Gaelectric have previously outlined our concern in respect of litigation proceedings against the TSO and/or the SEM Committee where such an event occurs.

We have outlined a potential issue which could arise as a result of a plant clearing the first auction but not the subsequent auction, leading to the unit terminating the former contract and forcing the promotion of a ‘best loser’ bid to take its place.

Unit ID	Service A	Service B	Service C	Service D
Unit A (initial winner)				
Unit B (1 st loser)				
Unit C (2 nd loser)				
Unit D (3 rd loser)				

The table above outlines that Unit A who won the initial DS3 contract was providing a level of service for Service A, C & D. The only other unit providing an equal level of service is Unit D.

As an impact of not clearing the CRM auction, Unit A does not execute its DS3 contract as it cannot finance off the DS3 results alone, and therefore the TSO is forced to look at the remaining losing bids to make up the shortfall. The TSO in this case is forced to go back to Unit D and Unit's B & C are not compatible with the shortfall in service provision.

As a result we have a scenario where an auction has cleared, the results must be re-run and Unit B & C, which were cheaper than Unit D are not awarded a contract. This presents a considerable risk to the competition and should be avoided by designing out such risks at an early stage.

Had the auctions been procured together, we believe this issue is largely avoided.

The DotEcon paper indicates that there would be *"no particular difficulty in integrating an auction of capacity with an auction of system services"*, and this should therefore be explored further.

We recommend that the SEM Committee set up a cross departmental working group between DS3 and CRM in order to work through these issues. We are particularly concerned that there is no holistic approach between the separate workstreams, resulting in risks such as those discussed above which could have been mitigated before the release of this consultation and the ongoing CRM consultation paper.

Gaelectric raised the point of combined procurement exercises at the recent (1st Feb) DS3 forum which was ruled out (for the first auctions) by the CER representative for the SEM Committee. We do not believe the reasons for this were adequately addressed and we request a formal response from the SEM Committee on this as soon as practicable.

Q3: What are your views on managing the interactions between the CRM and DS3 System Services auctions?

We refer to our answer to the questions above.

Gaelectric have indicated concern previously also in relation to the separation of the auction processes and specifically the impact of this on lead times. It was proposed in the DS3 consultation on qualification and contract principles that a lead time of maximum 5 years was required to ensure that new entrant projects could ensure completion of a financial close period followed by capital investment and construction. However the paper suggested that the clock would begin ticking from the date of the first auction, i.e. if the CRM auction occurred 6 months after the DS3 auction, the lead time would subsequently reduce by 6 months.

We wish to reiterate that this proposal is completely contrary to the stated aims of the SEM Committee to develop structures which accommodate, and attract, investment in new entrants. We have outlined above our reasoned opinion that new entrants require certainty over both revenue streams to enable investment. To expose new entrants to the risk that a delay in the CRM auction would result in an equivalent reduction in their lead time available to construct is not acceptable.

The suggestion essentially places new entrants at significant risk of running into their long lead time in the first contract (assumed to be DS3) as a result in delays outside of their control in the second auction and despite no delays in their construction and delivery programme.

We request an immediate clarification of this (and the proposal to combine auctions) by the SEM Committee given the impact it will have on project financing.

Q4: Do you agree with the proposals for separate DS3 System Services long-term and short-term auctions as set out in the DotEcon recommendation?

The DotEcon report is unequivocal in its indication that DS3 products are non-substitutable when comparing long term contracts and short term contracts. Gaelectric agree with this assertion and have long called for new entrant auctions to be held given such concerns.

We support auctions for long term and short term contracts however we are deeply concerned by the level of subjectivity that is proposed in the paper in regard to the TSOs ability to decline a bid on the basis of a feeling that further investment may be available down the road.

The fact is that this could equally result in a more expensive option being forced by the TSO.

We have very significant concerns regarding the appropriateness of the TSO making such decisions given their clear conflict in also bidding in Interconnectors into auctions. The TSOs will be intimately aware of the potential delivery dates for such new interconnectors and whilst we are not suggesting that the TSOs would intentionally act in a dishonest manner, if the risk presents itself, it must be mitigated.

We re-iterate proposals we have made in previous consultation responses that reserved, uncapped share of 20% of the DS3 Volumes be ringfenced for long-term new entrant contracts. We further support a structure whereby the TSOs cannot arbitrarily reject a new entrant contract on the basis of the following as proposed in the DotEcon report;

- TSO expectation of new investment bids received in future auctions; or
- Expectation of future clearing prices; a discount rate

The fact is that the TSO is not supposed to be a commercial player in the market and therefore has no place in estimating what future investment or clearing prices will clear the auction in future years. This could potentially be seen as 'picking a winner' and it is highly likely that it would result in the TSO facing litigation by unsuccessful applicants due to largely subjective reasons for not accepting their bids.

Gaelectric favour an approach whereby the TSO accepts bids in the current auction as necessary to meet the specified volume requirement. This is proposed as an alternative scenario on page 105 of the DotEcon report. Such a structure ensures that there is no undue influence asserted by the TSO in the marketplace.

In relation to the TSO forecasting the requirement for new capacity, this process is not clear in the paper and we request clarification of this in advance of the next consultation phase given its

importance for new entrants. We do not support, however, the TSOs being in a position to exert influence over auction results via determining a 'preferred portfolio' and a proposed portfolio. The TSOs are very clearly conflicted in this regard given they are responsible to an extent for the design of auction structures and for procurement of system services whilst also having a commercial asset which is to bid in (albeit as a price taker) into auctions themselves.

Take-or-Pay structures (Minimum Revenue Guarantee)

In relation to the minimum acceptable revenue for new entrants, we reject the assertion by DotEcon that this equates to a free option or any form of undue insurance policy that has the effect of not incentivising new entrants to deliver. The "take-or-pay" element of the contract was rightfully proposed in order to ensure such projects investable, and the definition of availability does not alter this.

Gaelectric strongly urge the SEM Committee to retain the concept of a "take-or-pay" element to the contract, however where plant availability falls outside of a threshold (e.g. +/- 5-7% for long term contracts) from the proposed targets within the contract, this is scaled down to insure the end consumer against paying for poorly performing plant, whilst equally maintaining a structure that is investible.

Minimum Revenue Guarantees should cover the entire bid package, as otherwise it is likely that a new entrant would not be in a position to finance operations despite the need for a new entrant being unequivocal, the fact that some tariffs are procured on a regulated tariff introduces price and regulatory risk which is not palatable for investors. This must be addressed and clarified by the SEM Committee.

Our calls for the reintroduction of the minimum revenue guarantee are further supported by the uncertainty regarding the availability metric which must be assumed for a long term contract by new entrants and places further risk on their bids.

In addition, the discussion regarding the how unsuccessful auction participants are utilised could have a direct impact on new entrants and therefore significantly undermine the package bid that they received.

New Entrant Lead Times

In relation to new entrants with shorter leads times- it is important that the TSO considers solutions that allow projects which can deliver quickly to do so given the positive impact such projects would have on the overall SNSP target and system security.

By way of example, a battery could be constructed in circa 12-24 months including financial close, and it is paramount that the DS3 auction design caters for the early development of these technologies.

We believe that the max lead time should be 5 years from contract execution.

New Entrant Product Substitutability

The DotEcon paper does not specifically comment on the interaction between 15 and 20 year contracts which have been proposed by the SEM Committee in previous decision papers. We request clarification on how the SEM Committee intends to auction 20 year contracts.

Furthermore in relation to 20 year contracts for projects showing a significant public benefit, we request immediate clarification by the SEM Committee as to how this is to be identified and the criteria that new entrant projects are required to achieve for eligibility. In absence of a detailed project plan, we assume a pre-qualification event is to be in place by the 3rd quarter of 2016 at the latest. The SEM Committee must be cognisant of the preparation that is required by participants to prepare bid packages, particularly for new entrants and where increased criteria is required to be evidenced to achieve a 20 year contract.

Project Plan

Given the proximity to DS3 auctions, we request immediate publication of an overall DS3 timeline to support planning by all participants.

Q5: Do you think the treatment of long-term contracting for System Services should be aligned with the proposed framework in the CRM?

Gaelectric fully support the premise that long term contracts should be aligned across the CRM and DS3 programmes. The financing of new entrant projects requires a strong degree of revenue certainty via a stable system services and capacity remuneration framework, and for these stable revenues to be underpinned by a contract tenor which is commensurate of the level of commitment being made by such participants. In our previous communications, we have advocated for a reserved, uncapped share of 20% of the DS3 Volumes be ring-fenced for new entrants to run in a separate auction.

Q6: What are your views on the proposals to calculate clearing volumes for the auction as set out by DotEcon?

Gaelectric have no major concerns with the proposal to procure via an 'additive' methodology however it remains unclear how this would interact with a bid package whereby a price would be designated for all services in a package and the entire package needs to be procured for the bid to be successful. In practice the TSOs would not be able to 'cherry-pick' services from within a bid package, but rather they are limited by the flexibility provided in the bids of potential service providers.

Q7: Do you agree with the proposals for introducing granularity for the purposes of calculating auction clearing volumes?

DotEcon have made legitimate proposals in relation to how new entrant and existing technology should be procured in the DS3 auction (i.e. separate procurement). It is unclear how said proposals would interact with the granularity approach, particularly where granularity is being driven by what is perceived to be a short term concern.

Specifically, the paper suggests that a locational granularity is likely to be required in the auction to split Northern Ireland and the Republic of Ireland. Gaelectric have repeatedly highlighted concerns that there is an over reliance being placed on the North-South Interconnector which in itself does not *guarantee long term* security of supply (we note the ongoing issues with the Moyle interconnector as an example).

Further, we have pressed the SEM Committee to implement locational characteristics in the DS3 and CRM auction, and in this regard we are enthused by the corresponding views of DotEcon in this regard. We however refer to our concern regarding long term security of supply and therefore implore the SEM Committee to ensure that when locational granularity is being implemented into the auction, that the new entrant auctions are equally procured on a locational basis over a long term contract which will therefore greatly enhance long term security of supply for Northern Ireland.

Q8: What are your views on the proposal to introduce flexibility on the volumes to be procured?

Gaelectric agree with the position put forward in the DotEcon paper regarding introducing a minimum quantity for system services with no subsequent need for a maximum limit due to the 'least-cost' objective function.

We do not support flexibility for the TSOs reducing the minimum requirement for services in the knowledge that they will have some services available to them from a grid code perspective. It is possible that participants will not clear the auction and this creates an ethical hazard for the TSO as they will be aware that services are available to them outside of DS3 procured participants.

Q9: What are your views on the proposals for package based bidding?

Gaelectric are concerned with the proposals for uniform pricing given that it does **not** support consistent revenues (for the reasons outlined throughout this response) for participants and therefore places a risk on participants which cannot be effectively hedged without impacting upon the value to the consumer. This is particularly the case for new entrants.

We strongly disagree that there is no need for a minimum guarantee for participants in the DS3 auctions. The proposals from DotEcon impose a number of risks on generators whereby they receive no guarantee of the revenue they will achieve. Examples of this include the issue of availability. It is

incorrectly assumed that participants would be in a position to accurately indicate their availability for a contract. The concept of availability is not in the complete gift of a participant and therefore cannot provide a guarantee of this figure, and equally should not be punished for not doing so.

Further, for new entrants, it is clear that the proposed regulated tariffs are not investible and will not incentivise investment for new entry. The tariffs are one year and therefore create price risk for new entrants expecting to achieve a 15-20 year contract. If the SEM Committee are serious in respect of incentivising investment, the minimum revenue guarantee must extend to cover regulated tariff procured services.

It is appropriate to include a tolerance band in the stated availability levels within which the minimum revenue guarantee is not impacted. Outside of these limits (we propose circa 5%), minimum guarantee levels can be reduced pro-rata to support consumer value.

Gaelectric further support that new entrants should have a maximum revenue limit to ensure that consumers are protected, however this should be an annual limit with no retrospective action taken on revenues over a longer period. To implement this, a reconciliation would take place at the end of the DS3 services year. We welcome further engagement with the SEM Committee to structure such a proposal.

Q10. Do you consider that a provider will be able to predict its expected availability accurately on an annual basis?

A provider of a short term contract is unlikely to be able to predict their availability with a relatively high accuracy, given that availability is a measure of their technical realisability to provide services rather than their technical availability which is the traditional understanding of the term 'availability'.

The SEM Committee should clarify how over-delivery of quantity would be treated from a remuneration perspective, i.e. will it be paid on the same basis as the services provided on a base revenue basis.

A new entrant equally will not be in a position to predict their availability with the same degree of accuracy and in keeping with the need to ensure that long term contracts are stable in respect of their value to a project, we request consideration of this by the SEM Committee. Fears of overpayment under such arrangements could be abated through the maximum revenue limit proposal outlined above.

A new entrant needs to predict over a longer period and given the risks (which are largely out of their control), we do not believe that participants should be punished for this.

We support the use of availability tolerance bands within which the revenue to a participant is not eroded in any form, however below this there would be a pro-rata reduction in the minimum revenue guarantee to protect consumers from market power exertion and poor performance.

We also remind the SEM Committee that the proposed reliability scalars will ensure that there is an incentive to keep reliability above 90%, which should allay some of the perceived concerns related to the proposal to remove the minimum revenue guarantee by DotEcon.

Q11: Do you agree with DotEcon's proposals in relation to quantity units for the services outlined above?

Gaelectric have no issues with the quantity units as proposed in the consultation document.

Q12: What are your views on a suggested cap or clawback on expected availability per plant to manage DS3 System Service expenditure?

In reference to section 5.2 of the SEM Committee consultation document where a reference is made to DotEcon's proposals regarding actual deliveries exceeding expected deliveries, we wish to clarify that DotEcon refer to scenarios in which "*winners who significantly exceed stated availability face some claw-back*".

Further, it should be recognised that DotEcon did not find any reasonable scenario which improved a participant's chance of clearing the auction **and** earning enhanced revenue in operation. Given this, the risk seems particularly low. We do not believe that the SEM Committee should consider this further given that both the probability and impact have not been found to be credible.

We believe it would be difficult to implement a control such as a multi-year claw back given the risk this could have on financing arrangements, and provisions would likely lead to a deterrent for lending institutions given the added complexity. Similarly, a proposal such as the maximum revenue guarantee proposed above coupled with the planned volume scalars to be implemented should mitigate the prospect of generators over-earning significantly.

Q13: Do you consider the DotEcon Report to have accurately captured the considerations for availability the TSO should use for different DS3 System Service products? If not, please explain your reasons why.

Gaelectric support interpretation of availability as the greater of the market or dispatch positions for operating reserve and FFR services.

One issue that has failed to be addressed adequately in the DotEcon report is how the treatment of losers may affect TSO actions in dispatching available DS3 system services in the balancing market.

If auction losers are to be paid less, this may cause a moral hazard for TSO's whose objective will be to manage the DS3 services at least cost. This ambiguity surrounding the prioritisation of participants available to provide DS3 system services could seriously undermine the DS3 process. We therefore call on the SEM Committee to release a principles document outlining the requirement placed on TSO's when choosing available DS3 providers to dispatch.

Q14: Do you agree with the proposals to ensure lower payments are received by System Service providers who are not successful in the DS3 auctions but who are dispatched by the TSO to provide System services, than those providers who are successful in the Auctions?

Gaelectric strongly agree with the principle that participants who are not successful in the auction should receive significantly lower system services payments in the interest of creating a level playing field for all participants.

It is clear that this is a complex consideration. Should losing auction participants be paid the clearing price for providing system services, they would be (under the DotEcon proposals for contingent commitment) in a position to influence the energy market via having no specific limits on their balancing bids or offers. Further, there would be no clear incentive to participate in the auction, and indeed a losing participant could find themselves in a superior position to those who clear the auctions.

On the other hand, if losing participants are paid significantly less (a principle we agree with), there is a moral hazard created whereby the TSO, who is incentivised to reduce outturn spend, is therefore incentivised to procure less, or to utilise losing participants in real time as opposed to those who cleared the auction (note that this is a further reason to ensure that the minimum revenue guarantee is protected for long term contracts). This would be a completely undermine the DS3 process.

We therefore propose that the TSO is required to adhere to a principles document which highlights that the TSO will prioritise the use of services from successful auction participants, and will report regularly on the payments made to unsuccessful participants.

The DS3 and Capacity remuneration mechanism are intended to, amongst other objectives, create an entry signal for new entrants. In order for an efficient entry signal to develop, a corresponding exit signal is required.

Under the recent SEM Committee proposals this would not occur given an equal payment for those who did not clear a competitive auction. Not only would this not prevent existing participants to exit the market, the design was such that a participant who fails to win a contract in the DS3 competition would be in a superior position by being in a potential position of market power in the balancing market also.

The SEM Committee proposal amounts to a free option for incumbent generation which we strongly disagree with. It further diminishes the value of winning a contract by those who are successful in the contract and will inevitably lead to inefficient bidding practices.

Given our comments above we agree with and support the view of DotEcon that those participants who are unsuccessful in an auction should be remunerated at a considerably lower level to those who gain a contract via competition.

Q15: Do you agree with the proposals for determining the winner/price as set out in the DotEcon recommendation?

The proposals within the DotEcon paper are complex and we are concerned at the impact this may have on lending, however in theory we have no major concerns with the proposals, with a number of exceptions, particularly relating to the capping of auction prices at the regulated tariff which is proposed in the paper.

We believe this would undermine the auction process and request that the SEM Committee give due consideration to the investment signals required, and which are not achieved by the regulated tariff methodology.

Q16: Do you agree with the proposed treatment of interconnectors? Should this apply equally to all interconnectors?

Interconnectors differ fundamentally to other participants in that their capabilities of providing system services will largely be driven by electricity flows. After I-SEM go-live, these flows will be determined by the EUPHEMIA algorithm and price differences between markets, thus interconnector owners will have limited ability to determine their availability to provide DS3 systems Services.

Given the locational constraints present in the SEM the necessity for locational considerations when procuring system services is acknowledged in the Dot Econ paper. Gaelectric request the SEM Committee to come forward with further clarification on what potential caps on system services contracted from a single providers may be implemented. The implementation of any such caps should take consideration of the locational grid constraints, the number of prospective providers in that area and the necessary DS3 volumes to ensure the security of supply in that area.

Q17: Do you agree with DotEcon's proposed preferred model of Contingent Commitment in DS3 System service Auction procurement?

Whilst we support arrangements in place to ensure that new entrants are not relatively disadvantaged when compared to incumbents in respect of the commitment model, we do not support a position which invokes losses on market participants.

The approach taken here by DotEcon with regard to incremental and decremental offers and bids submitted to the balancing market is a clear attempt to transfer risk to participants, however we dispute the appropriateness of this given the management of this risk is not in the control of generators. It seems that the measures are designed to manage the issue of market power, however there are numerous market power workstreams ongoing across a range of market developments, and in the context of this we again reiterate that market power should be a centrally managed workstream with decisions made under a holistic review of market power across the range.

We do not support the premise that all participants should be restricted in their ability to at least meet their incurred costs in the provision of services. It is entirely inappropriate that where a provider

provides a services, it should be remunerated for this at the contract price. DotEcon propose 2 options for the 'Incremental offer' considerations;

In one particularly penal scenario, a participant would operate at a loss when being called on. There seems to be an inherent assumption that the generator should be penalised for not being in-merit, despite the fact that this is likely to be beyond the control of participants.

An alternative option is to Inc a participant and revoke the DS3 availability payments which are received as a result of being brought into this position. This leads to a perverse scenario whereby a participant wouldn't be remunerated for DS3 services despite being technically realisable to do so.

We believe this issue stems from a fundamental misunderstanding (perhaps given that the proposals emanate from the telecoms industry) of the costs involved in the provision of enhanced services. It is clear that participants will incur both short run and long run (fixed) costs for providing system services however the proposal actively ignores both. . The DotEcon proposals will transfer considerable risks on participants; we do not believe it is appropriate for such transfer of risk which will create volatility in the DS3 auction.

All risks for participants will be reflected in their bids, however this does not create a credible hedge and will result in new entrants being substantially disadvantaged when compared to existing generation, as they will be forced to quantify these risks over the period of a long term contract. This is an imperfect outcome for both participants (particularly given the barrier to entry created for new entrants) and consumers alike, and therefore must be avoided.

For the reasons above, we have a preference for an oversight role which can investigate potential issues for market manipulation (note that this in line with our view of market power which we have supported in other workstreams). This is in line with the SEM Committee alternative proposal. It is important to note that we do not support any measures which revoke DS3 revenue from participants in any circumstances when these services are technically realisable.

We do however have some concerns about the nature of the inc's and dec's that participants will be required to submit to the balancing market. These should not be fixed and should reflect a participants fuels costs along with other energy market fundamentals. As the value of these inc's and dec's will vary over time, particularly for new entrants with 15/20 year contracts, participants should be able to update their inc's and dec's regularly.

Q18: Do you agree with the position proposed by DotEcon that successful winners in the DS3 Auction should bid in the BM only at DEC prices set to a proxy of the energy price (section 7.2 above)?

See above answer to Question 17

On a further point, Gaelectric seek confirmation that during a period of scarcity where BM prices exceed the RO strike price, should a plant be dec'd to provide reserve, there is no liability for difference payments on RO contracted volume that is not provided due to TSO actions to ensure system security.

Q 19: Do you agree with the position proposed by DotEcon that successful winners in the DS3 Auction should bid in the BM only at INC prices set to a proxy of the energy price, or on a costs minus System Services income basis (section 7.2 above)?

See answer to Q17 with regard to appropriate recovery of costs.

In addition to the points raised in Q17, the points raised in DotEcons report fail to appropriately address the issues faced by energy storage. Whenever energy storage is inc'd from its ex-ante market position by the TSO, an opportunity cost exists due forgone revenues in later time periods it cannot deliver in because of an exhausted store. This is an issue that thermal generators will not encounter and therefore ***these opportunity costs of forgone revenues from deviating from a participant's ex-ante position should be included in the permissible incremental and decremental submissions.***

Q20: Do you support the application of an alternative contingent commitment model that avoids direct commercial interaction and obligation within the Balancing Market (section 7.3 above)?

For the reasons outlined above Gaelectric are of the view that the DotEcon proposals for the contingent commitment model is overly prescriptive and will not result in participants recovering their costs. The inherent uncertainty in managing the interaction between DS3 availability and energy associated with this approach will prevent the investment required reach the SNSP targets set by the TSO's. Restricting the balancing market bids submitted by market participants may also be in contravention of European guidelines. The alternative contingent commitment guidelines still presents challenges for long term contract holders attempting to predict their availability however our proposal of introducing bands within which availability into the future could fluctuate would help manage this. Measures to prevent overpayment on the part of the TSO's would also be mitigated through the maximum revenue available proposal outlined above coupled with the volume scalars that will be included in the final DS3 calculations.

Q21: Do you agree with the proposed treatment of plant that does not require it to be in the schedule or on for provision of System Services?

If a plant is capable of providing DS3 system services without a market position, it should receive its entire contracted payment and this availability should contribute to any obligations under which it operates.

Q22: Do you believe that either the Full Commitment model or the No Commitment model offers a better option for DS3 System Service providers? Please explain your reasons for your view.

Gaelectric are of the view that the no-commitment model favours existing incumbent generators by offering them a "free option" whereby they can receive DS3 availability payments if the energy prices are low but there is no obligation on them. This would be reflected in auction prices where prices may be low with any new investment being priced out of the auction. We are of the view that this will

result in little material increase in the provision of DS3 system services. We believe that a full commitment model will place excessively onerous obligations on contract holders to constantly remain at their contracted position (despite this being out of their control). While this may ensure system service provision it may detract from energy market volumes, cause overpayment for DS3 system services and ultimately result in the inefficient operation of the market. As proposed in the DotEcon report, the contingent commitment model places excessively onerous requirements on long term contracts holders to predict their availability. Similarly, the incremental offers and decremental bids as proposed in DotEcon paper are overly prescriptive and will not allow participants to adequately recover their costs. For these reasons Gaelectric support the SEMC alternative contingent model with market over-sight as incorporated into the I-SEM market power mitigation measures.

4 CONCLUSION

Gaelectric welcome the report by DotEcon which at its heart contains the potential for a commercial solution to DS3, however presents a number of deviations and enhanced risks for participants which must be addressed by the SEM Committee ahead of a decision. We request a comprehensive response from the SEM Committee as soon as practicable given the impact that DS3 has on investment and indeed the impact it will have on pricing in the energy market and CRM auctions.

Gaelectric support the premise of new entrant auctions, with a minimum 20% volumes set aside for new entrants, and with no TSO subjectivity in relation to procurement.

We have supported the re-establishment of the minimum revenue guarantee which covers the entire bid package in an effort to support a minimum investment case without supporting 'profiteering'. Within this response we have supported a maximum revenue limit also in order to protect the consumer against perceived extra-profits.

Gaelectric have provided comprehensive feedback on the issue of participant risk and particularly around the area on contingent commitment and availability as defined in the auction bids for system services. We look forward to the response from the SEM Committee in respect of these areas which are crucial to the investment case for new entrants.

We wish to take the opportunity to reiterate our comments made in the introduction of this response which stated that it is our belief that DS3 is the single most important market development underway at present given it is a programme which is intended to support the enhance the investment signal for renewables by mitigating the considerable challenges associated with achieving 2020 renewable targets, and further it is the most important vehicle for new entrant investment which will set the tone for developing a future electricity system portfolio which is both flexible and fast acting.

In order to achieve an effective outcome from the DS3 programme, we believe that it must be developed as a programme which is underpinned by stable, transparent and investable revenue streams.

We look forward to engaging further with the SEM Committee throughout the DS3 programme. Should you have any queries in relation to this response, please do not hesitate to contact us.