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Ref: TEL/CJD/16/021

12th February 2016

RE: DS3 System Services Auction Design Consultation Paper (SEM-15-105)

Dear Mo, Andrew,

TEL welcomes the opportunity to respond to this consultation.

TEL considers that DS3 is of greater importance to the Irish System than the I-SEM. There is a need to get DS3 right first time. The proposals presented in this consultation are overly complex, both for generators and for the TSO's to resolve. The proposals will not ensure security and sustainability and will frustrate renewable policy delivery. The fundamental point of DS3 is to maximise the benefit for consumers of the high levels of wind capacity on the island, which requires significant and timely investment primarily from thermal generators. The process that is implemented for DS3 System Services must provide the greatest opportunity for this timely investment.

The response has been separated into two sections: Section A describes TEL's views on the DS3 System Services Auction Design Consultation Paper and Section B answers the questions raised in the Consultation. In section A we would like to raise the following points in response to this consultation:

1. Investment clarity is paramount
2. An integrated auction for DS3 and CRM
3. Auction commitments
4. Cap and clawback
5. Package based bidding

Section A

1. Investment clarity is paramount

In order to get sufficient investment to meet the demand for System Services there has to be clarity throughout the process. The process should be as simple as it can be (bearing in mind the extensive changes for capacity and energy revenue streams). There must be sufficient revenue certainty to entice new investors to provide system services. Without this new investment the DS3 project will not succeed and it will not be possible to reach the 75% SNSP level. The system will have significant wind curtailment (greater than 5%) and Ireland will not meet its carbon targets.

Revenue certainty for new investment involves two aspects:

a) Guaranteed length of tenure (Long Term Contracts)
It has previously been outlined in both the Procurement Decision and the Competition Consultation, that annual and long term auctions will take place together but only for those services where there will be sufficient competition. This has a significant flaw as some services may be deemed competitive prior to others and the auctions will then take place in different years. Investors who need to have a return across a number of services will be commercially constrained from participating in these limited auctions. They will not be able to avail of long term contracts.

The DotEcon paper suggests packaged bids and separating the short and long term auctions. This is a good starting point but we would suggest going further. The short term auctions should only occur when there is deemed to be sufficient competition, but the long term auctions should commence in 2017.

All long term contracts should be offered on all of the services that can be provided by that participant. This is in line with what was originally described in the Procurement Consultation for the Multiple Bid Multiple Timeframe Option 5. This would lead to greater investment and the investment would occur sooner. This is exactly what is required in order to meet the 2020 targets.

b) Guaranteed minimum price that is sufficient to justify investment
The cost-plus regulated tariff that has been proposed will not be sufficient to encourage investment. The price must be set at a level that will attract new entry, if it is not, investment will not occur. Unfortunately the RA's are in a position where they have only one opportunity to set the regulated tariffs at a level to encourage investment. If the prices are set too low, there will be no investment in time for 2020. This cannot be overemphasised.

If the prices can be set a level which will encourage the requisite investment, then investors can bid in their actual costs, safe in the knowledge that until there is sufficient competition they will benefit from payments above their costs. This will encourage investment sooner, leading to a reduction in costs once there is sufficient competition for a clearing price to be set. The consumer will be protected as the overall cost of the service will remain within the €235 million cap in the first three years and will reduce subsequently once the clearing price replaces the regulated tariff.

TEL urges the RA's to ensure that investors see clarity and certainty in the DS3 System Services process, otherwise the success of the project is at risk.

2. An integrated Auction for DS3 and CRM

The DotEcon paper discussed the possibility of merging the DS3 and CRM auctions. This makes sense. If a participant requires success in both the DS3 and CRM auctions, then to hold them separately leaves the possibility of the participant being successful in the first and failing in the second. If this occurs, the participant will not be able to provide the required capacity (assuming the CRM auction occurs first). This will see additional costs for both the system and for unsuccessful participants in the CRM auction. It could lead to both the CRM and DS3 auctions having to be rerun.

3. Auction commitments

The DotEcon paper outlines three commitment models to ensure that participants that are successful in the auction provide system services either through the market or physical dispatch. While the paper itself correctly dismisses both the "no-commitment" and "full-commitment" model, the "contingent commitment" model is recommended.

This model is based on the idea that plants that bid in their maximum quantity (e.g. 100 units) and their expected availability (40%) are somehow guaranteeing the product of these (40 units). The proposal is that plants should be able to provide these 40 units 100% of the time. These are not equal. A plant that states it is only likely to be available 40% of the time, should not be committing itself to provide 100% of the time.

The proposal from the RA's of the alternative contingent bidding model appears to be more in line with the Decision.

4. Cap and clawback

The DotEcon paper recommends that there should be a cap in payments to providers, and after this cap that there will be a clawback of the excess. We believe that this is already catered for in the Procurement Decision with the volume scalar. That scalar will reduce the overall amount paid for the service in line with budget. Furthermore the cap and clawback actually conflicts with the purpose of the performance scalar. This scalar will reward high performance. Presumably, if a participant bids in an availability of 50% and manages to supply 60% they would be rewarded under the performance scalar. Whereas the purpose of the clawback seems to be to limit the payment to an individual provider to their contracted amount, even if the provider is scheduled by the TSO to provide more than the contracted amount.

TEL would reiterate the need for a minimum annual revenue requirement, as described in the Decision Paper (SEM-14-108), to be implemented as it will provide investor certainty.

5. Package based bidding

TEL sees considerable merit in package based bidding, particularly allowing participants to bid for all of the services at one time. However with the formula proposed for the packaged bids, the use of setting the quantities at the "maximum amount" in the bid parameters could result in providers not being able to cover their costs.

We are concerned that due to the proposed formula and bid structure, the single price for the package of services could result in perverse pricing for some system services. For example, it may see a higher price for SOR than for POR.

Finally new investors will find it extremely difficult to estimate technical availability to provide services fifteen years out considering the potential divergence in wind generation.

Section B

Question 1: What are your views on the proposals to try to ensure a level of consistency between CRM and DS3 System processes?

TEL agrees with the principles proposed by the SEMC to ensure the level of consistency between the CRM and DS3 system processes. The inclusion of the DotEcon recommendation of separate auctions for new and existing plant with separate volumes for long-term contracts should be included in the SEMC actions. As discussed at the workshop, it is worth having the CRM as an additional service for the purposes of the Auction.

Question 2: 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.

TEL agree that a combined CRM and DS3 auction could mitigate the need to rerun auctions due to participant failure in either auction. Hence, the SEM-Committee should consider facilitating a combined CRM and DS3 auction.

Question 3: What are your views on managing the interactions between the CRM and DS3 System Services auctions?
It appears likely that there could be a circular relationship between the two auctions. If a participant requires being successful in both streams, and is successful in Auction 1, but fails in Auction 2, then they will not be able to provide the service they are contracted for in Auction 1. This will lead to Auction 1 failing, The next best participant in Auction 1 cannot simply be awarded the contract (along with a price increase) as they will be too late to participate in Auction 2. The obvious solution is to both streams are handled in the same auction, and that there is a flag which allows those plants which require being successful in both to indicate this.

Question 4: Do you agree with the proposals for separate DS3 System Services long-term and short-term auctions as set out in the DotEcon recommendation?
Yes.

Question 5: Do you think the treatment of long-term contracting for System Services should be aligned with the proposed framework in the CRM?
N/A

Question 6: What are your views on the proposals to calculate clearing volumes for the auction as set out by DotEcon?
TEL agree with DotEcon's proposal for the auction volume requirement to be based on an additive basis. However, TEL do not agree with the proposal by DotEcon that a plants proposed volume equals their availability by their maximum quantity. If a plant states that it can offer 5,000 units of SIR, 20% of the time, it does not mean that the plant can offer 1,000 units all the time.

Question 7: Do you agree with the proposals for introducing granularity for the purposes of calculating auction clearing volumes?
No, the time granularity will be an issue where we have high winds in summer time. On August 3rd last year there was sufficient wind for 75% SNSP. The RA's cannot just assume that less system services are required in traditionally lower wind months.
Locational granularity would be inappropriate as it could lead to market power issues.
The report itself already fundamentally dismisses any benefit from technological granularity.

Question 8: What are your views on the proposal to introduce flexibility on the volumes to be procured?
TEL agree with the minimum volume requirement proposal to introduce flexibility on the volumes to be procured. TEL do not agree with the price dependent volume requirement proposal. The concept that the "TSO would compromise with a slightly reduced quantity and a much lower price….and the TSO can always procure additional volumes of system services from SS auction losers" is concerning, considering in the DotEcon paper it is suggested that losers of the auction should be paid a lower price than the winners of the auction. Such a proposal could provide the TSO with a perverse incentive to purchase from cheaper unsuccessful bidders.

Question 9: What are your views on the proposals for package based bidding?
TEL sees considerable merit in package based bidding, particularly allowing participants to bid for all of the services at one time. However with the formula proposed for the packaged bids, the use of setting the quantities at the "maximum amount" in the bid parameters could result in providers not being able to cover their costs.

We are concerned that due to the proposed formula and bid structure, the single price for the package of services could result in perverse pricing for some system services. For example, it may see a higher price for SOR than for POR.

Question 10: Do you consider that a provider will be able to predict its expected availability accurately on an annual basis?
No. What is even more of a concern is that the DotEcon proposal seeks to have providers forecast their availability up to 15 years in advance. This at a time where there is considerable uncertainty regarding wind generation rollout, and hence likely running (and then technical availability) of thermal generation.

Question 11: Do you agree with DotEcon's proposals in relation to quantity units for the services outlined above?
TEL agree with the units for the different system services.

Question 12: What are your views on a suggested cap or clawback on expected availability per plant to manage DS3 System Service expenditure?
The DotEcon paper recommends that there should be a cap in payments to providers, and after this cap that there will be a clawback of the excess. We believe that this is already catered for in the Procurement Decision with the volume scalar. That scalar will reduce the overall amount paid for the service in line with budget. Furthermore the cap and clawback actually conflicts with the purpose of the performance scalar. This scalar will reward high performance. Presumably, if a participant bids in an availability of 50% and manages to supply 60% they would be rewarded under the performance scalar. Whereas the purpose of the clawback seems to be to limit the payment to an individual provider to their contracted amount, even if the provider is scheduled by the TSO to provide more than the contracted amount.

Question 13: 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.
No. The DotEcon report is based on the idea that plants that bid in their maximum quantity (e.g. 100 units) and their expected availability (40%) are somehow guaranteeing the product of these (40 units). The proposal is that plants should be able to provide these 40 units 100% of the time. These are not equal. A plant that states it is only likely to be available 40% of the time, should not be committing itself to provide a lower amount ,100% of the time. The proposal from the RA's of the alternative contingent bidding model appears to be more in line with original Decision.

Question 14: 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?
No. It is counter intuitive that a situation arises where the most competitive auction loser is paid less than an auction winner when that auction winner is not available. This proposal has a perverse incentive for the TSO to under procure the necessary volume.

Question 15: Do you agree with the proposals for determining the winner/price as set out in the DotEcon recommendation?
TEL do not agree with the proposed winner determination approach due to the availability process, as per answer 13.

TEL do not agree with an assumption stated in section 6.1 (pg 88) that "bidders rationally would not care about the individual price for each service as long as the bundle of services in the package achieves sufficient revenues". Considering the system service revenues is based on the individual price, scalars and volume provided, the price is essential to the bidders. The price will be important to the value of extra provision of reserve by providers.

Question 16: Do you agree with the proposed treatment of interconnectors? Should this apply equally to all interconnectors?
N/A

Question 17: Do you agree with DotEcon's proposed preferred model of Contingent Commitment in DS3 System Service Auction procurement?
No. The Contingent Commitment model makes little sense. Providers are entering this auction with the expectation that they will earn additional income by providing these additional volumes to the market. In the Contingent Commitment model providers are expected to either bid below cost into the DAM, or reduce their BM incs by their DS3 revenue. Effectively this means that they will have no additional income, despite significant investment.The proposal from the RA's of the alternative contingent bidding model appears to be more in line with the Decision.

Question 18: 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)?
No, if a provider does not get into the market it is because the energy price was below its cost of generation. Therefore plants would have to bid below cost.Equally the time that these services will be most required is at times of high wind. At times of high wind there will already be an extremely low energy price. Below the cost of most thermal generators.

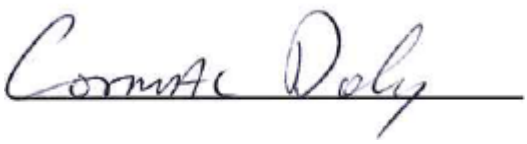
Question 19: Do you agree with the position proposed by DotEcon that successful winners in the DS3 Auction should bid in the BM only at INC prices set to a proxy of the energy price, or on a costs minus System Services income basis (section 7.2 above)?
No. See Q17.

Question 20: 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)?
Yes. This places the appropriate risks on providers to ensure that they provide the contracted services over a defined period of time.

Question 21: 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?
Yes. Plants that are on in the Market, but have been constrained off by the TSO should not be disadvantaged due to the actions of the TSO.

Question 22: 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.
Neither as TEL believe the proposal from the RA's of the alternative contingent bidding model appears to be more in line with the initial Decision.

Yours sincerely,



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