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Dear Conor and Leslie,

**RE: TSO DOCUMENT ON HARMONISED ANCILLARY SERVICES, OTHER SYSTEM PAYMENTS & SYSTEM, PUBLISHED 23<sup>RD</sup> SEPTEMBER 2008**

Thank you for the opportunity of responding to this important document. Ancillary service payments are needed to pay for services not remunerated by the wholesale pool through energy and capacity payments. Without these additional services the power system would be inoperable.

We caution against significant changes to ancillary services because this increases uncertainty in the market and can result in unintended consequences for investors, generators, and consumers. Rather, our expectation is that evolutionary change is needed. In this spirit we support the current focus of looking at ancillary service requirements over the next few years versus the longer term.

Any change to ancillary services must be tempered with the need to maintain consistent, stable and predictable investment signals for generators and stable prices for consumers. In this regard, we welcome proposals allowing for long term contracts as this will help reduce the cost of capital in turbulent financial times to the ultimate benefit of consumers in terms of price and security of supply. By the same token, we are concerned that uncertain provisions are in place to impose reserve causation charges on new generating plant and interconnectors and we would ask for greater clarity on this. We would strongly caution that reserve causation charges would make the investment climate much more difficult in what is already a difficult climate.

We are encouraged by the pricing principles of clarity, predictability, transparency and effectiveness. In terms of providing the right incentives, we do, however, firmly believe there is scope for the use of rewards as well as penalties in motivating desirable behaviour. The economics literature identifies an asymmetrical effect between these two, with rewards signalling a supportive role and being more effective than penalties<sup>1</sup>. Furthermore, there is evidence to suggest that a combination of rewards and penalties leads to welfare improvements over penalties alone<sup>2</sup>. We would recommend a mixed penalty-reward system as this would improve the position of generators who perform well without reducing the quality of ancillary services delivered.

Finally, any changes to ancillary services (or grid code requirements) should respect the technical limitations of plant equipment as detailed in manufacturer specifications. This does not mean that a blanket dispensation should be given to legacy generators as this would seriously distort exit signals in the market. A reasonable compromise might be to include a requirement to upgrade or modernise plant equipment where costs are not excessive. Emissions control commitments under IPPC licence conditions should also be respected.

Certain changes are necessary and should be welcomed, particularly the introduction of alternative fuel payments. As recently highlighted in the Irish Government's White Paper<sup>3</sup>, the CER's proposed decision paper on secondary fuel obligations<sup>4</sup>, and the All Island study on gas storage and liquefied natural gas<sup>5</sup>, alternative fuel capability helps to address concerns over security of supply. As an incentive for installing this capability, generators should be able to recover their costs and generate a reasonable stable return for providing the service. We do not agree that the CER-proposed eligible costs capture all relevant costs that a combined cycle gas turbine generator (CCGT) would necessarily incur in the provision of alternative fuel capability. We highlight with particular concern the absence of the following costs which are not recovered elsewhere (either through energy or capacity payments):

- a. The costs of equipment for dual-firing burners.
- b. The costs of large fuel storage tanks, bunds, fuel unloading equipment, testing equipment and specialised safety and fire protection equipment.

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<sup>1</sup> See Sims, H.P. (1980), "Further Thoughts on Punishment in Organizations", *The Academy of Management Review*, Vol. 5, pp. 133-138. Also see Fehr, E. and S. Gächter (2000), "Fairness and Retaliation: The Economics of Retaliation", *Journal of Economic Perspectives*, Vol. 14, pp. 159-181.

<sup>2</sup> See Falkinger, J. and H. Walther (1991), "Rewards versus Penalties: On a New Policy Against Tax Evasion", *Public Finance Quarterly*, Vol. 19, pp. 67-79.

<sup>3</sup> <http://www.dcenr.gov.ie/NR/rdonlyres/54C78A1E-4E96-4E28-A77A-3226220DF2FC/27356/EnergyWhitePaper12March2007.pdf>

<sup>4</sup> <http://www.cer.ie/en/electricity-security-of-supply-current-consultations.aspx?article=7d14283f-b667-4cdc-996b-61f6e56fd94e>

<sup>5</sup> <http://www.detini.gov.uk/cgi-bin/downutildoc?id=2161>

- c. The cost of storing demineralised water for controlling NOx emissions
- d. The cost of procuring and regularly transporting distillate oil to fill the tanks and replacement as it degrades with use and storage.
- e. Increased maintenance costs commensurate with the frequency with which the plant is required to run on distillate.
- f. The costs associated with accommodating and managing the audit and testing regime – i.e. those related to operational coordination and management during a test period. And the costs associated with the test itself each time it is scheduled.
- g. The cost of liquid fuels having a finite shelf life requiring them to be replenished after a certain storage period.

We are aware of an argument that fixed costs associated with the provision of alternative fuel capability are compensated via the best new entrant calculation in the capacity payment mechanism. We strongly disagree with this contention on the basis that the best new entrant: (i) is an open cycle gas turbine (OCGT) that can only run on a single fuel, not a CCGT with dual fuel capability; and (ii) has a required quantity of distillate enabling the unit to operate at full-load for 3 days, not 5 days.

We welcome proposals for the introduction of CCGT multimode operation as a new ancillary service as this will capitalise flexibility already on the system and will encourage flexible CCGT operation. We are however keen that generators be kept whole in the SEM for providing these new services. We suggest a general approach to multimode operation could be as follows:

- (1) Grid pay difference between running costs calculated from commercial offers submitted to market and actual running costs of CCGT operations; or
- (2) Grid pay generators for the provision of multimode operations.

(1) could be achieved either by submissions of multiple commercial offers by generators or post-event submission of operating costs to grid. Calculation could then proceed on a similar basis as the constraint payments calculation only using DQLF only and the two sets of commercial offers and (2) could be achieved through longer term contracts with grid and capture any costs associated with the provision of the service.


In conclusion VPE support a cautionary approach in the reform of ancillary services through harmonisation. We do not believe a significant increase in ancillary service allowances is warranted. Instead, a more efficient allocation of allowances through, for example, alternative fuel payments and CCGT multimode operation is sufficient at this stage. In the interests of maintaining consistent, stable and predictable investment signals for generators and stable prices for consumers we welcome provisions for long term contracts and clear, predictable pricing principles. We would encourage the introduction of rewards as well as penalties in the incentive structure of ancillary services as this would improve the position of generators who perform well without reducing the quality of ancillary services delivered. We are also keen for

the technical limitations of generators to be reasonably acknowledged without granting blanket dispensations that would distort exit signals in the market.

In addition to these comments, we provide further views in the attached Annex relating to each of the ancillary services, other system payments, and system charges discussed in the TSO document.

Please do not hesitate to contact us if you would like further information or you would like to meet with us to discuss the points we make.

Yours sincerely

A handwritten signature in blue ink that reads "K Hannafin". The signature is written in a cursive, slightly slanted style.

Kevin Hannafin  
Senior Regulation Analyst

## **Annex**

### **VPE Response to Proposed Ancillary Services, Payments & Charges**

*(NB: Please refer to our supporting cover letter)*

#### **Reserve**

- Any changes to ancillary services (or grid code requirements) should respect the technical limitations of plant equipment as detailed in manufacturer specifications. This does not mean that a blanket dispensation should be given to legacy generators as this would seriously distort exit signals in the market. A reasonable compromise might be to include a requirement to upgrade or modernise plant equipment where costs are not excessive. Emissions control commitments under IPPC licence conditions should also be respected.

#### **Reactive Power**

- No specific comments.

#### **Black Start**

- Measures to enhance Black Start capability are necessary and welcome as evidenced by the absence of new Black Start services over the last twenty five years.

#### **Warming Contracts & Maintenance of Heat State**

- More research and analysis is necessary to assess the benefits of warming contracts and their effect on the wholesale market unconstrained dispatch.

#### **Combined Cycle Gas Turbine Multimode Operation**

- We welcome this as a new ancillary service (please refer to supporting cover letter).

#### **Pre-Emptive Response**

- In principle we not are against pre-emptive response but generators should not be expected to take on additional risk in providing this service and we would like clarification that Turlough Hill will not be rewarded twice for essentially the same service.

## **Alternative Fuel Payments**

- We welcome this proposal subject to generators being recompensed for the costs of providing this service (please refer to our supporting cover letter).

## **Short Notice Declaration Charges**

- In principle we support measures that will incentivise behaviour that enhances system security and that reduces operating costs. Incentives only work in altering behaviour if that behaviour is controllable. On this note we welcome the introduction of a 10MW threshold designed to exclude from consideration small fluctuations in output due to ambient temperature changes. Analysis shows that a 10MW threshold is an adequate margin, for much of the operating year, to allow ambient related non-availability to be re-declared without penalty. However, this threshold is not sufficient in all cases. Examples of this are in low ambient temperature periods, when our gas turbine compressor inlet anti-icing systems are in service, or large scale weather changes which affect, not only our gas turbine mass flow, but also the performance of our condensing steam turbine from vacuum degradation due to high wind speeds and/or air temperature changes. We do not agree with the TSO's commentary that both trip charges and SND's should apply to the same event. How can a generator give 12 hours notice of a trip?
- Short notice declaration charges, as proposed, are set too high. It would be instructive to know how these charges have been derived.
- The SND charge seems particularly penal in a situation where a generator has experienced a problem on start-up and must delay his sync time, even by a few minutes. In this situation a re-declaration of availability from, say 400MW to 0MW, may attract a penalty of €40,000. This charge may also be accompanied by a 'late synchronisation' charge in the future, as mentioned in this paper.

## **Trip Charges**

- Consistent with our view on short notice declarations, we support the principle of incentivising behaviour that enhances system security and reduces operating costs. However, we believe that the Trip charges proposed are overly onerous, especially given that outages are a normal part of generation business. We suggest that a threshold payment approach would be more appropriate.

## **Generator Testing Charges**

- We suggest that generator testing charges should differentiate between plant that is operational from one that is commissioning

## **Generator Performance Incentives**

- Measures to encourage good generator performance should be welcomed providing they are effective. We do not agree with the proposed approach that relies entirely on negative incentives by charging for underperformance without rewarding good performance. We strongly suggest that rewards for good performance be incorporated into the incentive structure (please refer to our supporting cover letter).