



Response to SEM-10-075



ESBPG response: Harmonised Ancillary Services Arrangements and the Bidding Code of Practice

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Executive Summary

ESBPG agrees with the principles championed by the Regulatory Authorities (RAs):

- Not to distort price signals
- Ensure economic & efficient costs are passed onto the consumer.

The RAs believe that due to the harmonisation of the two ancillary services offerings the definition of what is a fixed and what is a variable cost needs to be clarified and that this may require changes to be made to the bidding rules.

The consultation document proposes three alternative models each with its own limitations.

However, given ESBPG's understanding of the problem that the RAs' options are addressing, ESBPG believes that any requirement for change is premature. This is because:

- Although the current arrangements for pricing the commercial bid is not perfect any distortion arising from not netting off variable ancillary services (AS) payments will only have a limited effect on the SMP's signalling efficiency
- There is no double count of the Ancillary Services (AS) payments as ESB PG believes is stipulated in the paper
- The value for ancillary services deducted from the capacity payments sum (€30m) approximates that allowed as a pass through for the TSO.

As stated by the RAs' Option 1, although pure, is not preferred as it will require complex bidding because of the technical nature of the timing of the payments for the ancillary services in relation to the plant's operation. ESBPG agrees that this would be a significant and complex change that far outweighs the small value of the variable ancillary services in the energy market (€2.6m in an overall wholesale market worth €2.5bn).

The **current arrangements are already aligned** with the intent of the RAs' preferred option 2 and therefore no change is necessary either in calculations or systems. ESBPG believes that in the interest of market certainty, continuity and maintaining a pragmatic approach to market rule modifications that **no change is necessary** to the bid structure.

The current arrangements already reflect the RAs' preferred option and no further change is necessary. There is no double counting since the value of the capacity payments mechanism has already been reduced by approximately the TSO's total allowed annual sum for ancillary services payments.

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1 Background to the proposed changes

1.1 Defining variable costs.

The RAs have been advised that clarification and proposed changes are necessary given an overlap between the Bidding Code of Practice (BCOP) and the Harmonised Ancillary Services (HAS).

A review of the definition has determined that any payment made for reserve which is paid whilst the plant is operating is deemed variable however, whether it should be included in the SRMC bid as per the strict rules of BCOP is being consulted on.

The consultation will consider the need to have an exact formula within the Commercial Offer Data against the costs of greater uncertainty and complexity.

1.2 Removing the potential for double payment of services provided- The RAs' options.

In the paper ESB PG's understanding is that it is argued there is an overlap between the HAS and the BCOP with the potential for the double payment of services offered.

It is argued that the BNE does take into account all AS but since these are treated as fixed costs they do not need to be bid into the COD.

Given the RAs' preferred option there is a suggestion that these variable payments are not included and are thus double counted, however, in the calculation of the BNE the AS are also related to payments made that would be made only when the plant is operating.

2 ESBPG's view on the existence of double-counting the revenues for AS

2.1 The RAs have asked - how, if at all, should the variable benefit of HAS payments be factored into bidding?

ESBPG believes that the changes necessary to the bidding structure for the inclusion of the variable costs of the AS is too complex and any benefits in signalling terms would be limited.

2.2 Variable ancillary service costs are already captured in the BNE

In line with option 2 proposed in the RAs' consultation paper, ESBPG reviewed the methodology for the calculation of the BNE and capacity payments. ESBPG has concluded that the full revenue from the provision of variable AS has already been deducted.

To deduct these AS payments again would mean that the service is being provided for free, this would not provide the correct economic signal and both the service would be withdrawn and there would be no desired reduction in the SMP.

In cash equivalent terms and using the information from the RAs' paper on BNE cost for 2011 the actual value of the variable ancillary services already deducted are calculated below.

2.2.1 The BNE cost has deducted ancillary services revenues

Cost Item	Northern Ireland Distillate
Annualised Cost per kW	83.14
Ancillary Services	4.41
Infra-marginal Rent	0.00
BNE Cost per kW	78.73

Source: SEM-10-053

2.2.2 The Annual Capacity Payment Sum has been adjusted downwards by €30.5m for the Trading Year 2011

The CER's calculated capacity requirement for 2011 is 6,922MW and at the agreed BNE cost results in a net capacity pot of €544.9m of which a deduction of the value of €30.5m (4.41€/kW/yr * 6,922MW) has been made for Ancillary services.

Year	BNE Peaker Cost (€/kW/yr)	Capacity Requirement (MW)	ACPS (€)
2011	78.73	6,922	544,956,545.05

Source: SEM-10-053

2.2.3 The TSO's allowed ancillary services costs are approximately the same value as the sum deducted from the capacity payment sum.

The regulator has taken the Harmonised Ancillary Services between ROI & NI into account when forecasting the TSO's allowed costs for its forecast of PR3 Ancillary Services costs.

Table 39: TSO External (Non-Controllable) Opex PR3 (€m's 2009 prices) - Allowed

	2011	2012	2013	2014	2015	Total PR3 Allowed	TSO PR3 Forecast
CER Levy	0.86	0.91	0.96	1.01	1.06	4.79	4.79
DUoS costs	0.40	0.40	0.40	0.40	0.40	2.00	2.00
Interconnector services	0.60	0.60	0.60	0.60	0.60	2.99	2.99
Inter-TSO Compensation	1.13	1.13	1.13	1.13	1.13	5.64	5.64
Ancillary Services	45.10	46.30	49.40	50.90	52.50	244.20	244.2
Stage 1 Working Capital	4.15	4.71	3.30	1.66	1.42	15.24	0.0
TSO External (Non-Controllable) Costs	52.23	54.05	55.78	55.69	57.11	274.86	259.62

Source: CER/10/206

Ancillary services in the allowed TSO revenues are made up of several parts an estimated breakdown is reported below this example has used an assumption of 5% for black start.

Service Description	% allowed cost pass through (1)(4)	€m allowed cost pass through (3)
Operating Reserve	66.5%	29.99
Reactive Power	28.5%	12.82
Black start (2)	5%	2.25
Total Ancillary services	100%	45.06

1. Applying a 70/30 split of non black start AS
2. The black start value is an assumed value for illustrative purposes
3. % of allowed pass through applied to the TSO's allowed ancillary service value of €45m
4. 70/30 split obtained from Eirgrid correspondence and based on their judgement.

Of the €45m that has been allocated as a pass through cost to the TSO for total ancillary services, approximately 66.5% of this is attributable to operating reserve and equates to €30million. This sum reflects the value for the total operating reserve that has been deducted from the capacity payment sum.

ESB PG has recalculated the split between variable cost and the fixed cost element of the operating reserve (without adjusting for any penalty) to assess the scale of any change that may be needed. The following variable operating reserve costs can be calculated using the known operational characteristics of plant (those circled in red are defined as variable):

Table 1

	€ BNE annual payment (1)	BNE size MW (2)	€/mw (3)	Capacity requirement MW (4)	€m adjustment (3)*(4)
Variable operating reserve	72,942	190.1	383.7	6922	2.6
Fixed operating reserve	789,840	190.1	4154.86	6922	28.7
Total operating reserve	-	-	-	-	31.3

Source: SEM-10-053

Cost Item	Annual Availability (Half Hour)	Annual Hourly Rate €/MWh	Annual Payment €
Primary Operating Reserve	8,760	2.22	9,724
Secondary Operating Reserve	23,834	2.13	25,383
Tertiary Operating Reserve 1	26,644	1.76	23,447
Tertiary Operating Reserve 2	26,644	0.88	11,724
Replacement Reserve Unit Synchronised	26,644	0.2	2,664
Replacement Reserve Unit De-Synchronised	3,097,413	0.51	789,840
Reactive Power (Leading)	21,024	0.13	2,733
Reactive Power (Lagging)	21,024	0.13	2,733
Total Revenue			868.249
Penalties			30,544
Total (after penalties allocation)			837,705

Source: SEM-10-053

In effect to deduct a further variable payment would result in double counting a deduction with **no payment** being made for operating reserve.

The distortion of a further deduction on this price signal would have a greater impact on those incentivised to provide the service than any benefit that could be accrued from making an adjustment to the SMP of the (estimated) €2.6m sum value of the variable element of the AS. This would be exacerbated if total AS and not only variable revenue was deducted as indicated in option 2.

3 **ESBPG's conclusion**

Given this conclusion ESBPG believes that no further change is necessary to the current working system and the signals and payments made are efficient and are in line with the RAs' decisions and views on:

- the TSO's price control assumptions
- the need to retain certainty and be pragmatic
- the need to pass on efficient and economic costs to the consumer.

The **current arrangements are aligned** with the intent of the RAs' preferred option 2 and therefore no change is necessary either in calculations or systems. ESBPG believes that in the interest of market certainty, continuity and maintaining a pragmatic approach to market rule modifications that **no change is necessary** to the bid structure.