



SINGLE ELECTRICITY MARKET COMMITTEE

DS3 System Services Procurement Design

Summary of Responses to SEM-14-059

SEM-14-109

19th December 2014



TABLE OF CONTENTS

| | | |
|---|---|----|
| 1 | INTRODUCTION | 3 |
| 2 | ECONOMIC ANALYSIS | 4 |
| 3 | ASSESSMENT OF PROCUREMENT OPTIONS | 10 |
| 4 | RESPONSES ON PROCUREMENT OPTIONS | 15 |
| 5 | OTHER ISSUES RAISED | 22 |
| | ANNEX..... | 24 |

'The SEM Committee is established in Ireland and Northern Ireland by virtue of section 8A of the Electricity Regulation Act 1999 and Article 6 (1) of the Electricity (Single Wholesale Market) (Northern Ireland) Order 2007 respectively. The SEM Committee is a Committee of both CER and NIAUR (together the Regulatory Authorities) that, on behalf of the Regulatory Authorities, takes any decision as to the exercise of a relevant function of CER or NIAUR in relation to an SEM matter.'

1 INTRODUCTION

- 1) The SEM Committee wishes to thank market participants and other stakeholders for their efforts in responding to the Consultation Decision and in participating in the public Stakeholder Forum in July 2014. As part of the consultation process the stakeholders were offered the opportunity to meet bi-laterally, with the Regulatory Authorities. The SEM Committee would like to thank those stakeholders who engaged in this process. Active stakeholder engagement is an important part of ensuring the new system services proposed under DS3 can be delivered in a way that provides the greatest benefits for the consumer and participants in the all-island market.
- 2) This paper provides a summary of the responses received in relation to the Draft Decision Paper on the DS3 System Services Procurement Design (SEM-14-059). The SEM Committee also sets out its position on the issues highlighted in the responses. This follows careful consideration of the extensive set of responses received to the Consultation Paper and the bilateral meetings held with respondents.
- 3) The SEM Committee received 26 responses (plus additional supporting reports) to the consultation paper, 5 of which were confidential. The SEM Committee will also publish the non-confidential responses on the All-Island Project website.
- 4) Annex 1 lists all of the responses received to the Draft Decision Paper.

1.1 STRUCTURE OF THE DOCUMENT

- 5) The document is structured as follows:
 - Chapter 2 highlights issues raised in responses relating to the Economic Analysis and summarises the issues raised in responses in relation to the procurement options set out in the consultation paper;
 - Chapter 3 summarises the issues raised in responses in relation to the procurement options set out in the consultation paper;
 - Chapter 4 summarises the issues raised in relation to the SEM Committee's preferred option – option 5;
 - Chapter 5 sets out other issues raised during the consultation process.

2 ECONOMIC ANALYSIS

- 6) This chapter provides a summary of the responses received in relation to the Regulatory Authorities demand side analysis and supply side analysis of DS3 system services. The responses will be summarised in line with the consultation paper and will cover the following topics:
- Supply Analysis
 - Demand Analysis
 - Procurement analysis
 - System Services Products
- 7) Each of these sections starts with a reminder of the consultation paper before summarising the responses by issue. The section concludes with a statement of the SEM Committee position on each issue.

2.1 SUPPLY ANALYSIS

2.1.1 CONSULTATION PAPER

- 8) The Consultation Paper set out the following in relation to the Supply Analysis:
- DNV Kema analysis on capital costs associated with enhanced system services
 - IPA report covering further analysis on potential capital costs associated with required investment to provide enhanced system services

2.1.2 SUMMARY OF RESPONSES

- 9) Where responses were received in relation to the supply analysis they were generally supportive of the analysis that was undertaken. There were some specific issues relating to the supply analysis which focused primarily on the approach taken to annualised costs. One respondent was concerned with the €70-€84m capital cost, as set out by IPA, may not be appropriate due to the nature of investments that may be undertaken, particularly where the investment is required on existing plant.
- 10) The main focus of the analysis was on the capital costs of investing in new equipment or retrofitting existing equipment, one respondent questioned the validity of the numbers used for non-generation devices.



- 11) Another respondent argued that there was insufficient detail from which they would be able to verify the data. One respondent identified that the supply analysis focuses on the capital investment costs and not the operational costs associated with the investment.

2.1.3 SEM COMMITTEE RESPONSE

- 12) The basis for the capital costs calculation was derived from independent analysis conducted by DNV Kema. The SEM Committee contracted the services of IPA to validate these capital costs. The SEM Committee is aware that the recovery period of 20 years may be considered inappropriate for investment required to update existing units. The potential lifetime of some generating units on the island may dictate that upgrades would not significantly extend their useful life and that a shorter recovery period may be required.
- 13) A generation based solution was chosen over a networks based solution as this would be likely to provide greater benefits to consumers at a lower cost. The generation based solution was used to determine the capital cost of providing the relevant services, this did not preclude network based solutions from competing with generation assets to be able to provide system services.
- 14) The SEM Committee did not assess operational costs of either generation upgrades or network devices. It was felt operational costs were likely to be recovered through other revenue streams (e.g. I-SEM) and may be difficult to reliably compare across different technologies or providers.

2.2 DEMAND ANALYSIS

2.2.1 CONSULTATION PAPER

- 15) The Consultation Paper set out the following in relation to Demand Analysis:
 - The key assumptions used in each scenario relating to wind build out and SNSP limit
 - A summary of the key outputs to be derived from the scenarios
 - An overview of the modelling sensitivities that were tested
 - A summary of the results from the scenarios modelled
 - Analysis of the modelling results



2.2.2 SUMMARY OF RESPONSES

- 16) Respondents were again generally supportive of the work carried out, with a number of respondents highlighting the potential market benefits that could be gained as a result of the new enhanced system services being implemented.
- 17) A number of responses to the consultation raised concerns over the publication of volumes of the enhanced system services. The consultation paper did not identify the volume of system services that could be provided by the existing fleet, nor did it identify the volume of the individual services that would be required to meet the increase in SNSP.
- 18) One respondent was of the opinion that the analysis was too high level, other criticisms of the analysis focused on the scenarios used, including assumptions, using one year as the basis for analysis and the risk of non-delivery of RoCoF requirements.

2.2.3 SEM COMMITTEE RESPONSE

- 19) The SEM Committee acknowledges the requirement for the provision of volumes of the services required should be provided by the TSOs. Indicative figures provided by the TSOs have been published while section 6 of the Decision Paper outlines the SEM Committee decision. This will also require the TSOs to inform the market of the existing capability to provide system services on an aggregate level.
- 20) The assumptions used by the TSOs in their analysis provided to the SEM Committee were based on previously approved and published information. Since the publication of this data further information has become available in relation to the forecasts for the economy and energy prices. The SEM Committee agreed the modelling inputs prior to the work being conducted, and whilst it is acknowledged this updated information could impact on the modelling results to re-run the modelling exercise would impact on the delivery timetable for DS3.

2.3 PROCUREMENT ANALYSIS

2.3.1 CONSULTATION PAPER

- 21) The Consultation Paper set out the following in relation to Procurement Analysis:
 - The SEM Committee advice in relation to procurement options from both Poyry and IPA was identified



- Definitions for the procurement basis set out to include: Dispatch based payments, Availability Payments and Capability payments
- The SEM Committee was of the view that any systems service payments introduced should be done so on a system wide basis, with no desire to introduce locational pricing
- The SEM Committee acknowledges that projects requiring capital investment may require longer contract lengths, however where existing capability to provide enhanced services existed the contracts should be rewarded on a short term basis
- The market for system services is highly concentrated, therefore there may need to be a market power mitigation strategy

2.3.2 SUMMARY OF RESPONSES

- 22) A significant number of responses queried the definition of dispatch based payments, a number of other respondents sought more clarity on the definition of dispatch based payments as envisaged by the SEM Committee. The main concern was that by moving away from a capability based payment could lead to greater uncertainty over revenues. The increased risk associated with this could impact on investment opportunities, in particular those projects that require debt funding. A number of respondents also highlighted the impact of increased risk on new entrants into the market.
- 23) Respondents were also concerned with the definition of availability based payments as introduced in the consultation paper. Availability payments, as per the consultation paper, would be linked to physical or market position. Responses again indicated that this had the potential to increase risk to investors.
- 24) Respondents did not disagree that longer term contracts would be required to facilitate investment. The consultation paper only proposed longer contracting periods for competitive approaches and did not propose introducing longer term contracts under the regulated tariff options. A number of respondents proposed that longer term contracts should be made available to any of the options. Not all respondents agreed that longer term contracts should only be made available to new investment.
- 25) Market power was raised as a concern by a significant number of respondents. The IPA analysis had identified market concentration for the services, several respondents highlighted this information in their response. One respondent noted that the level of concentration in the system services market would not be able to deliver an efficient outcome from a market based mechanism, it was also noted that market power could impact on dispatch based payments. One respondent noted that any market power mitigation strategies to be employed should be done so on a market wide basis.



- 26) Several respondents identified the benefits of locational pricing.

2.3.3 SEM COMMITTEE RESPONSE

- 27) The changes to the definition of availability and dispatch based payments were selected due to their potential relationship with the energy market developments. The SEM Committee notes the concerns raised that dispatch based payments could adversely impact investability of certain projects, particularly green field investment.
- 28) The SEM Committee did not propose setting tariffs for longer than 5 years, the certainty of tariffs was the primary driver for not offering longer term contracts, coupled with the potential to stifle innovation.
- 29) The consultation paper highlighted the existing high level of concentration for the provision of new system services. The proposals put forward by the SEM Committee were aimed at encouraging new investment to compete with existing market participants. Entry (and exit) from the market will have an impact on market power in the future. Existing market power is addressed separately in this paper.
- 30) The final point raised in relation to the procurement analysis was the potential to introduce locational pricing. The SEM Committee notes the arguments put forward in the responses as to the benefits of locational pricing, however this approach is not considered as being appropriate, at this time, by the SEM Committee. Locational pricing could also have an adverse impact on market power, in particular local market power.

2.4 SYSTEM SERVICES PRODUCTS

2.4.1 CONSULTATION PAPER

- 31) The Consultation Paper set out the following in relation to System Services Products:

- The 14 individual products were identified and analysed

2.4.2 SUMMARY OF RESPONSES

- 32) There were limited responses relating to the definition of products, however one respondent noted that Synchronous Inertial Response, under the current definition, could preclude synthetic inertia from being rewarded for providing such a service to the system.
- 33) Another respondent would like to ensure that the definition of the Services should not preclude demand side response from being able to provide services and be remunerated



accordingly. A respondent proposed that there should be incentives for providers who can deliver the services in timeframes faster than required by the definitions.

2.4.3 SEM COMMITTEE RESPONSE

- 34) The SEM Committee has previously consulted on the definition of the system service products. We note the responses raised in relation to the definition of these products, the specifics of payments for these services and the potential to include rewards for performance will be addressed in the detailed design phase.

3 ASSESSMENT OF PROCUREMENT OPTIONS

35) This chapter summarises the responses in relation to the over-arching assessment criteria that was applied to all 5 of the options. In addition to this there were a number of other issues that were originally applied to the preferred option (option 5), given the nature of the responses received it is preferable to address these issues separately from the option design. The responses will cover the following topics:

- Assessment Criteria
- Market Power
- TSO involvement
- Interaction with I-SEM

36) Each of these sections starts with a reminder of the proposals before summarising the responses on each procurement option. The section concludes with a statement of the SEM Committee position on each option.

3.1 ASSESSMENT CRITERIA

3.1.1 CONSULTATION PAPER

37) The Consultation Paper set out 4 key assessment criteria:

- Consumer Interest
- Investment
- Curtailment
- Renewable Targets

3.1.2 SUMMARY OF RESPONSES

38) Respondents generally accepted that the assessment criteria employed by the SEM Committee in the consultation paper was appropriate. One particular response highlighted the concern that the criteria did not address the challenges associated with operating the transmission system, in particular would have liked to have seen system security as an assessment criterion.

39) A number of responses did not agree with the application of the assessment criteria. A Key criticism of the approach adopted was that there is too much focus on cost reduction. Other responses indicated there was limited analysis on the value to the system of providing the system services. A couple of responses indicated that assessment criteria should have covered



increased competition, other similar responses indicated that the assessment criteria should ensure that the system services payments did not prevent market entry by rewarding existing plant that may be less efficient than new investment.

3.1.3 SEM COMMITTEE RESPONSE

- 40) Security of supply was not specifically addressed as an assessment criterion; the SEM Committee is satisfied that security of supply is sufficiently captured as part of the consumer interest criterion. The provision of system services is aimed at securing the operation of the system. Therefore it did not appear appropriate to assess procurement of DS3 services against security of supply as the SEM Committee does intend to select an option that would put security of supply at risk. In other words, option would not be considered if they did not facilitate secure system operation.
- 41) The SEM Committee's principle objective is to is: "to protect the interests of consumers of electricity in Northern Ireland and Ireland supplied by authorised persons, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the sale or purchase of electricity through the SEM." The SEM Committee does not agree that the analysis was too focused on cost reduction, instead the consultation paper focused on increasing competition, with an aim of providing a competitive price, where appropriate by facilitating the provision of services at the marginal price and delivering value for the consumer.

3.2 MARKET POWER

3.2.1 CONSULTATION PAPER

- 42) The Consultation Paper proposed a number of considerations in relation to dealing with market power:
 - Overview provided of potential Market Power issues
 - Proposal to include bidding code of practice
 - Rules to be established for long-term contract allocation
 - Alternative solution in the event competitive auction fails

3.2.2 SUMMARY OF RESPONSES

- 43) Market power was raised as a concern by a significant number of respondents. The IPA analysis had identified market concentration for the services; several respondents highlighted



this information in their response. One respondent noted that the level of concentration in the system services market would not be able to deliver an efficient outcome from a market based mechanism, it was also noted that market power could impact on dispatch based payments.

- 44) One respondent noted that any market power mitigation strategies to be employed should be done so on a market wide basis

3.2.3 SEM COMMITTEE RESPONSE

- 45) The market concentration for each of the system services could adversely affect its ability to deliver an efficient outcome. This formed part of the rationale for the SEM Committee to include provision for market power mitigation measures.
- 46) Whilst there was concern that market power mitigation measures may be targeted at specific market participants it should be noted that any market power mitigation measures would apply to any participant who has market power. This will be considered further in detailed design phase with the aim of mitigating any market power abuse. The SEM Committee is also considering market power in the context of I-SEM.

3.3 TSO INVOLVEMENT

3.3.1 CONSULTATION PAPER

- 47) The Consultation Paper set out that the SEM Committee did not propose to develop an incentive mechanism for the TSOs as part of this process. However in responses to the consultation paper a few other issues were raised in relation to the TSO involvement in the DS3 procurement process:
- Conflict of Interest relating to EWIC
 - Interactions with Dispatch Balancing costs

3.3.2 SUMMARY OF RESPONSES

- 48) A number of respondents raised concerns over the potential conflict of interest between the TSO as the buyer of system services and the owner of EWIC. EWIC is capable of providing some System Services and there was concern that over the conflict of interests between the TSOs as the owner of EWIC and setting volumes and or prices of system services from which they could directly benefit from.



- 49) Other respondents were concerned with the interactions between Dispatch Balancing Costs and system services and in particular the impact of decisions taken for dispatch balancing on system services payments. This is particularly relevant for dispatch based payments.

3.3.3 SEM COMMITTEE RESPONSE

- 50) The Consultation Paper set out that the SEM Committee did not propose to develop an incentive mechanism as part of this process but recommends that the Regulatory Authorities consider the development of appropriate incentives around system services that delivers value for the consumer. Having reviewed the responses the SEM Committee considers that there is value in implementing an incentive mechanism and this will be developed by the Regulatory Authorities in the Detailed Design Phase.
- 51) The potential conflict of interest within the EirGrid group regarding any payment to EWIC for the provision of system services is acknowledged by the SEM Committee. Section 6.13 of the Decision Paper outlines the SEM Committee's position to resolve this in order to ensure the optimal outcome for consumers.
- 52) The concerns relating to the interaction of system services and dispatch balancing costs are noted by the SEM Committee. There is significant work ongoing in relation to changes in the wholesale electricity trading arrangements under I-SEM and this interaction will be fully considered in both work streams. The SEM Committee also note that the TSOs have licence obligations relating to economic dispatch, which is related to this issue.

3.4 I-SEM INTERACTIONS

3.4.1 CONSULTATION PAPER

- 53) The Consultation Paper set out the potential interactions between DS3 and the ongoing developments in I-SEM in particular this focused on:
- The three revenue streams (energy, system services and capacity) should collectively work together to provide the appropriate incentives to the market for entry and exit
 - It is important not only that there is no double payments between revenue streams
 - Revenues should incentivise the type of generation most needed by the system
 - An analysis of the potential interactions was also provided



3.4.2 SUMMARY OF RESPONSES

- 54) There was no general consensus on the interactions with I-SEM, a number of respondents were concerned over the I-SEM delivery timelines, and were of the opinion that DS3 should remain as a separate programme. Other respondents acknowledged the interaction between the markets in particular the balancing market and suggested that the development of DS3 should be developed in line with I-SEM.
- 55) A number of respondents indicated that the ongoing changes to the energy market at this stage is creating significant uncertainty for investment and may adversely affect project development, this point was raised by a number of participants who were both existing market participants and potential new entrants.
- 56) One participant was of the view that where a new project would rely on revenue from both DS3 auctions and Capacity Auction should be able to withdraw their proposal without penalty if they failed to be awarded a contract in either of the two auctions.

3.4.3 SEM COMMITTEE RESPONSE

- 57) The timeline for delivery of I-SEM has changed since the consultation paper on procurement of DS3 services was issued. The SEM Committee sought and obtained permission, from the European Commission, to extend the I-SEM delivery from the end of 2016 to November 2017. The SEM Committee is aware of the relationship between system services and energy trading arrangements; however the SEM Committee does not consider it necessary to alter the timeline for delivery of DS3 in line with I-SEM at this time.
- 58) The uncertainty arising as a result of major changes to the energy trading arrangements including capacity payments is noted; however the reasons for changes to the energy trading arrangements and capacity payments have been well documented as part of the I-SEM high level design decision process. The SEM Committee also has to respect its duty to protect the interests of consumers, whilst taking into consideration the impact of its decisions on investor certainty. To that end the decisions taken in relation to the procurement of system services are done so with respect to the significant stakeholder engagement conducted in the consultation process.
- 59) The SEM Committee notes the proposals to permit a new project investor being able to withdraw their proposal without penalty if they failed to be awarded a contract in either the DS3 auction or the Capacity Auction. The SEM Committee is of the view that provision should be made for such projects. The details of these arrangements will be progressed in the Detailed Design Phase.

4 RESPONSES ON PROCUREMENT OPTIONS

- 60) This chapter provides a summary of the responses received in relation to the options proposed for the procurement of the DS3 system services. The responses will be summarised in line with the consultation paper and will cover the following topics:
- Option 1 – Regulated Tariff
 - Option 2 – System Services Pot
 - Option 3 – Regulated Competition
 - Option 4 – Competitive Split Auction
 - Option 5 – Competitive Multiple Bid Auction
- 61) Each of these sections starts with a reminder of the proposals before summarising the responses on each procurement option. The section concludes with a statement of the SEM Committee position on each option.

4.1 OPTION 1 – REGULATED TARIFF

4.1.1 CONSULTATION PAPER

- 62) The Consultation Paper set out the following description of the regulated tariff approach:
- Individual tariff set for each service, paid to all providers of that service
 - Tariffs fixed for five years and revised every five year period
 - Contracts issued by TSO on an ad hoc basis
 - Contracts reviewed every five years

4.1.2 SUMMARY OF RESPONSES

- 63) A high proportion of respondents stated a preference to have a regulated tariff approach, based on the value provided to the system, with payments made on a capability basis. Of those respondents who favoured this option many pointed to the benefits for new investment, and bankability of such investments.
- 64) Respondents in favour of option 1 also preferred the ability to award contracts for longer than 5 years where appropriate.
- 65) A number of benefits of such an approach were offered, these primarily focused on defined revenue streams where investment was required, as well as rewarding flexibility adequately.



Those respondents that preferred this option did so on the basis that it would reduce the risk of non-delivery of DS3 system services.

- 66) A significant number of responses also indicated that volumes of system services would be required, this was regardless of option selected.
- 67) Some respondents were keen not to have a cost-plus methodology whereby a BNE type approach could be adopted.

4.1.3 SEM COMMITTEE RESPONSE

- 68) The issue relating to longer term contracts to provide certainty for investors through a tariff mechanism has previously been discussed under section 2.3. The SEM Committee has also indicated some of the negative aspects of long-term tariff setting, including the potential impact on innovation. In addition to this the SEM Committee is concerned that setting a tariff for too long could adversely impact the consumer.
- 69) The SEM Committee has previously indicated the ongoing work with the TSOs to provide volumes of the services required, as well as the volume of services that can be provided by the existing fleet (on an aggregate basis)
- 70) A number of responses preferred a value based approach (similar to that proposed by the TSOs) as opposed to a cost based calculation. The SEM Committee was disappointed that none of the responses provided evidence to substantiate views that a cost based approach would not deliver investment. A BNE approach if designed correctly should allow for sufficient revenues to be recovered to reward investment while a value based approach presents a high risk of consumers not receiving a net benefit.

4.2 OPTION 2 – SYSTEM SERVICES POT

4.2.1 CONSULTATION PAPER

- 71) The Consultation Paper set out the following description of the system services pot approach:
 - Price based mechanism
 - System Services “pot” distributed between the services
 - Further distributed between all 12 months, then between each trading period
 - All available units receive proportion of pot for that trading period
 - No long-term contracts
 - Adaptation of existing CPM methodology employed in the SEM



4.2.2 SUMMARY OF RESPONSES

- 72) Option 2 was criticised by a number of respondents due to the lack of long term certainty over future volumes or longer term revenue streams this could option, the RAs would need to take into consideration the impact of this option on long term investment signals.
- 73) One respondent did indicate that option 2 could provide increased transparency on the value of the relevant services to the system.

4.2.3 SEM COMMITTEE RESPONSE

- 74) The SEM Committee agrees with respondents views on option 2 and does not propose to implement this option as described in the consultation paper.

4.3 OPTION 3 – REGULATED COMPETITION

4.3.1 CONSULTATION PAPER

- 75) The Consultation Paper set out the following description of the regulated competition approach:
- Services arranged in four groups
 - Voluntary, pay-as-bid tender process for groups 1, 3, 4
 - Voluntary, pay-as-cleared, intraday auctions for ramping
 - Long-term contracts for groups 1, 3, 4, short-term for group 2

4.3.2 SUMMARY OF RESPONSES

- 76) Responses relating to option 3 highlighted some of the key benefits which included the introduction of long term contracts, price discovery and certainty for investors in relation to volume and prices. It was also identified that security for investors could also provide benefits to consumers as a result of increased security of supply.
- 77) However the majority of responses received in relation to option 3 were not in favour of its implementation. Option 3 was criticised for being overly complex, the grouping of services and no linking of bids was highlighted as a key concern for those that clear the auction for a particular group.
- 78) Other concerns raised included transparency, new entry and subjectivity of awarding contracts.



4.3.3 SEM COMMITTEE RESPONSE

- 79) The SEM Committee agrees with respondents views in relation to the negative and positive aspects of this option. The SEM Committee considers that it would not be in the best interests of consumers to implement this option as described in the consultation paper.

4.4 OPTION 4 – COMPETITIVE SPLIT AUCTION

4.4.1 CONSULTATION PAPER

- 80) The Consultation Paper set out the following description of the competitive split auction approach:
- Services arranged in four groups
 - Two distinct auctions for each group long-term and annual
 - Mandatory, sealed, pay-as-cleared auction for annual contracts
 - Only operational costs recovered in annual auction
 - Voluntary, pay-as-bid auction for long-term contracts to cover capital costs
 - Only new investments can participate in long-term contracts
 - Based on recommended auction design as set out in the IPA report

4.4.2 SUMMARY OF RESPONSES

- 81) The main positive attribute of this option, as set out in the responses, is the proposal to separate long-run and short-run costs. There was some confusion over the allocation of long and short term contracts and how this could be managed. There were also some concerns raised over the lack of linking between bids, the impact could be that a participant is successful in one auction but fails in others thus rendering their project unviable. As with other options proposed respondents raised issues in relation to the transparency of this particular option.

4.4.3 SEM COMMITTEE RESPONSE

- 82) The SEM Committee notes the positives and negatives associated with this option. While the SEM Committee does not propose to adopt option 4 many aspects of this approach (e.g. mandatory, sealed bid auction) are considered desirable features of a competitive approach to system services procurement.

4.5 OPTION 5 – COMPETITIVE MULTIPLE BID AUCTION

4.5.1 CONSULTATION PAPER

83) The Consultation Paper set out the following description of the competitive multiple bid auction approach:

- Mandatory, sealed, pay-as-cleared, instantaneous auction
- Multiple, mutually exclusive bids permitted
- Each bid includes price and capability for each service, provides a set of mutually exclusive outcomes for the auction
- TSO determines demand curve based on range of outcomes
- Least-cost outcome is selected, results in individual uniform prices for each service
- Units decide contract length when bidding, existing capability of unit must be included as a bid and fixed one-year contract for existing capability.

4.5.2 SUMMARY OF RESPONSES

84) More than 10 respondents to the consultation were clear in that they would not favour option 5. Some of the main concerns were related to the complexity of the option, transparency of auction outcomes, auction failure and risk relating to both price and timely delivery. One of those responses indicated that the consultation on the options appeared to be a “minded to decision”.

85) A number of respondents were concerned that the fall back position proposed in option 5 of developing a regulated tariff would result in developing 2 solutions at the same time.

86) The competitive process preferred by the SEM Committee was criticised due to the lack of competition in each of the system services. The result of this could be to have a competitive process that leads to an uncompetitive outcome. There were concerns that regulatory intervention could impact the effectiveness of the option.

87) A number of respondents agreed with the technology neutral stance adopted by the SEM Committee, and cited the requirement for volumes of system services to be published by TSO. These volumes would be necessary to improve transparency and also for potential investment decisions.

88) There were several respondents who agreed with the principal of a competitive process and would favour that approach where it could be implemented. Some respondents proposed modifications to the auction process to give more certainty for investors. Two separate



proposals advocated a minimum payment mechanism for the auction process. The application of this mechanism was different in each of the proposals. One was for auction bids to include a minimum income constraint, whilst an alternative proposal was to set a minimum tariff that would be available to all who could provide the service and offer the opportunity to compete up to an overall services cap. Other respondents proposed a transitional approach, starting with regulation and moving towards competition over time.

4.5.3 SEM COMMITTEE RESPONSE

- 89) The responses indicated that this option introduced a complex mechanism for determining the price for system services, the complexity of the methodology in itself does not mean it is not the appropriate methodology. The SEM Committee is aware of the complexity of this issue and also note that no easy solution has been put forward that would address all of the concerns. In fact, there is an inherent complexity in any available solution for system services, given there are 14 different products with different characteristics, different existing volumes and different interactions with the market. No single solution is perfect; the SEM Committee must develop the optimum outcome given the competing objectives and its statutory duties.
- 90) Another major issue highlighted was the transparency relating to the outcome of the auction, with it being referred to as a “black-box approach”. The SEM Committee acknowledges those concerns and to implement this option would require further work in the detailed design phase to alleviate these concerns. However the SEM Committee would also like to highlight that the tariff setting process that was favoured by many respondents creates its own challenges in relation to transparency.
- 91) The SEM Committee does not propose to address the definition of auction failure at this stage of the process. The concerns relating to how auction failure is identified is noted by the SEM Committee. Defining auction failure at this time, without identifying the full auction process including possible tie-break criteria, is not possible at this time.
- 92) In relation to the comments received that a competitive process as envisaged under option 5, could result in an uncompetitive outcome links directly to auction failure, as indicated above the auction failure criteria will need to be developed in advance of any auctions, as well as remedial steps.
- 93) Another concern for respondents related to increasing uncertainty for investors as a result of changes to DS3, I-SEM and Capacity Payments. The SEM Committee acknowledge the ongoing changes in the development of the wholesale electricity market. The SEM Committee will



continue to ensure they fulfil their principle objective to protect the interests of consumers by promoting effective competition in the SEM.

- 94) The delivery timelines for DS3 and I-SEM were both to be delivered by the end of 2016. The SEM Committee recognises the challenges that will be faced in delivering DS3, and a timeline for delivery is set out in the Decision Paper.
- 95) One respondent commented that the consultation paper came across as a “minded-to” decision, rather than a consultation. The SEM Committee felt at the time it would be best to indicate in the consultation document that option 5 was preferred by the SEM Committee, however all five of the options consulted on were seen as viable and implementable options. The SEM Committee considers that failing to inform industry of its preferred option could risk participants inferring the SEM Committee’s thinking differently leading to a less productive consultation process than if participants are fully informed.
- 96) In relation to the volumes of the system services as required and existing, the SEM Committee has previously indicated in this document that it is working with the TSOs to ensure these can be provided.
- 97) In response to concerns raised in relation to the auction and the need for a more incremental approach the SEM Committee has incorporated a transition from regulated tariffs to auctions in the new regime. Only those services where there is sufficient competition will be procured through the auction. Therefore, in response to comments received, the SEM Committee has moved away from option 5 toward a more hybrid approach. Additionally, the SEM Committee has simplified the auction design and is minded to adopt appropriate simplifications in the detailed design.

5 OTHER ISSUES RAISED

- 98) In addition to the issues raised in previous chapters respondents were offered the opportunity to set out any additional issues that should be considered by the SEM Committee in relation to the procurement of System Services. Additional issues raised are summarised below.
- 99) This section starts with a reminder of the proposals before summarising the responses on each procurement option. The section concludes with a statement of the SEM Committee position on each option.

5.1 Adjustments to the Options

5.1.1 SUMMARY OF ISSUE

- 100) A number of respondents set out potential adjustments to the options as set out in the consultation paper. These adjustments included:
- Longer term contracts for option 1
 - Introduce some form of minimum income threshold for competitive auction
 - Two tier approach with both a regulated tariff and competitive element

5.1.2 SEM COMMITTEE RESPONSE

- 101) In the consultation paper the SEM Committee presented its opinion that long term contracts could result in forecasting errors being fixed into the procurement of services. This would only allow limited ability to correct for changes in circumstances. Market entry will also be impacted by the divergence between the forecasted volumes of services and actual requirement. Additionally as more efficient providers enter the market, the price for services should fall but long term contracts will limit the ability of the consumer to benefit from this increased efficiency. The SEM Committee set out in its consultation paper that it preferred to move towards a competitive approach, the SEM Committee is therefore unconvinced by the arguments presented in favour of longer tariffs.
- 102) One of the key concerns raised by respondents to the consultation was uncertainty, and this appears to have been one of the driving forces behind the proposed adjustment to have longer term contracts for option 1. One of the other solutions proposed by respondents to address this uncertainty issue was to introduce a minimum income constraint. The SEM Committee accepts the merits of the proposal, however implementation of such a solution will require further consideration as discussed in the Decision paper.



103) The other major variation on the options proposed was to introduce a two tier approach. The essential part was to develop some form of price floor e.g. a tariff for each of the services, and allow competition through some form of auction mechanism to allow some form of top-up. The SEM Committee again understands the merits of this proposal, but implementation would also require further consideration. These proposals have informed the SEM Committee's thinking and are discussed further in the decision paper.

ANNEX

- Activation energy
- AES
- Aughinish
- BGE
- Bord na Mona
- Brookfield
- EAI
- EirGrid
- Energia
- ESAVE
- ESB GWM
- ESB Networks
- Frank Burke
- Freqcon
- Gaelectric
- IWEA
- IWFA
- Mitsubishi
- NIRIG
- PPB
- SSE
- TEL
- Five Confidential Responses