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L I M I T E D

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Ref: TEL/CJD/15/228

16th December 2015

RE: DS3 System Services Qualification Process and Contract Design Consultation Paper (SEM-15-091)

Dear Mo, Andrew,

TEL welcomes the opportunity to respond to this consultation.

The response is divided into two sections: Section A describes TEL's specific views on the Qualification Process for DS3 and Section B answers the questions raised in the Consultation.

Section A

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.

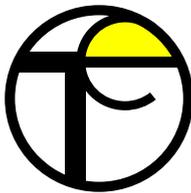
We would like to raise the following points in response to this consultation:

1. DS3 Auction integrity is essential
2. Investment clarity is paramount

1. DS3 Auction integrity is essential

What is proposed in the consultation is to allow investors to compete in the auction as long as they are happy to put up a bid/performance bond and potentially meet minimal other aspects (such as legal, financial and technical). We are concerned that these hurdles to participate in the auction are too low. They may not be sufficient to prevent speculative bids which ultimately do not turn up to provide a service after being successful in the auction.

In the following example there is a demand for 100 units and 125 units are bid in from five parties (each with a three year build in period) in the following manner:



Name	Volume	Bid Price per unit
A	25	20
B	25	30
C	25	40
D	25	50
E	25	60

The price will clear at €50, however if unit D does not deliver its plant, then the following will occur:

- a) The consumer will lose out as there will be insufficient services provided.
- b) Units A,B,C will all lose out as the clearing price will be set at €50, whereas it should have cleared at €60 if Unit D had been excluded from the auction.
- c) Unit E will lose out, as if Unit D had been excluded earlier in the process Unit E would have gained a contract.

The RA's must ensure that those that say they will build or expand plant do so. To this end, there have to be hurdles to participation in the auction beyond just Bid or Performance bonds.

A possible solution to issue b) above is that the clearing price would be reset to the regulated tariff.

2. Investment clarity is paramount

In order to get sufficient investment to meet the demand for System Services there has to be a consistent approach to each of the consultations focused on ensuring that clarity is provided and continues to be provided throughout the process.

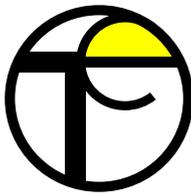
The proposed competition test followed by separate auctions is ultimately counterproductive. The TSO suggested in their 2014 "Portfolio Capability Analysis" and again in the enhanced scenario in the recent Volume Calculation Methodology Consultation that as many as 12 existing thermal plant (6 CCGT and 6 OCGT) may enhance or refurbish. Each of these units will be looking to offer a number of services. They will most likely need to have a long term contract for each of the services before they are able to establish an investment case. If, for example, a plant needs a return from 8 services and only 4 of them clear a competitive test, then only four will be able to receive a long term contract. Without a long term contract across all 8 services the investment case will not be made and the plant will not be enhanced.

Another barrier to investment is the lack of clarity as to what is a Material Investment. This needs to be defined as soon as possible. Any investor considering making an investment needs to know whether their plans are going to meet this material investment test.

TEL urges the RA's to focus on ensuring that investors see clarity in the offering, otherwise the success of the DS3 System Services project is at risk.

Section B

Question 1: *Do you agree with the proposed procurement steps or have any concerns regarding the implementation of such a process? Do you consider there is a need for fewer or more steps in the procurement process? Please provide detail to support your views.*



There are too many steps in the procurement process. The competitive test is by its nature self-defeating. Firstly, if a party wants to invest in a particular service they will not invest until there is an opportunity for a long term contract. Secondly if investors are seeking a return across a number of services then it must be possible to get a long term contract across each of these services at once.

Equally we propose that the tariffs are set as the first step in the process and they would effectively act as a ceiling on the bid auction, providing some upfront clarity for investors.

Question 2: *To what extent are the proposed steps also appropriate for Capacity? Do you consider there are benefits in running this process jointly for both Capacity and DS System Services? Please provide detail to support your views.*

The decision on the first consultation of CRM is not out yet, which we believe is essential to answering questions regarding the CRM process.

Question 3: *Do you agree with the above outlined principles for qualification? Please provide detail to support your views.*

While the principles are appropriate, the stated implication that it should be based on self-certification may not follow.

If “the qualification process and criteria should be the minimum necessary to meet the purposes set out above”, then it needs to ensure that bids are not speculative, and therefore should not involve self-certification.

Question 4: *Do you believe that the above outlined principles for qualification should also apply for the procurement of Capacity in the I-SEM? Please provide detail to support your views. As per Q3.*

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Question 5: *Do you agree with the use of a bid bond as part of qualification for DS3 System Services?*

See Section A.1

Question 6: *Do you have views on an appropriate level for the bid bond for DS3 System Services?*

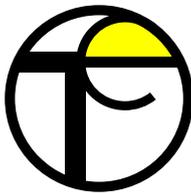
See Section A.1

Question 7: *Do your views on the level and usage of bid bonds differ for Capacity procured in the I-SEM?*

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Question 8: *Do you see benefits in having a combined bid bond, covering both DS3 System Services and I-SEM capacity?*

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Question 9: *Are there any approaches, in addition to those identified above, for identifying whether providers are new or existing?*

Both proposed approaches seem to be emphasising the costs of investment over the services provided. If there is material investment and if services are provided then the plant should be a 'New' plant for the purposes of a long term contract.

Perhaps a combination of new material investment and a threshold of new services provided would be an appropriate definition of "New".

Question 10: *Do you have views on an appropriateness of each of the proposed approaches?*

The threshold based aspect of both approaches is potentially adding a layer of complexity where none is required. The simple test should be, to ascertain is the investment providing new services, and has a material investment been made. This is in keeping with the Decision.

The suggestion in Approach 1 of a Learning Curve Effect is unclear. It could be read that rates offered to investors may change throughout the term of a long term contract. Alternatively it could be that there would be a defined expected cost per unit for each service.

Both definitions have issues. True if Generator A installs a new brand of battery and has to receive a return of €10/MWh over ten years to meet costs, and Generator B installs a similar system five years later they may only need €8/MWh. But that is for a different plant. From Generator A's perspective there is still a need to recoup the €10/MWh for the length of their contract. There needs to be investor certainty. If however the expected cost of generation for the service is incorrectly priced then the investment will not be made.

Question 11: *Do you have a view on whether and how the above approaches could and should be applied for the procurement of Capacity in the I-SEM?*

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Question 12: *Do you have a view on the proposals relating to existing plant as outlined above? Please outline any changes you would like to see to the above processes.*

All plants should detail their pre investment capability.

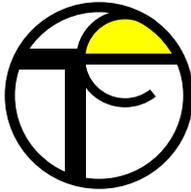
Question 13: *Please can you outline your views on the proposed general criteria outlined in 5.1 and provide suggestions/comments on how appropriate these are for technology providers and potential System service providers.*

At this stage in the process the general criteria should be limited to Legal, Financial and Technical. These are essential. A plant cannot be built unless the potential System Service Provider has the technical capability as well as the appropriate legal and financial status

Question 14: *Please detail your views on the options outlined for assessment of grid connection, planning consent, and environmental and other permits/licenses – what are the options you consider to be most appropriate in ensuring sufficient Systems Services are procured to enable SNSP levels to be accommodated as envisaged under the DS3 programme.*

See Section A.1

Question 15: *Would your responses to Questions 13 and 14 differ with regard to Capacity plant? If so, please explain why.*



No.

Question 16: *Do you agree with the example given above to identify emerging technologies?*

Question 17: *Should the inclusion of emerging technologies be on a capped share, or reserved share basis?*

The inclusion of emerging technologies should be on a capped share relative to each individual service.

Question 18: *Is it appropriate to have similar limits on emerging technologies for the procurement of Capacity under the I-SEM. If so, is the above approach also appropriate for that procurement process?*

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Question 19: *Do you favour a highly detailed assessment (Option A) above, or a lighter assessment with an increased reliance bid bonds, and on 3rd party assurance of bidder's data.*

See Section A.1

Question 20: *Do you agree with the above outline of evidence and data?*

Question 21: *If you consider that Option B outlined above is a preferred assessment process do you believe that some of the criteria outlined in 5.11-5.13 should be utilised as the minimum criteria in this assessment?*

Question 22: *Do you consider the above qualification processes to be applicable for the CRM qualification process? What do you consider to be the main differences (if any) between DS3 System Service qualification and procurement and CRM qualification and procurement and how should these be addressed?*

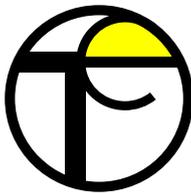
See Section A.1

Question 23: *Do you agree with the key principles to be considered by the TSOS when developing contracts for DS3 System Service procurement as outlined above?*

We have some concerns with the key principles as outlined in the section.

The proposed design will not see investors participating in the process. Investors will not build plant if they are not guaranteed a long term contract, equally investors with existing plant will not invest unless they have the option of winning a long term contract. Therefore the competition test is self-defeating. By holding an auction even where there are insufficient volumes, you encourage more investment earlier. Those participants who bid in earlier will get a long term contract with the price set at the regulated tariff until the first auction where there is sufficient volume to meet requirement. The price will then clear as with any auction, however the early movers will still have a long term contract.

The minimum annual clawback can only work where someone has under-recovered initially. For example, a participant has a minimum annual return of €1Million, and receives €500 thousand for the first year, in the second year they earn €2million, but the value is reduced to €1.5million. This would work. However if the under recovery is towards the end of the contract,



then the participant cannot bank previous revenue earned. They will never have the protection of the minimum annual return. If the plant again has a MAR of €1million and a five year contract. If the plant earns €2million in year 1, they cannot bank the extra million because if in the following year they earn no revenue they will not be able to avail of the MAR and will have no income.

Question 24: *Do you believe there are other key criteria that should be included in contractual agreement between the TSOs and System Service providers.*

All key criteria have been identified.

Question 25: *Which (if any) elements of the above discussion should also apply to the procurement of Capacity under the I-SEM?*

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Question 26: *Do you agree that bid bonds and performance bonds are required, and the performance bonds should be at risk on the delivery of specific milestones?*

The proposal that there should be bonds to enter the auction and once successful to meet key project milestones or initially provide the service or to test for the service is valid. Once the service has been provided these bonds should be returned and thence the contractor should be subject to incentives to ensure that the DS3 System Services must be provided.

Question 27: *What are your views on the compatibility of existing bonding arrangements and those proposed for DS3 System services? Do you consider there is the possibility to align some of these to reduce the financial burden to market players?*

No - The bonds for DS3 should be just in the set up period, whereas other market based bonds are enduring.

Question 28: *To what extent would your responses to the above questions also apply (or differ) for the procurement of Capacity under the I-SEM)*

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Question 29: *Which of the above options do you prefer? Please provide a view of why you have chosen a particular option and the advantages your chosen option offers.*

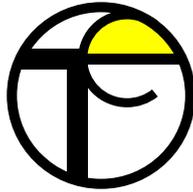
Question 30: *Based on your consideration of options for the management of the build phase for DS3, do you wish to amend or augment your responses relating the management for build phase for new Capacity under the I-SEM?*

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Question 31: *Do you agree that performance bonds should be set relative to the cost to consumers of any failure to delivery?*

See Section A.1

Question 32: *Do you agree that the level of performance penalty should vary inversely with the notice provided by the party that it will fail to deliver?*



There should be some relationship, but once the party has been involved in the auction then they should be liable for the vast bulk of the performance bond irrespective of the notice provided.

Question 33: *Do you believe that these principles (relating to the level of performance bonds and penalties) should vary between DS3 and I-SEM Capacity?*

The decision on the first consultation of CRM is not out yet, which we believe is essential to answering questions regarding the CRM process.

Yours sincerely,

A handwritten signature in black ink that reads 'Cormac Daly'.

Cormac Daly
Risk and Regulatory Manager