



Energy for
generations

Generation & Wholesale Markets

ESB GWM Response:

Electricity Support Schemes: Transitioning to I-SEM Arrangements

11th January 2018



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Contents

1. INTRODUCTION

ESB GWM welcomes the opportunity to respond to the Proposed Decision Paper.

The transition from SEM to I-SEM is a significant time for the energy industry in Ireland with many new challenges faced. Considered in conjunction with the move to decarbonise energy production, the energy industry faces more uncertainty than it has done in the past.

We welcome the publication of this paper and we note the considerable work that has taken place in getting to this draft decision stage. In particular, we note that the DCCAE has shown a genuine willingness to understand industry concerns and to seek to address those concerns while at the same time minimising exposure to the general electricity consumer.

Within this response we have set out our views on the various proposals in the paper, agreeing with them in some places and raising concerns with others. The key points in ESB GWM's response are as follows.

- While we understand that DCCAE may have chosen Option B as the reference price due to a limiting of PSO exposure, we believe that Option C is a better option in that it strikes a better balance between the REFIT holder and the consumer and should ultimately represent a lower overall PSO cost, leading to a more efficient market.
- We believe that the proposal to disallow any balancing costs for non-wind REFIT technologies and for the peat plants fails to take account of a cost that will inevitably be borne by non-wind technologies, and is discriminatory when compared to wind generation.
- We are of the strong view that the proposed treatment of capacity revenues for non-wind REFIT technologies and for the peat plants is unfair and unacceptable. We believe it would be contrary to the PSO Order for DCCAE and/or CRU to disallow these costs from total market revenue considerations.
- We believe that the ability to change the REFIT generator/supplier PPA for I-SEM is welcome but we believe that there are a small number of changes that could be made to make the process even better than proposed.

ESB GWM would welcome an opportunity to meet with the DCCAE to discuss any aspect of this response.

2. HIGH LEVEL PRINCIPLES – ASSESSMENT CRITERIA

At a high level ESB GWM would agree with the assessment criteria, albeit with some comments and clarifications.

In general the high level principles come down to two competing concepts, namely market efficiency and investor certainty. Striking an equitable balance between these two concepts will be the ultimate aim of this exercise. ESB GWM suggests that consumer costs and state aid rules compliance, while very important, are actually consequences of the balance between investor certainty and market efficiency.

Market Efficiency

ESB GWM suggests that market efficiency and consumer costs are strongly correlated. If market outcomes are efficient, PSO contract holders will be incentivised to get as much revenue from the energy market as they can, thereby minimising the draw on the PSO and delivering a well-functioning market at the same time.

A key point to consider when deciding upon the reference price is that the choice of reference price should not require a market participant to trade in a way that they would not otherwise do.

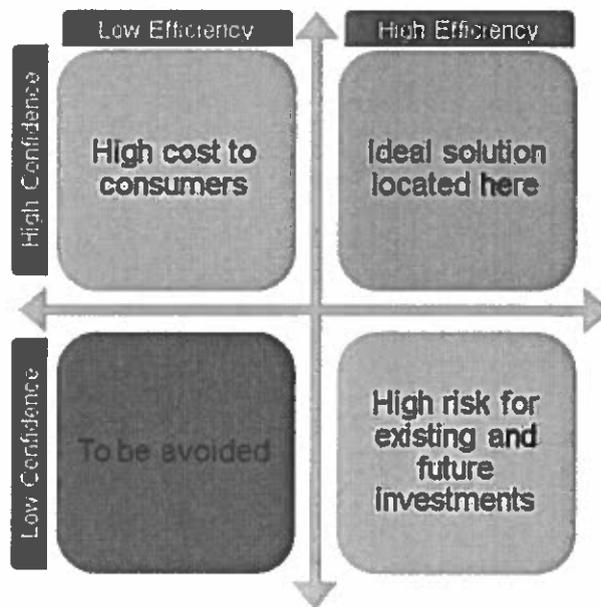
Investor Confidence

There has been significant investment in the electricity industry in Ireland which has been underpinned by various PSO backed schemes. Significant investment has also been made on the back of perceived stable arrangements such as an explicit capacity mechanism. Were there to be any perceived changes of the terms of PSO backed offerings after investments have been made there would invariably be a knock-on impact on future investments. Arguably, any knock-on impact would be much more significant for future new investment than for projects already in operation.

In this regard ESB GWM believes that the investor certainty criterion is too narrow and should cover investments across the markets and not solely investment in renewables. If the DCCAE were seen to change terms and conditions after a project investment had been made, this risk would be borne out across all investments in Ireland including for example the CRM. If the Irish government was seen to be willing to change terms retrospectively, investors may fear the lack of legal certainty, both from the government and the national regulator, which could ultimately deter or dampen investment in this jurisdiction.

Striking a balance

The final reference prices for the various schemes (REFIT, Peats and AERs) must strike an appropriate balance between market efficiency and investor certainty. This is illustrated below.



Striking an equitable balance between efficiency and maintaining investor certainty is about understanding what each of the different actors can realistically bring to the table.

- Existing investors have made significant investments and will understand that there is an expectation that they will trade act reasonably and responsibly in the traded energy markets and that inherent in this may be an element of risk. ESB GWM believes that a reasonable level of trading risk would have been inherent in any investment. However, the level of risk should be no more than what could have been reasonably and prudently expected at the time of investment. To introduce more risk at a later stage,



after the investment decisions have been made, effectively represents a change to existing terms and conditions and places investors in an unfair position.

- The Irish government has a series of policy objectives and has used the electricity customer to underwrite these policy objectives through the PSO. As part of this, there was an understanding that the PSO customer would underwrite reasonably and prudently incurred costs.

ESB GWM believes that the solutions in the paper strike a balance between the two opposing objectives to varying degrees and that a solution is available from the range of options proposed. This is elaborated on further in the next section.

3. ESB PREFERRED APPROACH

In this section, ESB GWM has set out its preferred position on the REFIT reference price for the various schemes and technologies and other aspects of the proposed decision.

3.1 REFIT Support

3.1.1 REFIT Wind

The proposed decision paper recognises the inherent forecast error associated with trading wind energy. For example, a wind farm when bidding in the day-ahead market is making firm decisions about expected output from their units in 36 hours' time. This position appears sensible and recognises the existence of legitimate balancing costs. ESB GWM contends that these costs are recovered today through Dispatch Balancing Costs (DBC) in SEM and so this merely represents a change in distribution of costs between SEM and I-SEM.

As discussed above, ESB GWM believes that a satisfactory outcome from this process would be where the REFIT holder is incentivised to the greatest extent possible to earn as much revenue as possible from the competitive energy markets and in doing so take as little money as possible from the PSO. It is this vision of a successful outcome that has driven ESB's commentary and positions in the proceeding sections.

3.1.1.1 Consideration of Option B.

It would appear that Option B seeks to quantify the inherent forecast error that might be experienced by wind generation and sets a blended reference price for large wind and one for small wind. Option B will tell the REFIT holder that the PSO customer will remunerate balancing costs up to a certain level and no more. ESB GWM can see why DCCAE is drawn to this approach since it puts a backstop on exposure to the PSO.

However, in seeking to find a compromise, Option B runs the risk of finding a middle ground but not really satisfying the requirements of any of the various parties. In coming to a final decision on this matter, ESB GWM asks the DCCAE to take the following points into account.

- If the balancing costs are ultimately lower than the Option B blend suggests, then the PSO will be locked into paying a balancing cost that doesn't exist. In addition, the use of the lower of the balancing price and the day-ahead price, if adopted on a trading period basis, risks an additional transfer to money from the PSO customer.
- If the balancing cost is genuinely higher than the set blends suggest, the REFIT holder could be disadvantaged, potentially to the point that it impacts upon future investment.

- If Option B was found to be too generous to REFIT holders because balancing costs are less than envisaged, there could be a compulsion to reopen the issue again. It is likely that this would undermine investor certainty on top of the additional effort for all involved to undertake a consultation on the matter.
- Finally, it is difficult to identify the exact impacts but the somewhat complicated design of Option B (using the lesser of the BM and DAM prices) could have a negative impact upon market efficiency in the longer term given the lack of easily identifiable incentive compatibility. A well designed support reference price should have not have any influence the specifics of a trading strategy other than to incentivise the windfarm to earn as much as possible; there is a potential that Option B does not achieve this.

In summary on Option B, ESB GWM can understand why DCCAE is drawn to its implementation but we believe that there are potential downsides with this option in terms of market efficiency and costs to consumers. This is drawn out further in the discussion of Option C below.

3.1.1.2 Consideration of Option C.

Having made the decision to compensate for balancing costs, Option C appears to be the opportune choice to use as the reference price for I-SEM. Over the lifetime of the REFIT supports, Option C has the greatest potential to ensure efficient outcomes in the energy market while at the same time minimising costs to consumers through the PSO. ESB GWM would hold this view based on the following.

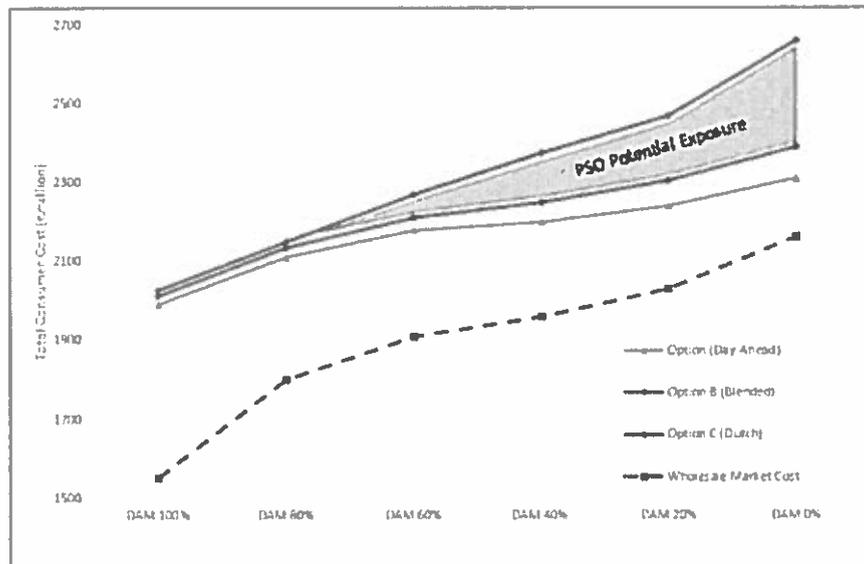
- Option C features a compelling incentive compatibility, one which should only benefit the PSO customer who underwrites the scheme. All REFIT holders would be incentivised to achieve the best price they can in the market. This is because any windfarm whose balancing costs are above the average will see a hole in their total revenues and any windfarm who achieves below average balancing costs will retain those revenues. With this option, the poorer performing windfarms will see revenues diverted to better performing windfarms with all windfarms incentivised to do better each year thereby reducing average balancing costs which can only reduce the draw on the PSO. We do not believe that this point has been fully appreciated in the qualitative analysis in the paper.
- There is no discernible difference in PSO costs shown in the modelling between Option C and Option B in normal trading market conditions while better performance in the future by the wind fleet could reduce the PSO.
- Option C, in effect, provides the perfect blend by using actual out-turn figures. Moving to a new market with balance responsibility, there is no information available on what is achievable in terms of trading in different timeframes. Taking into account the inherent incentive compatibility in Option C, the PSO customer should be best protected by only ever paying for actual balancing costs and benefiting where average imbalance costs are reduced.
- Option C already operates successfully in another EU market and so the concept is proven as is the ability to implement it.

The proposed decision paper isn't particularly clear on why Option C is seen as inferior to Option B. For example, once the decision is made to remunerate balancing costs then they both appear equivalent in terms of state aid considerations.

If the key reasoning not to proceed with Option C is the potential for an open ended exposure for the PSO, driven in particular by anti-competitive behaviour in the market we would urge the DCCAE to reconsider the

matter. In particular, competition law and the REMIT market regulations would prohibit the anti-competitive behaviour alluded to in the paper.

We have sought to illustrate the potential open ended exposure in the figure below (reproduced by ESB GWM based on visual interpretation of the figure on page 20 of the proposed decision paper).



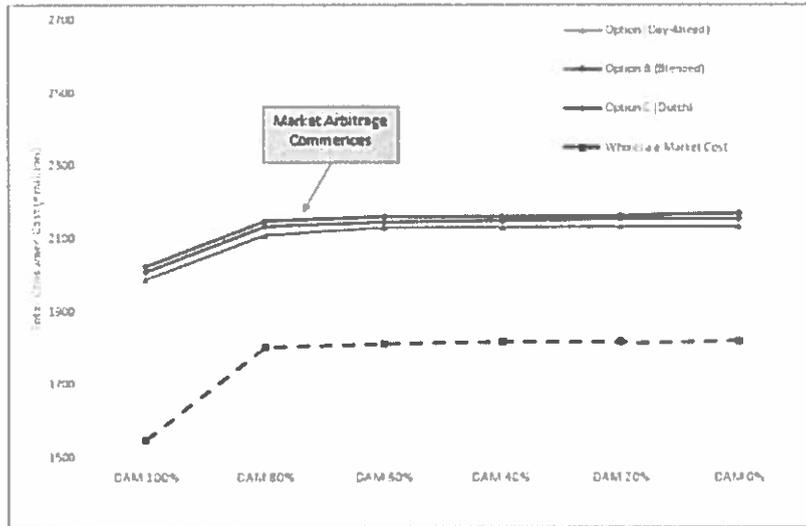
The figure above ultimately suggests that as less wind trades in the DAM and more moves to the BM that the two markets will act independently of each other. At the outset, we would urge some caution regarding the numbers in the figure on page 20 of the paper as they appear to assume that all wind would adopt a high BM volume strategy whereas this wouldn't be the case in practice. Circa 60% of wind in I-SEM will be contracted under REFIT and so subject to the impact of the upcoming DCCAE decision. All other wind would not be subject to the decision and so would likely employ the most economically advantageous trading strategy which would almost certainly not involve spilling all output in the BM.

Leaving aside the underlying concerns over the reliance than can be placed upon the above figure, ESB GWM contends that once I-SEM has been properly designed there should be significant scope for arbitrage across the markets. This arbitrage could happen in two ways.

- Where wind noticeably stays out of the DAM but turns into the BM, demand could choose not to purchase in the now more expensive DAM on the basis that they know the wind will ultimately turn up later. They could easily do this through some observation of market trends and some basic wind forecasting. This would have the effect of lowering the DAM price and increasing the BM price resulting in a reasonable level of price equalisation between the two timeframes.
- Assetless traders could observe an absence of wind in the DAM with a resultant significant spill into the BM and they could opt to sell a non-asset backed volume in the DAM and then buy it back later in the IDM or BM. This would have the effect of lowering the DAM price and bringing up the BM price resulting in a reasonable level of price equalisation between the two timeframes.

The concept of market arbitrage is well established and is observed in most electricity markets. Therefore there is no leap of faith required to accept the above hypothesis in our opinion.

ESB GWM is of the view that once the impacts of applicable competition law, market abuse rules (such as REMIT) and market arbitrage are taken into account, the actual response of the market under Options A, B and C to varying % Wind in the DAM will be different to that modelled by DCCAE on page 20. We have sought to represent what this impact might look like in the figure below (ignoring the underlying concerns with the assumptions used in the modelling mentioned above).



3.1.1.3 ESB GWM Preferred Option

In choosing between Option B and Option C, it would appear that the proposed decision could come down to placing an outer bound on the level of costs that the PSO might be asked to bear. The modelling results presented on page 20 of the proposed decision paper suggest that there isn't a significant difference in costs between Option B and Option C where 70% or more of wind output is traded in the DAM, and ESB GWM has above suggested that the extreme results on page 20 are unlikely to occur for a variety of reasons.

ESB GWM is of the view that Option C represents the best design for a REFIT reference price once the decision is made to remunerate balancing costs. Option C should incentivise REFIT holders to maximise their market revenues thereby minimising the amount of money paid through the PSO.

3.1.2 REFIT "Non-wind" Technologies

The proposed decision suggests that for REFIT supported technologies other than wind that the reference price should be the time weighted DAM price. At a high level, ESB GWM can understand how the DCCAE will have come to this position given the ability to forecast output etc.

However, the proposed decision paper does not make reference to the imposition of balancing costs on the non-wind technologies at all. Undoubtedly, wind faces numerous challenges in the energy market including the lack of predictability of its fuel sources but all these challenges are not caused by the variability of wind only. While wind is receiving recognition of all balancing costs through the blended reference price, non-wind technologies will receive no such recognition.

ESB GWM is of the view that the co-fired plants are likely to have balancing costs because it will not be able to achieve the DAM price for all its supported output. There are a number of reasons for this including trips and fuel quality issues.

All things being equal, and to maintain consistent and non-discriminatory treatment with wind REFIT holders, ESB GWM is of the view that a blended reference price should also be adopted for non-wind REFIT technologies. This would better reflect the reality of operating in the market and is consistent with the principle underpinning the PSO that a plant should be compensated for its operating costs. The blend should, like for wind, reflect the balancing costs attributable to the technology. For co-fired biomass this could be a DAM price weighting around 95%.

DCCAIE should be aware that a decision to adopt a blend for wind and not for other technologies would represent the imposition of an additional cost to these technologies, placing them at a competitive disadvantage with wind. At a very minimum, this needs to be borne in mind when considering the other costs and risks that are being imposed on these non-wind technologies.

3.1.3 Treatment of Capacity Revenues

The proposed decision states that for REFIT supported technologies, any capacity revenues earned will be recycled back through the PSO but any cost exposure related to participation in the CRM will be borne by the generator. The SEM Committee has already made decisions that generators participating in I-SEM will be able to lose up to 150% of their capacity payments through difference payments.

ESB GWM understands and supports the rationale for recycling capacity revenues back through the PSO. Supported projects should not be entitled to this additional revenue as an extra on top of the agreed REFIT support if this was the understanding when the project entered REFIT. However, ESB GWM is greatly concerned by the proposal to disallow costs associated with CRM participation from being recovered through the PSO, in particular in relation to the non-wind technologies in respect of which these are unavoidable costs.

As per the rules of the I-SEM CRM, wind generators have the option of not participating in the CRM and so arguably there is no additional exposure created by the proposed decision compared to the status quo. However, by contrast, non-wind technologies have no real discretion regarding their participation in the CRM as the SEM Committee has made their participation mandatory. In addition, co-fired plants would need to participate to receive capacity revenues for the non-REFIT portion of their capacity.

The proposed decision to disallow recovery of difference payments through the PSO places supported technologies with mandatory participation in a very difficult and indeed unacceptable position. ESB GWM contends that when the renewable schemes were being designed, this issue was not explicitly addressed, as the capacity difference payment did not exist as a market cost at that time. The price ultimately set for each technology reflected the risk profile expected at that time. Where additional risk is placed on a particular party there is generally an expectation that either the risk is manageable or that the participant is remunerated for carrying the new risk. Given that the REFIT holders only receive the agreed REFIT price there is no such additional headroom to carry new risks.

To highlight what ESB GWM believes is the unreasonableness of the proposal, we have set out a number of scenarios where different auction clearing prices impact on the risk carried by the REFIT holder.

Auction Clearing Price (€/MW/y)	30,000	40,000	50,000	60,000
Risk borne by REFIT Holder (€/MW/y)	15,000	20,000	25,000	30,000
Upside retained by REFIT Holder (€)	0	0	0	0

In the above example the risk carried by the REFIT holder increases as the auction clearing price increases. This is because the generator is exposed to 50% of the total CRM payments in difference payments. The magnitude of the risk is not manageable by the REFIT holder and is completely arbitrary from their point of view.

For non-PSO supported generators, this exposure can in a number of cases be managed through some infra-marginal rent between the plants' own net going forward costs and the clearing price, or the explicit inclusion of expected difference payments in CRM bids. However, the REFIT holder has no such insurance if all capacity payments are returned through the PSO. The REFIT holder therefore has a forced exposure to a risk it cannot influence and cannot manage.

ESB GWM is of the view that the proposed decision to not allow difference payments to be recovered through the PSO, if implemented, should only apply to costs above the total capacity revenue received from the market. For example if REFIT designated capacity revenues at a plant are €5m and difference payments amount to €1m that €4m would be returned through the PSO and not the full €5m. This is important because the capacity revenues in I-SEM are designed to include an allowance for difference payments. Notwithstanding our grave concern with the proposal in principle, to require the recycling of all capacity revenues would be even more unfair and discriminatory.

In the future, as the Department is aware, if the decision is made to continue these as co-fired peat plants, the plants would be partially supported under REFIT 3. The difference payments would be an unavoidable costs for these plants (as discussed further below). We discuss the arguments in respect of REFIT 3 further below.

The legislative basis underpinning the REFIT support is Section 39 of the Electricity Regulation Act 1999 and the terms of the PSO Order (as they apply to the REFIT Schemes). As noted above, it is an underlying principle of the PSO, as provided for in Section 39 of the 1999 Act that the order should "provide for the recovery, by way of a levy on final customers, of the *additional costs* " associated with complying with a PSO order.

The REFIT 3 Scheme is provided for in Article 6(D)(1) of the PSO Order which imposes a public service obligation on licensed suppliers to purchase electricity from certain generators under REFIT power purchase agreements. Article 2(3C)(a) of the PSO Order provides that "*additional costs' includes costs incurred by a supplier in complying with its obligations under Article 6D either before or after the coming into operation of this paragraph and which are not otherwise recovered*".

The terms of REFIT III provide at clause 5.4 that:

"5.4 To determine the level of REFIT support payable from the PSO levy to suppliers that have entered into REFIT PPAs, total market revenues are compared to eligible REFIT 3 costs under the REFIT 3 Terms and Conditions, as per the mechanism set out in CER/08/236. The total market revenues and total REFIT 3 costs in the calculation are the sum of the respective amounts in each PSO period. "

It is ESB's contention that to provide for capacity revenue as a revenue stream, without recognising the deduction of difference payments, is to provide a false inflation of "market revenues" contrary to the spirit and intention of the REFIT rules.

As the Department will be aware, CER/08/236 sets out the rules for calculation of the R Factor, again on the basis of the difference between the "total revenues" received from the market, versus the "total cost" of purchasing metered energy from the generator. To disallow a genuine market cost would be inconsistent with the principles in this paper.

In summary, if they are operated as co-fired plants following expiry of the existing PSO, ESB will be operating the peat plants on the basis and expectation of the PSO support under REFIT III, and in accordance with its terms. We understand that the PSO Order and the REFIT terms as requiring, both as a matter of statute and under the contractual terms of the scheme, the recovery of costs associated with the operation of the plant, and that must continue to be the case under the new market structure in I-SEM.

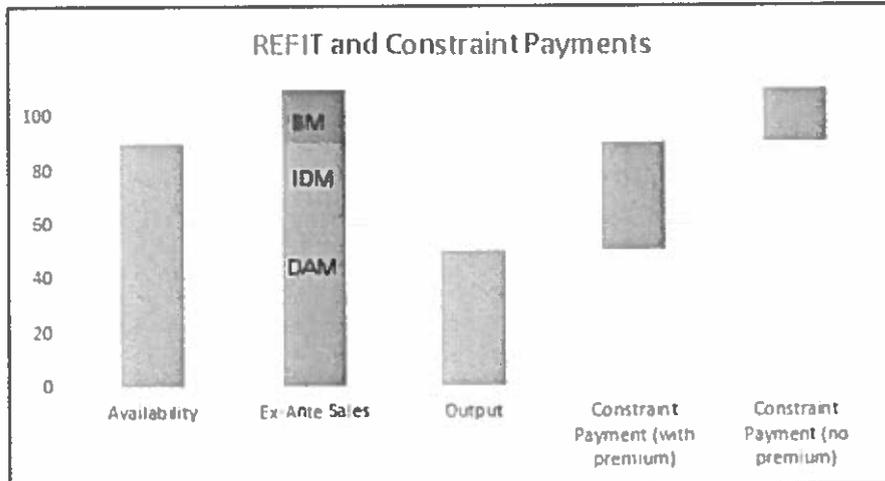
We do not accept the arguments that ESB would have no incentive to remain available if the costs could be recovered through the PSO. There are various reasons why that would not be the case. First, ESB GWM has obligations under the Grid Code to remain available. Second, the generator will only receive [PSO/REFIT] payments when electricity is actually produced.

In a previous section, we have discussed the introduction of risks and that they can be appropriate where they can be managed by the participant. While balancing costs may ultimately fall into the category of manageable risks, the absorption of difference payments risks does not fall into this category. ESB GWM believes that this proposal represents an unfair and draconian measure. In addition to representing a significant hit for existing REFIT holders, the decision will invariably have an impact on future investments and investor sentiment.

3.1.4 Treatment of Constraint Payments

The proposed decision paper states that constraint payments will be dealt with in the same manner as they are in SEM. ESB GWM is concerned about the practical ability to implement this solution. In SEM, the PSO reconciliation essentially looks at all revenues recovered through SEM and compares these to the allowed revenue under REFIT. To this end, the question of separating constraint payments out as a single cost item does not arise. The proposed approach in the paper changes this.

The move to I-SEM will see multiple market timeframes and opportunities to trade. Therefore, when a wind farm is constrained down, it could be difficult to clearly identify what the actual constraint payments are. This is further complicated by the settlement rules in I-SEM where a premium and discount is applied to constraint payments depending on certain conditions being met. The complexity of this issue is set out in the diagram below.



ESB GWM suggests that REFIT holders should retain constraint payments in I-SEM. We retain this position for the following reasons.

It is too complex an exercise to disaggregate trades to identify constraint payments and involves too much subjectivity. For example in a trading period a wind farm may have a number of buy and sell transactions associated with its position. The implementation of the proposed decision would involve a call being taken on what trades should be considered in the calculations (i.e. the most expensive, the least expensive etc.). Further to this, the non-consideration of constraint payments would be more consistent with the decisions being taken for market reference price where a deemed price is being proposed rather than an examination of each trade made by the REFIT holder.

The retention of constraint payments by generators is wholly consistent with state aid requirements. The current treatment of constraint payments is arguably wrong and takes legitimately earned revenues from REFIT holders. The implicit REFIT agreement is that holders will get a top up for each MWh they produce. Where a plant is constrained down the plant should be allowed to retain the underlying constraint payment. The PSO has no exposure since no top up is payable on constrained MWh. Since the generator was available to generate the MWh they should be allowed to retain that value, consistent with other generators with firm access.

3.2 PSO Peat Plants

ESB GWM's understanding of the proposals in the proposed decision are as follows.

- For the purposes of calculating market revenues, the time weighted DAM price will be used as the reference.
- Capacity revenues will continue to be recycled through the PSO but any difference payments incurred will not be recoverable.

ESB GWM sees the two proposals above as an imposition of additional costs on existing projects. However, there is a difference between the costs.

As per our REFIT position, ESB GWM can understand the rationale for the employment of a reference price and can see how the DCCA came to the position on the DAM price. As with the non-wind REFIT projects, the proposal will see peat plants carry the full cost of balancing in I-SEM while wind REFIT has been

insulated against this. To address this, ESB GWM suggests that DCCAE could consider an appropriate blend for the peat reference price.

ESB GWM is of the view that the DCCAE position with regard to the capacity mechanism treatment is unfair and should not be implemented. The same arguments made in Section 3.1.3 apply in this section and as set out earlier, to expose supported plant to difference payments the magnitude of which we have no control over without any corresponding remuneration is unfair and unacceptable. To this end we request that this aspect of the proposed decision is not implemented. ESB GWM believes that to implement this decision would ultimately have an impact on investors' willingness to invest in the market here.

ESB GWM believes that this issue could have been remedied by allowing the generators to stay out of the capacity auction and to make a corresponding deduction of the plant's capacity from the capacity requirement. This is what happens for REFIT wind. At this stage, however, it may not be possible to do this since the CRM is governed by the SEM Committee and because the first auction has taken place.

As it stands, the peat plants at Lough Ree and West Offaly are supported pursuant to a PSO dating back to 2002 in respect of the peat stations.

The legislation underpinning the PSO, particularly section 39 of the Electricity Regulation Act 1999 (as amended) and the Electricity Regulation Act 1999 (Public Service Obligation) Order 2002 (the 'PSO Order') (the 'PSO legislation'), effectively provides for recovery of *all additional costs incurred by ESB* in complying with obligations to which it is subject under the PSO Order.

Article 5 of the PSO Order imposes a series of public service obligations on ESB in respect of certain listed peat generation stations (the "Peat Stations"), including, without limitation, the obligation to construct the Peat Stations, and a requirement to ensure that when constructed, throughout the PSO period, ESB has available to it the peat generated from those stations.

Article 8 of the PSO Order provides for ESB to recover its "additional costs" in complying with the public service obligation for peat, as determined by the CER. Additional costs may only be recovered under Article 8 where they are calculated in "accordance with the method for determination of costs provided for in the Notification"

This reference to the "Notification" is the notification made by the Department of Communications Energy and Natural Resources to the European Commission for state aid purposes, dated November 2000 (the "PSO Notification"). The PSO Notification sets out the mechanism whereby the additional costs to ESB of fulfilling its public service obligations in respect of the peat stations can be recovered. More particularly, section 5 sets out the methodology for determining allowable costs and their recovery.

The principle, as set out in the Notification, is that ESB should be allowed the same level of cost recovery as an "IPP operating a peat-fired station to Best International Practice (BIP)". Accordingly, the "basis for payment" as set out in paragraph 4.51 is the "difference between the cost to ESB of building and operating, at a reasonable rate of return, the power stations and the market price of electricity (currently defined as the BNE)."

The Notification distinguishes between "controllable" and "uncontrollable" costs. Uncontrollable costs are defined at section 5.17 of the PSO Notification as:

"(a) expenditure the level of which is determined by parties other than ESB upon making this submission, whether determined by competition or otherwise,

Or

(b) expenditure over which ESB cannot exercise control during the project lifetime..."

In respect of uncontrollable costs, Section 5.18 of the PSO Notification provides that *"(c)osts outside ESB's control will be passed through on the basis of actual cost, whether higher or lower than that included in the projections contained in the notification..."*

In addition, Section 5.25 (Change of Law) of the PSO Notification states that *"(i)n the event of a change in any legal requirement which increases or decreases the amount of the additional cost incurred in meeting the PSO, such increase or decrease in costs shall be added to or deducted from the levy..."*

The terms "Change of Law" or "legal requirement" are not defined in the PSO Notification. However, it is usual for a change in law/legal requirement to be interpreted as including directions, determinations, decisions instructions or rules of a relevant competent authority. ESB will be required to adhere to the Capacity Market Code pursuant to the terms of its generation licence, as that licence will be amended for I-SEM. The difference payments arise by virtue of participation in the capacity market pursuant to those rules.

As noted above, ESB cannot control difference payments. The level and amount of payments are dictated by factors beyond its control concerning the availability of plants, decisions of the regulator, and market forces. Further, it is clear that these costs arise by virtue of a Change of Law. As such, it is ESB's strong contention that these costs are recoverable under the terms of the PSO Notification either as an uncontrollable cost, or as a Change of Law. In fact, it would be contrary to the PSO Order for the Department and/or CRU to disallow these costs.

In summary, ESB operates the peat plants on the basis and expectation of the PSO support both under its existing PSO and in accordance with its terms. It has both a legal entitlement to recovery of its costs as a matter of statute, and a legitimate expectation that these costs should be recoverable.

We do not accept the arguments that ESB would have no incentive to remain available if the costs could be recovered through the PSO. There are various reasons why that would not be the case. First, as noted above, ESB's entitlement to recovery under the PSO Notification for the peat stations is predicated on the principle that it will operate the plants in accordance with Best International Practice. Second, ESB has obligations under the Grid Code to remain available.

4. NEXT STEPS

4.1 Final Decision

ESB GWM looks forward to an early decision from on this very important issue. As part of this final decision we would urge the DCCAE to include an appendix with the decision setting out in detail the mechanics of the decision and the underlying algebra. Specifically, if there is a subjectivity about how averages or benchmark prices are to be calculated it is best to address this now. To do otherwise risks creating further uncertainty for REFIT holders where, in a worst case scenario, PPA negotiations cannot be finalised until the CRU has made its decision on the R-Factor calculation. ESB GWM believes that the CRU consultation should be more of a housekeeping exercise and should not contain any new policy considerations.

4.2 Amendments to Power Purchase Agreements

ESB GWM welcomes the recognition in the proposed decision paper that there may be changes required to generator-supplier PPA agreements as a result of the move to I-SEM. The SEM design may have driven certain commercial market facing arrangements which may not ultimately be sustainable with the move to I-SEM. ESB GWM believes that with some small amendments the proposed clarifications from the DCCAE could work even better for REFIT holders. ESB GWM believes that these changes compliment the DCCAE's aim of facilitating competition between PPA providers such that REFIT generators have the capacity to secure PPA counterparties to continue operation in the market under the new arrangements as stated in the proposed decision paper.

4.2.1 PPA Changes at I-SEM Go Live

The proposed decision suggests that the once off change of PPA arrangements would be permitted at the start of the 2018/19 PSO year. However, if I-SEM goes live as planned in May 2018, there will be a four month period in I-SEM where the SEM generator relationship would have to endure. If a change in PPA relationship is required on 1st October 2018, ESB GWM suggests that this change is actually required earlier at Go-Live.

ESB GWM is of the view that changes to supplier-generator PPA relationships could be implemented from I-SEM Go Live (within a PSO year) rather than or as well as at the start of the next PSO year. We have set out how this could work below.

1. The existing or outgoing supplier will have already made a submission for the windfarm for the 2017/18 PSO year. This submission would have been made in early 2017 to CRU and that supplier would be paid by EirGrid in the 2017/18 PSO period.
2. The REFIT generator would notify a change of supplier from 23rd May 2018 noting that after said date the new supplier will be in place.
3. The new supplier will not receive any PSO support for the windfarm in the 2017/18 PSO period since it would not have made a submission to CRU in early 2017 (this cost would have to be carried by the incoming supplier in the short term). The new supplier will make a PSO submission for the 2018/19 PSO year.
4. To address the fact that PSO support went to the old supplier and not the new one from 23rd May to 30th September, some cleansing will be required as follows;
 - a. The outgoing supplier returns the money through the R-Factor through submission made to CRU in early 2018 and early 2019. To minimise PSO exposure, the outgoing supplier could potentially notify EirGrid to stop making PSO payments to them within the current PSO year from 23rd May onwards. This may be something that could be mandated as part of a mid PSO year change by CRU and DCCAE.
 - b. The incoming supplier would make R-Factor submissions to CRU in early 2018 and early 2019 to recoup the PSO revenues that it didn't receive during the 2017/18 PSO year. This would require a concession/clarification from DCCAE/CRU that they will allow an R-Factor submission from a supplier for a windfarm where they were not actually on the 2017/18 Statutory Instrument.

ESB GWM suggests that the above solution could be put in place to allow generators change their PPA relationship at I-SEM Go-Live rather than waiting for the start of the next PSO year.

4.2.2 Second Opportunity for PPA Changes

As stated above, ESB GWM welcomes the proposal by DCCAE to allow a once off change of PPA generator supplier relationship. However, ESB GWM believes that a second opportunity to change PPA at the start of the 2019/20 PSO year would be useful and appropriate.

Given the complexities of moving to I-SEM including many uncertainties, it is likely that many suppliers and generators will put in place one year commercial agreements to provide for an opportunity to review matters once the market settles down. In light of this, the time when generators may really wish to change supplier is not at Go-Live or shortly afterwards but would actually be at the start of the 2019/20 PSO year. We believe

that this proposal would be beneficial for REFIT backed generators and compliment the DCCAEs aim of facilitating competition between PPA providers such that REFIT generators have the capacity to secure PPA counterparties to continue operation in the market under the new arrangements.