Single Electricity Market Committee

Inclusion of Aggregated Generator Units in the SEM

AGU Contract

Decision

SEM-08-178

18 December 2008

Introduction

On 22nd August 2008, the SEM Committee approved a modification to the Trading and Settlement Code, Mod_05_08, providing for the inclusion of Aggregated Generator Units in the SEM. The SEM Committee's decision required the Generator Aggregators to enter into a contract with the appropriate Regulatory Authority (RA) to ensure compliance with the suite of SEM documentation that the registrant of a licensed Generator Unit would have to comply with. On 22nd August 2008 the RAs published draft details of the regulatory contract that Generator Aggregators would be required to enter into. Two versions of the contract were published; one for the Northern Ireland Authority for Utility Regulation (NIAUR) and one for the Commission for Energy Regulation (CER). The RAs sought responses by 19th September 2008.

Responses

In this section, the comments received from the respondents are set out together with the SEM Committee views on those comments.

Responses were received from Viridian Power and Energy Limited (VPE) and the Single Electricity Market Operator (SEMO).

VPE submitted comments[1] as follows:

We appreciate these Agreements are intended as a legislative 'stop' gap, i.e. until a more formal consultation on the licensing framework is undertaken. Nonetheless, we expect these Agreements to endure for some time to come, whilst potentially also forming a substantive regulatory footing on which the future regulatory framework will then be based. For this reason, and before diving into the finer legal drafting issues, in this response we must consider whether the Agreement has any fundamental aspects to it that might make it unworkable. Our review highlights a number of issues and these are as follows:

1. *Clause 8.1 requires the Generator Aggregator (GA) to ensure its Commercial Offer Data is cost-reflective. This is further defined within Clause 8.2 to mean: "…equal to the Short Run Marginal Cost related to that Aggregated Generator Unit in respect of that Trading Day".*

   Our concern with this Clause is firstly with regard to the rationale for why SRMC is appropriate for AGUs. We would welcome an explanation for the SRMC basis that might apply to AGUs against the original SEM SRMC objectives, as we fail to understand why this requirement is considered so necessary in this instance. It is difficult, for example, to envisage how an AGU could have significant local or global market power in the SEM.

   Second, even if SRMC were appropriate, we note that it may not be practicable to implement given the number and/or diversity of Member Generators within the aggregation process.

[1] Viridian's comments are in italics

We therefore fail to understand the rationale for such a measure and how this might work in practice. Reference to SRMC should be removed, or at the very least, the justification provided.

The SEM Committee notes VPE's comments about the requirements to submit Commercial Offer Data in line with its Short Run Marginal Costs (SMRC) set out in clauses 8.1 and 8.2.

The provisions in the draft contract are the same as the conditions in the generic generation licences. In the Ireland, but not in Northern Ireland, generators under 10MW must be licenced. Accordingly, in Ireland the position prior to this modification has been that even de minimis generators are subject to the same cost reflective bidding principles as larger generators. Furthermore, for AGUs in Ireland it is arguable that even without these contracts, cost reflective bidding principles will apply in this context given that the member generators are obliged under their licences to ensure that they comply with the principles and the BCOP.

If the AGU bidding on their behalf breaches the bidding principles then this may result in their members being in breach of their licences. Given that this position is not mirrored in Northern Ireland then it is important that this inconsistency in approach is addressed to ensure that there is uniformity in the SEM and to prevent a kind of two-tier application of the bidding principles whereby AGUs in Ireland but not in Northern Ireland would be bound by such principles. Further, given that all other Price Making Generator Units[2] in both jurisdictions are subject to bidding principles, as a matter of equity, if for no other reasons, such principles should apply to all AGUs.

The reason for applicability of the bidding principles to all generators goes back to the consultation on market power in the SEM. As set out in section 3.1 of the "Market Power Mitigation in the SEM, Bidding Principles & Local Market Power, Decision paper", 8th September 2006 (AIP/SEM/116/06) which suggests that although Demand Side Units (DSUs) and Interconnector Units do not have these principles enforced upon them they would be expected to comply with them. The SEM Committee point out that AGUs are distinct from DSUs and Interconnector, notably in the case of the former that they are capable of exporting and in both cases are more likely to have a significant impact on the market price. As such, compliance with the Bidding Code of Practice for AGU's is in line with the SEM design.

The SEM Committee note VPE's point on enforceability but do not believe that this should exclude AGU's from the bidding principles.

2. *The GA must be free to contract for its capacity as it sees fit consistent with maintaining compliance with both the Grid Code and the Trading & Settlement Code (T&SC), i.e. whether not it has legal ownership of the various generators that comprise the AGU(s). This important distinction must not be frustrated in any way by Section (2)(A), which reads:*

[2] With the exception of Interconnector Units and Demand Side Units

"If applicable, the Generator Aggregator has entered an agreement with the Member Generators to act as an Aggregator Generator Unit on their behalf for the purposes of registration…"

Confirmation from the RAs that it is not intended to limit the GA's freedom to contract or own capacity within an AGU would be very much appreciated.

In relation to VPE's second point, the SEM Committee can confirm that there is no intent to limit the Generator Aggregator's freedom to contract and or to own generators within the AGU. Section 2(A) of the contract is intended only to ensure that where appropriate, the Generator Aggregator has contracted with the asset owner.

3. *Generator licences takes precedence over and above the T&SC (as per section 2.4), and we therefore assume these Agreements will similarly take precedence over and above the T&SC. Again, confirmation would be appreciated.*

In relation to VPE's third point, the SEM Committee notes that, were there to be any conflict between the terms of the AGU contract and the SEM Trading and Settlement Code, then the terms of the contract would apply. However, the SEM Committee does not believe that any such conflict exists and should it be found to exist in the future, would expect parties to take steps to seek to remove such conflict.

4. *It is important to keep the GA operational costs as low as possible, with administrative and compliance obligations kept to an absolute minimum. We note Clause 4.2 requires the GA to notify the RAs of any Member Generator changes, but we also note that Member Generator changes are subject to the registration process under the T&SC and therefore already notifiable to the RAs. The T&SC would seem to render this Clause both unnecessary and unduly burdensome.*

In conclusion, the four principled points noted above need to be addressed before we will be in a position to comment more specifically on the finer points of the legal drafting.

In relation to VPE's final point, the SEM Committee notes that the provisions of Mod_05_08 include the requirements upon a Generator Aggregator to provide updates to its Participation Notice whenever there are changes to the component generators of the AGU. The SEM Committee therefore agree that the provisions of Clause 4.2 to notify the relevant RA of changes to the composition of the AGU are unnecessary.

SEMO, in conjunction with **the System Operators,** submitted comments[3] as follows:

1. *The Regulatory Authorities appear to be seeking to address the absence of a licensing mechanism relating to Generator Aggregators by proposing a further change to the TSC (Section 5 and AP1) requiring Generator Aggregators to enter*

[3] SEMO Comments are in italics

into a contract with either the CER or NIAUR. The contract deals primarily with compliance with the Grid Code/Distribution Code and the Bidding Principles (mainly the requirement to bid on the basis of Short Run Marginal Cost). The purpose of the contract is to provide a means by which Generator Aggregators are bound to comply with the Codes in the absence of a licence condition requiring them to do so.

The key issues here appear to be remedies and enforceability. The amendments to the TSC say that if the Generator Aggregator no longer has a contract with the relevant Regulatory Authority, then it must be deregistered. The main enforcement mechanism therefore appears to be the ability to terminate the agreement for breach. However, with respect to the breach itself, it is not clear that the proposed agreement will necessarily provide an effective remedy.

As drafted, the contracts provide for the relevant Regulatory Authority to issue a remediation notice specifying what must be done to remedy a breach (clause 10). They then provide that:

"Where the Generator Aggregator commits a breach of this Agreement that has not been remedied in accordance with Clause 10, [the relevant RA] will be entitled to a court order for specific performance." (Clause11).

The intent here seems clear in that, as would be the case with a licence condition, it is the performance of the obligation under the licence that is required, not an action for breach of contract resulting in an award of damages. However, the parties cannot agree by contract that a remedy of specific performance is to be granted. It is an equitable remedy and only available at the discretion of the court. A judge would have to find that damages could not adequately compensate for the breach before making such an order. A frequently quoted example of a case where a court is likely to award specific performance is the sale of land. Since land is of a unique character, an award of damages can never take the place of the land that the vendor has agreed to sell and the court may consider it equitable to order the vendor to convey the land.

However, there is no legal certainty that the remedy would be awarded here. A judge would have to look at the matter on its merits and may reasonably come to the view that financial compensation is appropriate. He may also take the view that no remedy is appropriate as the Regulatory Authorities will not have suffered any loss - it is other market participants that are likely to suffer a loss.

An alternative formulation would be for the Generator Aggregator to agree that damages would not be a sufficient remedy and that it would not oppose the Regulatory Authorities seeking a remedy of specific performance. That still does not mean that a court will award it, only that the Aggregator is in breach of contract if he attempts to defend the application.

On the issue of Specific performance, the SEM Committee agrees that the provision is unlikely to be directly enforceable although may still have an impact on the court's decision. The suggestion provided by SEMO would have similar "swaying" rather than binding effect given no matter how the clause is drafted it is still ultimately the court's decision. However,

SEMO's suggestion clarifies the position. Accordingly, the SEM Committee proposes the following amended wording:

'Without prejudice to any other rights or remedies that the Commission/Authority may have, the AGU acknowledges and agrees that damages alone would not be an adequate remedy for any breach of the terms of this Agreement by the AGU. Accordingly, the AGU agrees that the Commission shall be entitled, without proof of special damages, to the remedy of specific performance for any threatened or actual breach of the terms of this Agreement'.

2. *There is also a subsidiary point in that in Northern Ireland, third parties may have statutory rights to enforce the contract where it can be shown that terms in it are for their benefit. So it is not inconceivable that an affected party may look for redress. That avenue would not, I believe, be available under Irish law.*

As SEMO point out, this is an issue in Northern Ireland by virtue of the Contracts (Rights of Third Parties) Act 1999. In Ireland the common law rules on privity of contract still prevail, although the Irish Law Reform Commission has made a proposal to introduce similar legislation on third party rights in Ireland. The SEM Committee proposes inserting a standard provision on this as follows:

'Third Party Rights

A person who is not a party to this Agreement shall not have any rights under or in connection with it'.

3. *It is noted that the proposal is to govern the contracts by Irish and Northern Irish law. However, the TSC is governed by NI law so it opens up the question as to whether both these agreement should be governed by the same law to ensure that all participants in SEM are treated on a non-discriminatory basis.*

The SEM Committee notes that this agreement is purely in place to simulate vital licence conditions. Licences are done on a national basis and it seems appropriate to deal in the same way here. The obligations in each agreement are identical. It does not seem discriminatory to choose the most convenient forum for the parties involved. It would not make sense for the CER to have to bring an Irish undertaking to the Northern Irish courts and apply Northern Irish law when both parties involved operate under Irish law normally. The TSC is different in nature- it applies universally to Irish and Northern Irish participants. In order to ensure uniformity and legal certainty and to avoid confusion it has to be governed by one law.

4. *Other issues may arise in that, for example, if there were a licence, the MO or the SO might challenge a decision of the Regulatory Authorities with respect to a licence provision by way of a judicial review. However, it is far less clear that this avenue would be available in relation to a decision not to enforce the terms of a contract. This may call into question whether there is an effective remedy available.*

The SEM Committee acknowledges that the agreement is not a perfect long term solution and is intended as a short term remedy to the problem of AGU compliance. An enduring licensing regime will address this problem and work is under way to progress that as expediently as possible.

SEM Committee Decision

The SEM Committee are grateful for all the comments received.

The SEM Committee determines that the AGU regulatory contracts shall be as published on 22 August 2008 except that:

- in each form of the contract, the provisions of Clause 4.2 shall be replaced by the words “not used”.
- In each form of the contract Clause 11 will be replaced with ‘Without prejudice to any other rights or remedies that the Commission/Authority may have, the AGU acknowledges and agrees that damages alone would not be an adequate remedy for any breach of the terms of this Agreement by the AGU. Accordingly, the AGU agrees that the Commission shall be entitled, without proof of special damages, to the remedy of specific performance for any threatened or actual breach of the terms of this Agreement’.
- In each form of the contract a new Clause 22 shall be inserted as follows:

  ‘**Third Party Rights**

  A person who is not a party to this Agreement shall not have any rights under or in connection with it’.

Final versions of the two contracts, modified in accordance with this decision are published with this decision paper.