Brookfield

Brookfield Renewable Energy Group (Ireland)

Response to
ISEM High Level Design Draft Decision

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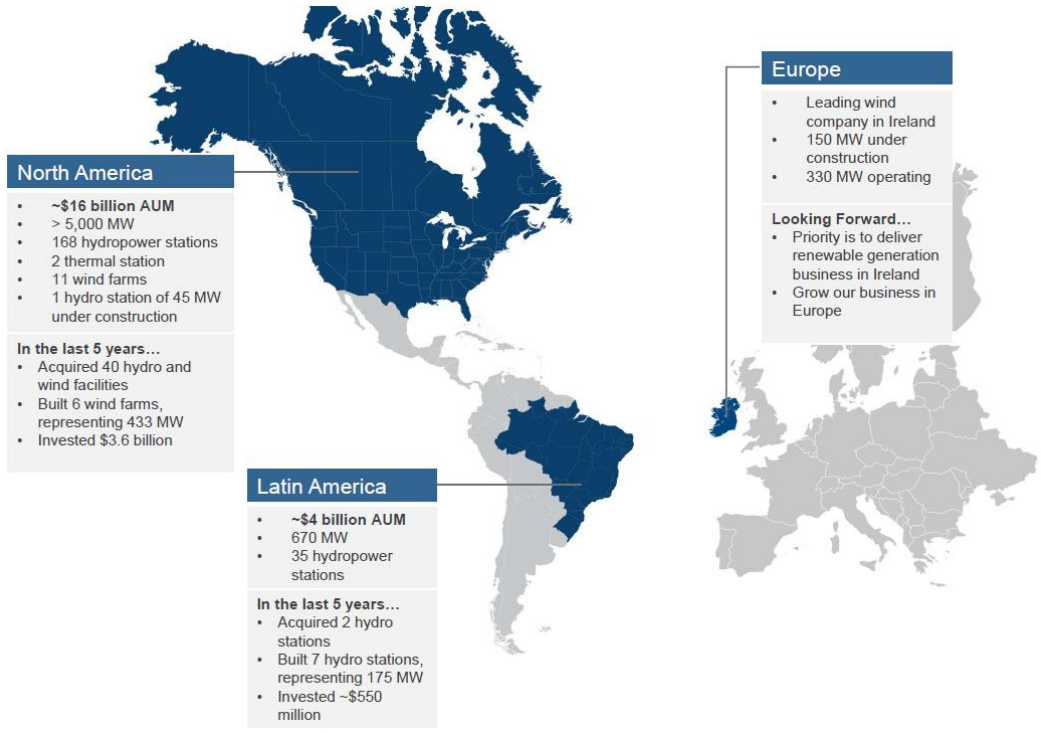

Brookfield Renewable Energy Partners – Global Footprint

Brookfield

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Introduction

Brookfield Renewable Energy Group (Ireland) (BREG) is a wholly-owned subsidiary of Brookfield Renewable Energy Partners (BREP). Following the completion of the acquisition of the wind generation assets of Bord Gáis Éireann at the beginning of this month, BREG now owns and operates 321 MW of wind capacity across 17 wind projects in 8 counties in Ireland and Northern Ireland. BREG have an additional 137 MW of wind generation in construction and a development pipeline of approximately 300 MW of wind and a 200 MW tidal generation project across Ireland and Northern Ireland.

Brookfield brings a unique global perspective to the design discussions for the Integrated Single Electricity Market (ISEM) in Ireland, given our extensive experience operating renewable energy across diverse power markets, including markets where wind energy is significantly integrated into the broader electricity market construct. We are pleased to bring this experience and perspective to our recommendations.

The ISEM Market redesign will represent a fundamental shift from Ireland's current energy market design. While we recognize the imperative behind the ISEM, including broader EU target model requirements, as a recent entrant to this market with a resultant substantial investment into the Irish economy, BREG are concerned about any and all changes to the existing market with particular regard to the stable treatment of wind generation under which that investment is founded. We feel it important that any changes to the SEM work toward preserving the economic basis of this recent investment, as well the fundamental economics of wind generation more broadly across Ireland given its central role to the country's energy policy and its security of supply, price and environmental benefits.

This response will first discuss the BREG perspective of the key issues that must be considered in the final decision on the High Level Design of the ISEM. It will then comment on the proposed Energy Trading Arrangements before discussing the need for a non-discriminatory Capacity Remuneration Mechanisms that recognizes wind's contribution. Finally this response will address specific issues with the ISEM HLD draft decision outside of the Energy Trading Arrangements and the Capacity mechanism such as market power, the compatibility with renewable supports and stability of the REFIT program, as well as the treatment of priority dispatch.

Summary

Wind generation delivers indigenous, sustainable and renewable energy to consumers across the island of Ireland. By 2020, it is targeted to represent 40% of the SEM's installed capacity across Ireland and Northern Ireland. This penetration will benefit consumers by providing a secure, renewable, environmental energy source that protects them from exposure to volatile gas, coal and carbon markets. These benefits and wind generation's large share of the market necessitates that it must be central to the ISEM market design.

BREG believes that the key market attributes of the current SEM (including; liquidity of the ex-post market, market transparency, cost recovery for generators, ex-post balancing regime, market power mitigation measures, and the capacity payment mechanism) have been successful in delivering competitive end costs for consumers and an environment that can attract investment needed to meet renewable energy policy targets. BREG believes that rationale behind these key attributes remains and the SEM Committee (SEMC) must consider the contribution of these key attributes to the success of the SEM when determining the detailed design of the new ISEM energy and capacity remuneration arrangements.

Any erosion of the commercial position of existing wind generators amounts to retrospective changes that would be extremely damaging to the ISEM's attractiveness for investment. Such an approach will damage the regulatory and commercial certainty that investors need to enable delivery of renewable targets and must be avoided. Increased regulatory risk and volatility has a direct effect on the ability to finance wind projects. The SEM is competing with other jurisdictions to attract capital and a stable regulatory and market regime is essential for growth in renewables to continue.

BREG recognise that some elements of the SEM are inconsistent with the European Target Model and will require changes. However, we urge the SEMC to ensure that the High Level Design protects the commercial position of existing generators while promoting the objectives of the Target Model. To this end, market mechanisms must be found that incentivize market participation for the benefit of all stakeholders and do not expose renewable participants to additional risks and costs which increase the investment risk profile for current and perspective market participants.

Of most significance to existing and future wind generators is that the ISEM must be compatible with both existing and proposed renewable support mechanisms without undermining their underlying economics. For merchant wind generators the mechanisms must be in place to incentivise market participation rather than simply penalising non-participation. This is closely followed by the need to limit wind generation's exposure to balancing costs. The design of the balancing regime must reflect the characteristics of the market containing 40% wind (that can increase to 75% at any one instant).

The HLD draft decision proposes a Capacity Remuneration Mechanism (CRM) that appears to significantly discriminate against wind generators. BREG believes that the proposed mechanism must be rejected in favour of a price-based CRM that is transparent and non-discriminatory and recognizes the capacity contribution of all participants, including wind generation.

1. Energy Trading Arrangements across the Market Timeframes

This response will now comment on the Energy Trading Arrangements proposed in the HLD draft decision. However, we preface these comments by noting that the ISEM should be developed on the premise that wind generators commercial position in the SEM, which these assets have been (and will be) financed on, must be protected in the ISEM market design and mechanisms. Furthermore, we believe that the market arrangements must be consistent with facilitating more wind generation on the island of Ireland and enabling more efficient cross-border interconnector flows.

1.1. Forwards Market Timeframe

Proposed Decision (i.) The I-SEM will have only financial trading instruments for within zone trading

BREG agree with the proposal to limit trading in the forward market timeframe to financial trading instruments. This proposal should enable market participants to hedge out price risks over longer timeframes without removing liquidity from the Day Ahead (DAH) and Intraday (IDM) market timeframes, which would be the case if Physical trading was proposed.

Measures that promote liquidity and transparency in the DAH and IDM are a crucial element in the design of a successful ISEM due to the need to promote efficient cross-border trade across interconnectors and address market power considerations in a small market with low levels of interconnection.

The concept of an "intermediary" has evolved in the SEM, where a generator can contract with a counterparty such as a supplier (the intermediary) for the physical delivery of energy over an extended period (usually a number of years) who then participates in the market on behalf of the generator. This arrangement is the basis on which power purchase agreements for all wind generators operate, including REFIT and merchant wind PPAs. This concept has not been acknowledged in HLD draft decision. BREG request that the concept of an intermediary remains as it is currently understood and this is acknowledged by the SEMC in the HLD.

Proposed Decision (ii.) Subject to further discussions and agreement with other neighbouring markets, Cross-Zonal trading will be supported only by Financial Transmission Rights (FTRs).

BREG reiterates the need for efficient cross-zonal trading and consequently efficient interconnector use which is the central objective of the European Target Model. The solution must provide the ability to trade across borders in the forwards timeframe while enabling price and volume risks to be hedged. It must also address market power concerns where portfolio players should not be able to benefit from amassing large amounts of interconnector capacity.

Given the importance of measures to concentrate liquidity into the Day Ahead and Intraday markets and ensure that Interconnectors are operated efficiently, FTRs present some advantages. However, there may be a need to re-evaluate the suitability of the transmission rights regime as the market evolves.

1.2. Day Ahead Market Timeframe

Proposed Decision (iii.) The European Day Ahead Market will be the 'exclusive' route to a physical contract nomination.

BREG supports the proposal that the European Day Ahead Market will be the 'exclusive' physical route to market in the Day Ahead timeframe. We believe that this proposal will promote more efficient Interconnector (IC) trade than the current SEM due to the removal of price risk from IC trading decisions. More efficient IC trade is an important element to ensure that the curtailment of wind generation is mitigated, along with the successful, timely delivery of the DS3 Programme. Without the effective mitigation of curtailment levels, wind development will become unviable and renewables targets will not be met.

BREG agrees with the proposal in the draft decision to relax the requirement for mandatory participation in the Day Ahead market for wind generation. In our view mandating wind generation to participate in the Day Ahead market is not fair or efficient. Wind generators face challenging forecasting risks due to its intermittent resource that no other market participants face. Forcing wind generators to submit forecasts at this point does not empower wind to minimise its energy imbalance by participating in the market timeframes as it sees fit, it merely guarantees that wind generators will be exposed to an unacceptable balancing risk.

The proposal for mandatory participation for other types of generators and demand in the DAH market is one that BREG agrees with, primarily based on liquidity and transparency concerns. Accepting that generators will naturally converge on the market timeframe with

the highest prices, we believe that there are fundamental issues with the ISEM with regards to market size, concentration and limited interconnection, which necessitate the need for mandatory participation in the DAH for generation (excluding wind) and demand.

Proposed Decision (iv.) Unit-based participation for generation in general, with (gross portfolio) aggregation arrangements for DSU, demand and (some) variable renewable generation.

We support the proposal for unit-based participation for generation excluding wind generation and demand. We believe that unit-based bidding in the current SEM aids transparency of price formation and is an important element of the market mitigation strategy that should be retained. However, there are clear advantages for allowing aggregation arrangements for intermittent renewable generation. It is extremely challenging to forecast the output of wind generators up to 36 hours in advance. The mean error when forecasting the output across a portfolio of wind farms will be less than the combined error of the individual wind-farms, assisting wind's ability to accurately forecast its output. Furthermore, the operation overheads involved in managing individual wind farms make this solution impractical as well as unfair for smaller participants.

BREG seek clarity from the SEMC on their proposal to allow "(some) variable renewable generation" to participate as an aggregated portfolio in the Day Ahead, Intraday and Balancing markets. BREG believes that all wind generation must be permitted to use aggregation arrangements to participate in the market as they see fit.

1.3. Intraday Market Timeframe

Proposed Decision (v.) Continuous intraday trading will be the exclusive route to Intraday physical contract nominations (with scope to introduce periodic implicit auctions as/if these develop at the European level).

Proposed Decision (vi.) Unit-based participation for generation in general, with (gross portfolio) aggregation arrangements for DSU, demand and (some) variable renewable generation.

As per the Day Ahead market, BREG agrees with the proposal for the centralised Intraday market to be the exclusive route to market in the Intraday timeframe. The Intraday market is the only opportunity market participants will have to trade out any balancing exposures from the Day Ahead timeframe prior to the Balancing market. Efforts to promote liquidity in this market timeframe are essential and the proposals for exclusivity and for unit-bidding

are supported. As in the Day Ahead timeframe, BREG believes that all wind generation must be permitted to use aggregation arrangements to participate in the market if they chose to do so.

1.4. Balancing Market Timeframe

The introduction of Balance Responsibility represents a massive shift away from the current SEM approach of using outturn demand and output from wind generation to calculate system prices. In the current SEM the cost of differences between the market schedule and the dispatch schedule due to network and energy actions are socialised meaning that, in effect, generators and demand have no balancing exposure. For wind generation whose output is intermittent and difficult to predict beyond a few hours ahead, this element of the current market design provides investment certainty and has been a key element in delivering substantial investment to date.

While recognising that the EU Target Model mandates changes with regards to the Balance Responsibility of market participants, BREG requests that the SEMC give careful consideration to the need to maintain the overall commercial position of wind generators when deciding on this important element of the ISEM market design. Wind generation delivers benefits to consumers in terms of security of supply and environmental benefits. Wind also provides consumers with protection from volatile energy markets and has delivered lower system prices. If the market design puts additional commercial risks on wind generators such as balance responsibility; market mechanisms and incentives must be in place to enable wind generators commercial position to be maintained to ensure the benefits of wind generation are fully exploited for all stakeholders, not least consumers.

Proposed Decision (vii.) Starting point for dispatch is detailed and feasible production plans required for all market participants following DAM.

Proposed Decision (viii.) Mandatory participation in Balancing Mechanism (BM) after DA stage.

Proposed Decision (ix.) Unit-based participation in BM for generation in general.

BREG accepts that changes will be required between the market schedule produced in the Day Ahead and Intraday markets and the dispatch schedule to account for energy and network balancing actions. However, in principle, if a generator is required to change from their market schedule it must be through balancing market actions, taking into account their

Incremental (Inc) and Decremental (Dec) bids. Any movement away from market schedules as a result of the TSO converting market schedules into technically feasible schedules must obey this principle. Ensuring that market bids are technically feasible is another issue that can be addressed through bidding rules and/or market surveillance.

BREG supports the proposal for unit-based mandatory participation in the Balancing Mechanism after the Day Ahead stage. The highly constrained nature of the network on the island of Ireland is likely to remain due to requirements for reserve, inertia and other network support measures. When considered alongside the introduction of balancing responsibilities for generators, the need for transparency and liquidity in the balancing market is paramount. Making the balancing market mandatory provides the transparency and liquidity needed to deliver the most efficient economic solution. It also addresses market power concerns that portfolio players could with-hold generation to influence balancing prices.

Proposed Decision (x.) Marginal pricing for unconstrained energy balancing actions.

Proposed Decision (xi.) Pay as Bid for non-energy actions (possibly combined with local market power mitigation measures).

Notwithstanding our strong belief that Imbalance prices should be treated differently to Energy Balancing actions, BREG supports marginal pricing for unconstrained energy balancing actions and Pay-As-Bid for non-energy (network) balancing actions.

An energy market/system with high levels of wind generation will require increasing levels of flexibility both from all existing market participants, demand and generation and by other flexible solutions. BREG strongly supports the DS3 Programme as a means of delivering this flexibility but also recognises that price signals in the energy market are needed that reward the provision of flexibility. The proposal to set energy balancing price at the price of the marginal energy balancing action does this, in BREGs view.

Pay-as-bid for network balancing actions is also supported where, in principle, a generator should not be able to profit purely based on their location on the network. Given the highly constrained nature of the Irish network, it appears sensible to enable the TSO to mitigate local market power. Regulated contracts to address specific local constraints is one way of doing so.

The process of 'Flagging and Tagging' of Energy and Network balancing actions by the System Operator must be transparent. Because of the size of Ireland's energy system, 'flagging' the action from one generator while 'tagging' the action from another could have a huge impact on the energy balancing price which is set at the price of the marginal MW.

Proposed Imbalance Decisions:
(xii.) Unit-based
(xiii.) Single imbalance price
(xiv.) Route to market for small players (aggregator of last resort)

BREG is highly opposed to the proposal to settle imbalance volumes at the marginal costs of energy balancing actions taken by the TSO. Our view is based on the premise that the commercial position of wind generators must be maintained.

Imbalance prices can and should be treated differently to Energy Balancing prices. The Network Code for Balancing recognises Imbalance prices and Energy Balancing pricing under separate Articles[1]. The proposal to set imbalance prices at the marginal cost of energy balancing actions has been made without any rationale being presented for its choosing, nor impact assessment of the consequences. BREG believes that this proposal is unduly penal towards wind generators and goes far beyond incentivising wind generators to balance by exposing them to volatile, unpredictable, potentially high marginal prices that would be very damaging to investment certainty.

The ultimate aim of the Target Model is to achieve efficient cross-border trade and the current socialised balancing regime combined with high levels of wind in the market must be the context within which an imbalance solution is found. A solution must be found to imbalance pricing that maintains the commercial position of wind generators and provides a market environment that will enable the additional investment in wind generation needed to meet policy objectives. For example, part of the solution could be an imbalance pricing regime that protects wind generators from extreme volatility by taking the average price of the energy balancing action in that trading period. This could be complimented by recognising the curtailment of wind generation as a Decremental balancing action that receives payment if used and in doing so provides an incentive for wind generators to help the balance the system. Such solutions should be explored in a separate consultation on the issue of imbalance pricing and settlement and could include measures to cap imbalance

[1] ENTSOE: Draft Balancing Network Code Article 38 (Procurement of Balancing Energy) and Article 60 (Imbalance Price)

pricing exposures for wind generators while retaining signals to incentivise balance responsibility.

BREG support the inclusion of an 'aggregator of last resort' to provide a route to market for all wind generators. The inclusion of such an aggregator will help to provide the security needed for wind projects to achieve and retain financing. However, the scope and the responsibilities of the role of aggregator should be considered in the detailed design phase of the ISEM project, allowing all stakeholders to input their views, with a view to ensuring that there are no barriers to entry for independent commercial aggregators.

2. Proposed Capacity Remuneration Mechanism (CRM)

BREG is firmly of the view that a CRM is required in the ISEM market solution and that the proposed mechanism is unduly discriminatory against wind generation. We strongly believe the CRM must remain transparent and non-discriminatory and reward wind generation for its contribution to capacity and generation adequacy, while also recognizing its unique operating characteristics.

Wind generation is the only indigenous, renewable energy source of scale on the island of Ireland. It contributes to consumers' long term security of supply and is not dependent on an imported fuel source, helping to reduce consumers' exposure to volatile global energy markets. The proposed Reliability Option mechanism treats wind generation in an unfair and discriminatory manner by implicitly excluding it from successfully taking part.

When investing in the SEM, generators have a legitimate expectation that revenues from market mechanisms will be retained. Altering the Capacity Remuneration mechanism so that an entire class of generation is effectively excluded could be seen as a retrospective action that is very harmful to investor certainty.

2.1. Rationale for Capacity Remuneration Mechanism in ISEM

The current CRM has been successful in giving generators a reliable, transparent revenue stream, providing clear investment signals. For consumers it has helped to deliver stable energy prices and generation adequacy. BREG believes that this price-based approach is appropriate to a small market where a single large generator entering or exiting the market has a large effect. It has delivered generation adequacy and addressed the "missing money" problem.

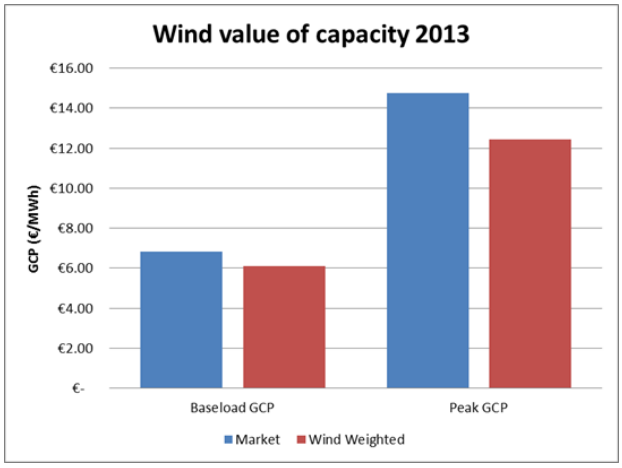
BREG believes that the current CRM objectives remain relevant but acknowledge that additional objectives may be required which include compliance with EU State Aid requirements to avoid distortion of cross-border trade, to be technology neutral and to fit into the broader European decarbonisation policy (supporting renewables).

The draft decision states that de-risking of investment and the avoidance of boom and bust cycles is a key rationale for maintaining an explicit CRM in the ISEM. BREG agrees with this rationale however it appears at odds with the Reliability Option design chosen for the ISEM CRM which provides short term protection from high prices for consumers but does not appear to give the necessary investment certainty for it to de-risk any future investment in capacity adequacy solutions. We believe that the proposed CRM should be rejected and replaced by a long term price-based CRM that is non-discriminatory and technology neutral, inclusive of wind generation, and gives the certainty needed to de-risk investments and deliver long term security of supply to consumers.

2.2. The Proposed Reliability Option (RelO) Mechanism

As stated above, we believe that while the proposed RelO mechanism will protect consumers from peak energy prices it will not deliver the stable long term investment signals needed to deliver generation adequacy and avoid boom/bust cycles such as what we are seeing in neighbouring markets.

We believe that the proposed RelO mechanism discriminates against wind generators by design. An implicit penalty is created when market prices exceed the strike price and generators in receipt of RelO payments must pay back the difference. By their very nature, high prices will occur in the ISEM when wind generation is low. This creates a risk and potential exposure for wind generators that would have to be priced into their capacity auction bid, rendering it uncompetitive. We are also concerned about the effectively retroactive nature of this change for wind generators, both those that partake in the REFIT scheme, and those early-movers that are outside of REFIT which are particularly exposed to CRM changes.



(Source: BREG analysis)

The chart above, based on the current Capacity Mechanism, demonstrates that wind generation does provide capacity to the system when it is needed most, i.e. at peak hours (17.00 to 21.00) by comparing the wind weighted price with the average capacity price across all generators. BREG believe that, despite providing this capacity, wind generation may not receive any remuneration under the proposed Reliability Option Mechanism because of its implicit design elements. This is inherently discriminatory and we believe runs contrary to the stated goals of the capacity mechanism of de-risking investment and avoiding boom and bust cycles as well as being contrary to the principle of technology neutrality espoused in the EU State Aid Guidelines.

2.3. Alternative CRM:

Notwithstanding our belief that a price-based capacity mechanism should be chosen and represents the best way to deliver generation adequacy and protection from high prices to consumers, BREG believes if the proposed RelO mechanism is to be chosen by the SEMC, it must recognize wind generation clearly and compensate them for the capacity they provide.

This can be achieved by including wind generation's capacity contribution from the volume to be set as the capacity reserve. Wind generators should then be rewarded using a price based mechanism for the capacity it provides. This payment could be set at the clearing price in the auction for the reliability options. Such as solution would allow the SEMC to retain their proposed design that provides consumers with protection from high energy prices, but while delivering a non-discriminatory solution that compensates wind generation fairly for the capacity it provides.

3. Other Market Design Considerations

3.1. Renewables Supports

The ISEM market design must be compatible with renewables support schemes, both existing (AER, REFIT 1,2 and NI Renewable Obligations) and proposed (such as the UK CfD regime). An achievable reference price for all wind generation is important, particularly for REFIT-supported wind, to ensure that the impact on the PSO and the R-Factor reconciliation process is minimised. Further consultation with all stakeholders including the DCENR and DETI is essential on the interaction of support schemes and the new market design.

3.2. Market Power

The SEM has delivered a high level of transparency, equity and competition. BREG believes that the market mitigation measures such as the Bidding Code of Practice, the Market Monitoring Unit, Directed Contracts for energy in the forwards market timeframe and restrictions around horizontal unbundling and vertical integration that have been in operation throughout the lifetime of the SEM have contributed hugely to this success.

In CEPA's 2012 review of market power[2] in the SEM, their analysis showed that in 2020 market power will remain an issue in a significant number of scenarios where, due to large amounts of wind generation on the system, in periods of low wind generation generators with even modest market shares become pivotal as they become the marginal price setters. The report recommends that a robust market power mitigation strategy is likely to continue to be required. BREG echoes the requirement for continued market power mitigation measures, particularly due to heightened market power concerns in the Intraday and Balancing timeframe, where wind generation may be exposed. The "conduct and impact" test used by System Operators in many US markets is an example of a mitigation measure that could be introduced to address these concerns. Under this test the RAs determine a plants competitive benchmark bid incorporating a margin for the generator. If the benchmark bid is exceeded by the generator a review of the bid is "conduct"(ed) where the price outcomes of the bid are determined. If the "impact" exceeds a material threshold, the bid is adjusted to the benchmark bid level.

This response has already highlighted that the liquidity and transparency of the centrally traded market timeframes (Day Ahead, Intraday and Balancing) are of particular concern to

[2] CEPA – Market Power and Liquidity in the SEM

wind generators, particularly given the proposed relaxation of the Bidding Code of Practice. BREG believes that market making obligations in the intraday market for large portfolio players would assist with liquidity. However bidding in the balancing market is concerning and we request that these concerns are addressed in the detailed design phase to ensure that fair and transparent behaviour is guaranteed for all market participants in the ISEM.

BREG request that the market power concerns raised in this response are addressed in the High Level Design decision paper and furthermore are clearly included in the project planning and scope for the different work streams that will make up the detailed design phase of the ISEM project.

3.3. ISEM Project Plan

A detailed project plan must be published along with the HLD decision given the challenging timelines and the volume of change that the ISEM will mean for all stakeholders in terms of implementing processes and systems needed to accommodate the new market.

Current expectations are that the detailed design will be finalised in Q1 2015, leaving a maximum of 20 months to meet a Dec 2016 deadline for the ISEM market to go live. During this short time period the definition, procurement, implementation and testing of systems and processes will have to be completed. This is an extremely challenging target and if it is to be met clarity is first needed from the High Level Design decision paper and subsequently throughout the detailed design process. The High Level Design decision paper must include the detailed design work streams and the process for consultation and industry engagement during this crucial design phase to ensure the concerns of all stakeholders are addressed.

3.4. Local Market Issues

Priority dispatch

The principles of priority dispatch and access are set out in the RES-E Directive (2009/28/EC) and transposed into Irish law. BREG reiterates the need for the SEMC to continue to acknowledge this through its support for the retention of absolute priority dispatch. However, in the HLD draft decision, priority dispatch is listed along with treatment of losses and firm access as an example of existing SEMC policy. BREG would like to highlight that priority dispatch, along with the other obligations listed in the RES Directive, is a legal requirement and this should be clearly stated in the decision.

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Treatment Firmness/Losses/Other Local Market Policies

BREG would like to underline the importance of retaining underlying policy and current treatment of issues such as firmness and losses, as the SEMC has indicated in the HLD draft decision. These are of critical importance to market participants, particularly wind generators and should they prove to be incompatible with the ISEM design and require substantial changes it must be flagged in the regulatory impact assessment prior to a decision being made on the design of the ISEM and be consulted on in the detailed design phase of the ISEM project.