



***Response to Integrated Single Electricity Market (I-SEM)  
Consultation on the Aggregator of Last Resort Framework***

***SEM-14-106***

**On behalf of  
AES Kilroot Power Ltd and AES Ballylumford Ltd**

**30<sup>th</sup> January 2015**

## Aggregator of Last Resort

AES welcomes the publication of the consultation document on the Aggregator of Last Resort (AOLR) Framework (SEM-14-106) and the opportunity to provide comments on the process for determining the framework structure of the AOLR. AES would like to submit the following response to the Regulatory Authorities to their consultation.

AES is a global energy company with assets in the all island market consisting of coal and gas fired conventional and CCGT plant with additional distillate fired peaking gas turbine plant. AES is a non-vertically integrated independent generator which owns and operates Kilroot and Ballylumford power stations in Northern Ireland with a combination of merchant and contracted base load, mid merit and peaking plant. The responses to this consultation are therefore conditioned by the nature of our current position and portfolio of assets operating in the SEM.

### Summary Key Messages.

This response is submitted with reference to the level of detail that is currently available on the design of the balancing market and the interaction of renewable support mechanisms with I-SEM. Both have implications for how wind generators participate in the market and therefore on the design and function of the AOLR. As further progress is made on detailed market design AES believes it may be necessary to revisit the design and function of the AOLR.

At the AOLR workshop held in Dundalk in December 2014, there appeared to a low level of participant interest for the proposed last resort service as most small wind generators already have a route to market through their PPA contracts with suppliers who effectively provide an aggregation service. Therefore if the demand was low it would favour a low cost mechanistic approach to reduce the risk of stranded asset or unnecessary expense incurred through an unmerited overly complex solution.

As the title implies AES believes that, in principle, the AOLR should be an option of last resort with a less favourable route to market than could be provided by a commercial aggregator offering this service or if of sufficient scale, from participating directly in the market.

The design of the AOLR framework should not provide disincentives to the emergence of commercial aggregators capable of offering more favourable commercial terms to small generators.

Whilst understanding the requirement to provide small generators with an uncomplicated and low cost route to market the model derived should also incentivise small generator market participants to look for more favourable arrangements such as commercial aggregators or power purchase agreement contracts with suppliers, leaving the aggregator of last resort for those unable for whatever reason to secure more favourable commercial terms.

AES therefore believes that the AOLR should consist of a mechanistic approach only to provide route to market, where all small generator volumes are entered into the day ahead market at

a discounted price, with no intraday trading and any forecast error imbalance is settled at the imbalance price.

In providing for small generators with no other route to market AES believes that the AOLR function may be required in the market on an enduring basis and not as a transitional measure as envisaged in the consultation paper.

#### Potential Aggregator Of Last Resort Models (Section 4)

##### **1. Do you agree with the potential functions of the AOLR as outlined? Are there any additional functions that the AOLR could potentially perform in I-SEM?**

- AES understands the requirement for aggregators in the I-SEM to reduce the barriers to participation in the I-SEM and may facilitate the only route to market for a number small wind and other technology generators.
- AES believes the aggregator of last resort function should be that as described, a function of last resort. AES has concerns that some of the functions identified in the consultation paper would appear to be those that a commercial aggregator would seek to provide i.e. active trading, pooling of risk, which if undertaken by the AOLR could prevent the emergence of commercial aggregators to perform these functions.
- As some of the identified functions are already performed by suppliers for PPA contracted small generators, AES accepts that it may take some time for commercial aggregator entities to emerge depending on the volume of small non PPA contracted generators and level of interest for the service.
- However AES believes that as there may always be some level of small generation unable to secure viable commercial routes to market via PPAs etc., the role of the AOLR may be an enduring requirement and the inclusion of functions such as pooling of risk and active trading in the AOLR function may discourage the emergence of commercial aggregators
- AES therefore believes that the AOLR functions should be those required by the mechanistic model only providing market access only and that functions that could be provided by commercial aggregators such as trading in the different time frames, pooling of risk and nominations to TSOs should be available to small generators through a commercial aggregation route.

##### **2. Which of the three models proposed in this paper do you think should be implemented? If none, are there alternative models to the ones proposed that should be considered?**

AES is not in favour of any of the options as identified and outlined in the consultation paper but in general favours a mechanistic approach to the AOLR function.

##### **Option 1**

- This option allows all 4 functions identified to be carried out by the AOLR, essentially the features that a commercial aggregator could provide. If allowed to perform these functions the AOLR may provide significant benefits to participants but also prevent the emergence of commercial aggregator entities and it is difficult to envisage how a commercial aggregator could compete with an AOLR offering option 1.

- Although incentivising better wind forecasting would be a benefit to the market, the AOLR should in principle provide less favourable commercial opportunities and terms that could be obtained via commercial aggregators, supplier PPA contracts, or by direct participation in the market and thus the AOLR option should incentivise small generators to look for better opportunities.
- AES is not in favour of this option.

### **Option 2**

- The difference between Option 1 and Option 2 appears to be based on the inability to pool market financial risk in Option 2. This places the requirement on individual generators to provide continual trading instructions to the AOLR or via a trading strategy.
- As the small generators are price takers this approach takes the form of volumes bid into each market timeframe based on individual forecasts provided to the AOLR. This presents a significantly greater challenge for small wind generation participants to provide their own active trading facilities and would effectively preclude a significant number of small generators from participation.
- As a high level of interaction on market decision making is required with the AOLR in this option, participants may be better off participating directly in the market negating the need for an AOLR and therefore AES does not believe this to be a viable option.

### **Option 3**

- The mechanistic approach, would require small generators to have their energy purchased at a discount to the market reference price to provide less favourable conditions than the supplier PPA route.
- The role should be passive, submitting bids based on a formula agreed between all generators and would provide the cheapest route to market for participants. However the lack of intraday trading may persuade generators that they are not getting the best price for their energy and may create the opportunities for commercial aggregators to emerge.

### **Alternative Option**

- AES favours an alternative option featuring a purely mechanistic approach built into the market rules or performed by a commercial entity providing the AOLR function. This involves small generator forecasted volumes bid into the day ahead market as price takers at a significantly discounted market price to provide an incentive to seek better commercial arrangements and with no intraday trading.
- Small generators imbalance would then be settled at the imbalance price for variation to their forecasted volumes
- The AOLR would charge a fee to cover the setup of the function and the discounted market price revenue would enable the AOLR to cover the balancing cost exposure.
- This would provide the easiest and cheapest route to market for small generators and simplest trading arrangements for participants with the initial AOLR set up costs covered by either the participant fees or the market.
- With a discounted market price, this option should also provide incentive for small generators to look for more favourable commercial arrangements and incorporate a

renewal with AOLR each year only if more favourable arrangements cannot be obtained.

- In short this should by default be the least attractive route to market but still attainable.

### Governance of the Aggregator of Last Resort Entity (Section 5)

#### **3. Would you consider providing aggregation services in the new market? If so, would you consider being the AOLR service provider?**

No

- AES would note that suppliers already provide aggregation services to small generators through PPAs and these should continue into I-SEM. It is important that the AOLR function should not impact on wind generators naturally seeking PPAs with suppliers.

#### **4. Should the RAs, or alternatively the TSOs, be responsible for establishing the AOLR framework and the subsequent procurement of the AOLR service provider? Outline reasons for your preferred option and if there are any further issues that merit consideration.**

- AES believes establishing the AOLR function should be the role of Regulatory Authorities. The requirement for legislative change should not prevent the RAs from taking the appropriate action.
- AES also prefers that procurement of the AOLR service provider should also be the role of the Regulatory Authorities and that the provider should preferably be independent of the TSO.
- AES agrees with the comments in the consultation paper that the AOLR should not be in a position to delay or hinder the commercial offerings and will perform its functions independently of any other interests in the market.
- Due to uncertainty on the size of the AOLR generation volume, which may or may not be a significant amount of generation, AES views that it would be difficult for the TSO to perform this role and demonstrate the transparency required on issues such as trading, cost cross subsidy, (both of aggregator and TSO activities), and is uncomfortable with the TSO performing this role and participating in the market due to its potentially conflicted position.

#### **5. If the TSOs are selected as the preferred agent for establishing the AOLR framework, should the TSOs carry out the function in house or outsource it to a third party through a competitive tendering process? Outline reasons for your preferred option and if there are any further issues that merit consideration.**

- AES' preferred option is for the RAs (or the TSO) to run a competition to appoint the AOLR and for the AOLR to be a separate entity performing a mechanistic role.
- Accepting the fact that the TSOs could be ready for market go live and provide a facility that could actively trade in all market time frames, issues of conflict of interest would undoubtedly occur.

- As stated in the consultation, in some options the AOLR attempt to secure the best commercial outcomes for aggregated generators, the TSO duty of non-discrimination and its role to provide a safe, secure and economic operation of the system would appear to have the potential to conflict.
- In addition the EU unbundling requirement for the TSO function to be separate from the functions of generation and supply would be compromised under this arrangement.
- Also AES is also concerned that if the TSO were established initially as the AOLR it could prove difficult to incentivise the emergence of commercial entities to undertake the role.
- The RAs could also consider obligating all suppliers (over a specified threshold) to act as commercial aggregators in a similar format to that in GB, accepting that this may need legislation or licence change.

**6. Do you believe the options for the AOLR proposed in this paper present a potential cross subsidisation of AOLR costs by others not involved with the AOLR?**

- AES is of the view that the potential for cross subsidisation is less with the mechanistic market rule approach for the aggregator of last resort entailing less favourable commercial aggregation services than can be found elsewhere.
- Appropriately structured fees and market discounts rates should enable the AOLR to sustainably perform its function and the transparency measures proposed will help to ensure clarity on cross subsidisation.

**7. Do you agree with the transparency measures proposed and if there is other information that should be disseminated to participants?**

- AES' preferred option is a mechanistic approach and as such agrees that information on the AOLR operation and performance in the I-SEM should be published to incentivise and assist market participants to seek out the best available commercial option.
- AES also believes that reports detailing the revenues earned and distributed, fees paid and costs incurred in providing the AOLR service and operation should also be made public to ensure against the potential for cross subsidy of the AOLR activity.

**Incentives & Cost Allocation (Section 6)**

**8. Do you agree that incentives are important for the AOLR? Are there other incentives that should be considered by the RAs?**

- AES favours a mechanistic approach model and therefore performance incentives on the AOLR would be limited to cost of participation reduction and ensuring that the market discount to cover imbalance ensures sustainability of operation.
- AES believes that a contribution from participants availing of the AOLR Service via a dedicated fee is appropriate as setup and operational costs are expected to be low with this model.

- This would be transparent and along with the discount from the market price could be used to compare the AOLR function with commercial aggregators or other commercial opportunities.
- As the mechanistic approach is the last resort it is important that it does not try to compete with commercial aggregators and PPAs and by fees charged and discount rates applied is clearly identifiable as the less favourable place to be.
- The mechanistic nature and lack of intraday trading may not provide participants with confidence that they are obtaining the best price for their energy, therefore if profits are realised, a share can be returned to the participants.

**9. Do you agree with the issues raised surrounding cost allocation and the potential stranding of assets? Are there other issues that merit consideration?**

- AES agrees that AOLR set up costs and ongoing costs of participation should not present a barrier to entry for small scale generators and therefore substantial numbers of non PPA contracted participants could register.
- The AES preferred mechanistic approach would present the lowest cost route to market for small generator participants with no other viable commercial option and also the lowest cost option for AOLR set up and operating costs which would reduce the stranded asset risk.

**Participant Eligibility (Section 7)**

**10. Do you agree that no upper threshold limit for wind participation in the AOLR should apply? If not, please propose a limit and provide reasons for this position.**

- If a mechanistic approach is chosen and significant volumes of generation register with the AOLR, an overall limit on AOLR participation may be required due to the potential for substantial difference between the DAM volume and actual outturn.
- However as volume grows this could present a benefit to trading in the intraday market and hence create the circumstances for a commercial aggregator to emerge, or for individual participants to leave the AOLR and trade themselves in all market timeframes.
- AES agrees that greater participation of generators in the AOLR would have the benefit of spreading the fixed costs of aggregation and would be desired in order to support an aggregation role being undertaken by a commercial entity.

**11. Should smaller participants, other than wind, be considered eligible for participation to the AOLR? If you agree please outline the participants that merit consideration or if you don't agree please provide reasons.**

- AES agrees in principle that other small generator technologies unable to avail of better commercial opportunities could avail of the AOLR services to obtain a last resort route to the day ahead market.
- The provision of AOLR services for more predictable generator technologies may also provide a more stable and predictable income to sustain the AOLR function and also encourage the emergence of commercial aggregators.

- Participants could be organised by generation and demand side basis and by technology types but with the same annual renewal arrangement basis.

**12. If participants other than wind should be included in the AOLR, should these be grouped for the purposes of bidding into the ex-ante markets and settlement given their respective risks in the new market design?**

- AES believes it should be possible to group generators by technology type and/or by reliability and predictability of output.
- Predictable output generation technologies with no other commercial route to market should be able to avail of the AOLR service and be grouped such that they are not exposed to the risk of imbalance from less reliable generation technologies, such as the wind forecasting risk.