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Consultation on the Aggregator of Last Resort Framework (SEM-14-106)

Dear Warren and Kenny

SSE welcomes the opportunity to respond to the RAs' consultation on the Aggregator of Last Resort (AOLR). Reaching correct decisions on implementation of the AOLR function depends on focusing solely on the needs that the role must meet. We are not sure that the requirements for the framework have been fully defined or thought through in the consultation paper. The paper states:

"The intention of the AOLR is to help mitigate risks for smaller variable generation units in transitioning to a new market design based on their active participation and will act as a backstop route to market for certain variable generation."

That isn't a clear function – it is two different functions. Is the framework designed to:

- Act as a backstop route to market for variable generation that cannot contract under normal commercial terms with an aggregator (i.e. any supplier or asset-less trader)?
- Provide transitional contract terms until a market for PPAs or similar (contracts between aggregators and generation) is sufficiently developed in I-SEM?

You cannot select both without confusing the operation of the function and compromising on its success. In this response we seek to assess the proposed AOLR Options against the first function – i.e. an enduring backstop route to market for variable generation that cannot contract within I-SEM (**an Aggregator of Last Resort**).

We conclude that the contractual terms should be properly defined **first** to ensure that the service is a last resort – to *"minimise the risk of crowding out of alternative commercial solutions"*, with the operation of the function effectively being performed as a typical aggregation function with the balancing risk being managed at the discretion of normal commercial entities – to *"avoid distortion of [overall] market outcomes"*.

Our mechanism for achieving this would be defined as follows:

- The contractual terms for the Aggregator of Last Resort function would be dictated by the Regulator, to incentivise participants to transition to a regular commercial contract within the I-SEM market. An administrative discount would be applied to the PPA terms.
- Aggregators bid a £/MWh fee (Management fee) required to purchase and manage a generator's output under the terms of the PPA (levelised costs would be based on an assessment of the estimated profit or loss accruing to the Aggregators).
- This is expected to be an incentive to suppliers to offer terms better than the backstop PPA to generators, so that they don't have to deal with additional levelised costs.

If you have any questions in relation to our response, please don't hesitate to contact me at connor.powell@sserenewables.com

HLD Decision on the AOLR


The HLD is the starting point for the AOLR function – it states that the mechanism will:

- be transitional
- help smaller players access ex-ante market timeframes
- allow such players to avoid investment in their own trading capability
- help mitigate particular risks in transitioning to I-SEM
- be complementary to the intermediary role

Some respondents to the original consultation suggested that the AOLR role should be ongoing, rather than solely for the transitional period around I-SEM start-up. In this regard, SSE would draw on experience from SEM implementation. At that time, the RAs proposed to allow:

“the registration of Intermediaries [and they] should be confined to a small number of instances under limited circumstances. ... that strict criteria should be applied in assessing applications, such criteria being driven by the objectives of counterbalancing a simplified transition, which would avoid significant additional pressure (financial or otherwise) on market participants in advance of go-live, whilst ensuring the retention of proper regulatory controls on the market”

In other words, for exactly the same reasons that the AOLR service is being proposed for I-SEM. However market participants were able to demonstrate to the RAs in 2007 that intermediaries had an enduring value in managing the technically complex SEM interface



requirements of multiple PPA generators and the intermediary role has become a key part of the market.

For this reason, SSE would counsel against a hasty decision to time-limit the AOLR role, before the implications of I-SEM project development are considerably better understood. For this and other reasons explained below, SSE believes that AOLR must be presumed to be an enduring role.

Purpose of the AOLR

As stated in the current consultation (1.1.3), market arrangements for smaller generators are:

“not intended to deliver the aggregated volumes for these players directly into the imbalance arrangements, as a short-circuit of the DAM and IDM. ... the intention is to facilitate access to and participation in these ex-ante markets to reduce exposure of these players to the imbalance arrangements.”

SSE fully supports this objective, as maximum participation in the DAM and IDM is of crucial importance to the development and maintenance of liquidity in the market. **Commercial aggregation services (suppliers or asset-less traders) will contract with the vast majority of these participants and deliver their volumes into the ex-ante markets, but some participants might be unable to commercially contract.**


Simply passing their aggregated volumes into imbalance is a bad outcome for the market overall, and for the individual participant. If, as expected, development of distributed generation continues in Ireland and Northern Ireland, there is likely to be a steady flow of new participants joining the market. Therefore, even if some form of time limit were to be placed on use of AOLR, **there will be an enduring requirement for a backstop route to market.**

Scale of AOLR user

In terms of participant size served by AOLR, SSE believes that the cumulative impact of many small capacity projects on the system is as great as that of a number of larger projects. It is therefore important that the market is accessible to as many generators as possible; including the vast majority of potential participants for whom the investment required for participation would be completely uneconomic.

The HLD decision considers that the AOLR is:

“... to help mitigate risks for smaller variable generation units ...”



While this would be the likely target market, this description carries the implicit message of an upper limit to the size of generator unit allowed to make use of the service. SSE believes that setting a size limit would be a mistake, because any such limit is inherently arbitrary and not constrained by any technical parameter. After all, the volume of data exchanged and the DAM/IDM market processes are the same whether 1 MW or 100kW is being traded. In the absence of good cause, setting a fixed size limit for access to AOLR could be seen as discriminatory.

The simplest solution to defining scale is by returning to the definition of the service. It is a backstop function for “*variable generation units*” that have been unable to contract in the market. By setting genuinely **last resort contractual terms** for the use of the **Aggregator of Last Resort** function, the service provides a perfect incentive for generating units to invest either in their own trading desks or to procure a more bespoke trading service with normal commercial terms from some other provider.

On this basis, SSE believes that it would be inappropriate to define any size parameters to limit use of the AOLR by participants. Any artificial constraint on the business scope of the AOLR would also have an unnecessarily adverse impact on the commercial viability of the service provider or service providers (or the management fee that they can bid to offer the service).

AOLR commercial context

SSE considers it entirely inappropriate for the Market Operator or System Operator to be engaged in any form of trading activity. As stated in the consultation:

“The TSOs primary function relates to the safe, secure and economic operation of the transmission network, whereas the aggregator is responsible for achieving optimal revenues for its portfolio [...] Moreover, as per EU legislation, the performance of TSO functions should be separate from the functions of supply and generation.”

There is no way to adequately ensure that the TSOs primary function does not conflict with that of the AOLR, and setting up special legislative and licensing procedures to ensure separation would ultimately preclude other providers from ever performing the AOLR function.

It should also not be assumed that an AOLR service should be limited to a single provider, or indeed that providers should be suppliers or a traditional electricity market participant. In our model, aggregators would bid a £/MWh fee (Management fee) required to purchase and manage a generator’s output under the terms of the PPA (levelised costs would be based on an assessment of the estimated profit or loss accruing to the Aggregators).

The market design should therefore envision AOLR as a defined service, offered on an enduring basis, potentially by a range of providers, on either a standalone basis or as part of a wider range of I-SEM related services. The service should not be provided by the TSO. **If no providers indicate interest in providing the service, suppliers could be mandated to offer it.**

The different options aren't suitable as a last resort

We don't believe that any of the options is suitable because they are essentially descriptions of different commercial aggregation services modified to attempt to make them (potentially) unattractive. **The design of a last resort service has to start with the contractual terms, rather than the means by which the function will be performed.**

Portfolio settlement aggregator (Option 1):

As defined in the consultation paper, this option will have a single aggregator that "*seek[s] out optimal revenues*" or "*seek[s] the best prices*" and passes on the proceeds of the aggregate of all trades to individual participants. However, it does not effectively transfer trading risk from the individual generator to the aggregator, which would be the primary purpose of a traditional route to market like an offtake PPA.


While the balancing risk is socialised across an aggregation portfolio, a lack of defined contract price would be unacceptable to any bank and unacceptable for any wind generator that requires access to the REFIT scheme. **Option 1 cannot operate as a universal backstop and is not suitable as an aggregator of last resort – it is just an aggregator/intermediary with a business model that has been defined through a regulatory process rather than a commercial negotiation.**

Individual settlement aggregator (Option 2):

This option includes some distinctly bespoke elements, e.g. "*this single portfolio will be bid into the ex-ante markets by the AOLR based on the combination of **each generator's instructions***" (4.5.1), "*AOLR could provide a wind forecast and **each generator could then specify** to the AOLR the volume it wished the AOLR to bid" (4.5.2) and "**generators to provide instructions by way of a 'trading strategy'** say, a certain percentage of a forecast quantity **to be bid into each of the DAM and IDM**".*

This is effectively a full service trading desk. As a full service trading desk it appears to place requirements on the contracted generator to provide detailed information and instructions, exactly the functions which these participants are trying to offload to an aggregator/intermediary.

Option 2 is not a last resort function – it is a premium service, making it unsuitable to perform either of the two functions defined in the consultation paper. It also fails to



transfer balancing risk, making it unsuitable for many participants that require a predictable price for their output (i.e. project financed generation projects or REFIT supported projects).

Passive Aggregator (Option 3):

A mechanistic approach to provision of the last resort service is preferable to either of the other two approaches, on the grounds that a more customisable approach should be available from commercial service providers. However, this option still fails to contractually transfer balancing risk from generator to aggregator, making it unsuitable for some participants.

Also, without transferring the balancing risk to a commercial entity, some volumes in the market will be being offered on mechanistic terms which will necessarily represent a *“distortion of [overall] market outcomes”*. A commercial function defined by regulatory process rather than commercial negotiation will undoubtedly create opportunities for regulatory arbitrage, potentially to the detriment of normal market functioning. **Option 3 is least worst of those presented in the paper, but does not**

A different approach to design an aggregator of last resort

The RAs should start with **last resort contractual terms**, design a competitive process for reducing the cost of service provision and allow the counterparties to the contracts to manage the output contracted in a normal commercial manner.

SSE’s mechanism for achieving this would be defined as follows:

- A regulatory discount would be applied to the contractual terms for purchase of a generator’s output, to incentivise participants to transition to a regular commercial contract within the I-SEM market.
- Aggregators bid a £/MWh fee (Management fee) required to purchase and manage a generator’s output under the terms of the PPA (levelised costs would be based on an assessment of the estimated profit or loss accruing to the Aggregators).
- This is expected to be an incentive to suppliers to offer terms better than the backstop PPA to generators, so that they don’t have to deal with additional levelised costs.

This function would exist on an enduring basis, with an annual auction for the management fee and the universal contractual terms being defined by the regulator.

Annex 1: Response to consultation questions

Question 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?

The AOLR functions defined are effectively those of a commercial aggregator. We understood that the AOLR was intended to perform a backstop service for generators unable to contract in I-SEM rather than a service competing with commercial aggregators.

Question 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?

We don't think any of the options proposed is appropriate. We have included an alternative approach in our response.

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

We will be providing aggregation services in the new market. We may consider being the AOLR service provider.

Question 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.

The RAs should be responsible for establishing the framework and procurement of the AOLR service provider – the function as envisaged by SSE is effectively the design of universal contractual terms, and an auction for different providers to act as counterparties to generators unable to contract in I-SEM. This should sit with the RAs.

Question 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
Question 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?

The TSOs should not establish a commercial framework for the provision of last resort services. The function as envisaged by SSE is effectively the design of universal contractual terms, and an auction for different providers to act as counterparties to generators unable to contract in I-SEM. It would not be appropriate for the TSO to perform the first function, and it is not clear why the TSO would have any special ability in performing the auction for the second.

Yes.

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

Information on the terms of the service should be available to all participants. As the aggregator(s) will be managing a generators output under last resort terms, there is no clear reason why more or less information should be required of it than a normal commercial aggregator.

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

In the model described by SSE, competition provides an incentive.

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

An enduring backstop service with regulated terms should not incur significant additional set up or operation costs (the provider would simply be adding the generator to their own portfolio and performing the role defined in the regulated contract). This would reduce the risk of asset stranding.

Question 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.

A specific upper threshold limit should not be required if the last resort terms are properly defined.

Question 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.

The function could be available to other generation participants that cannot contract in I-SEM. However, it should not be available to demand – that is a very different role.

Question 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?

SSE's favoured approach is a contract of last resort, which would mean that the aggregator can choose to manage their balancing risk in whatever way they see fit.