



**Response by Energia to SEM Committee
Consultation SEM-14-106**

***I-SEM Consultation on the Aggregator of Last Resort
Framework***

30 January 2015

Executive Summary

1. Energia is one of the largest contributors to the achievement of renewable targets on the island of Ireland through its investment, development, contracting and trading activities in the renewable sector. Energia has demonstrated its ongoing commitment to working with small developers and providing them with commercial arrangements which help them manage their risks and operate in the market.
2. Energia recognises that I-SEM will be complex, especially for smaller generators who may not have the resources to access the new market. Therefore, Energia supports the maintenance of existing mitigation measures for small scale generators and the development of existing and new market access arrangements.
3. This consultation follows a decision of the SEM Committee on the High Level Design (HLD) of I-SEM stipulating that an AoLR shall be provided for in the new market design. Energia fully supports the provision of an AoLR service in I-SEM providing it is appropriately designed as a last resort transitional mechanism for smaller generators to access the market, as clearly envisaged in the HLD,
4. In our view it is too early in the design of the market, with too many unknowns, to be consulting on the detailed framework for AoLR. At this stage we feel it would be better to focus on optimising the detailed design of I-SEM and then deal with elements of that design which may fail to deliver an acceptable solution for potential users of AoLR services. We therefore suggest that this consultation is premature and should be re-visited, with a cost benefit analysis of each of the AoLR options, when there is clarity regarding the above and other important aspects of the detailed market design.
5. It is important to consider the demand for and design of an AoLR service in the context of pre-existing mitigation measures such as de-minimis treatment and intermediary arrangements.
6. Numerous suppliers, including Energia, already compete in the provision of aggregation or intermediary services and will continue to do so under I-SEM. It is important therefore that the AoLR service is designed to meet its stated objectives in the HLD which is to provide a backstop last resort alternative to commercial aggregation or intermediary services for smaller generators to access the market. The AoLR should be specifically designed to meet these objectives.
7. We have a concern that most of the options and proposals put forward in the consultation paper, if implemented, could act as a significant barrier to entry for commercial aggregators as it could be very difficult for these parties to differentiate favourably from the AoLR in terms of price (including fees and credit terms), product offering (functionality) or contractual terms (e.g. contract length or risk allocation). There is therefore a material risk that the AoLR option becomes the preferred option which would clearly distort the market contrary to the HLD.

8. Of the options presented in the consultation paper, our preference is Option 3 (the 'mechanistic approach'). Option 2 could be considered further as an alternative but Option 1 should be ruled out on the basis of unduly competing with commercial aggregators.
9. Notwithstanding the above, we maintain that the design of the ALoR framework should be deferred and re-visited at a later stage of the detailed design process.
10. Irrespective of which option is taken forward the following principles should be adhered to:
 - Any AoLR model must not compete directly with the off-take market that currently exists in SEM and will continue to exist under I-SEM and therefore must only act as a route to market, as envisaged in the HLD.
 - Commercial aggregators must be able to differentiate favourably from the AoLR in terms of price (including fees and credit terms), product offering (functionality), and contractual terms (e.g. contract length and risk allocation).
 - AoLR should assume market responsibilities (i.e. act as an intermediary) and provide nominations to the TSO.
 - As this is not a market issue (option to obtain a commercial off-take contract still exists), the costs and liabilities associated with the provision of this service should be borne by the beneficiaries of the service. There should be no cross subsidisation as this would unfairly disadvantage commercial aggregators.
 - Establishing the AoLR framework and procuring the service provider should clearly be the role of the RAs regardless of the legislative requirements. The I-SEM project plan has a legislative workstream, any legislative requirements to support the AoLR framework should be progressed through this.
 - The TSOs should not carry out this function in house for the reasons outlined in the consultation. The TSO should also not be responsible for procuring this service under any circumstance as there would be material conflicts of interest in them being the counter-party to contracts for the provision of these services.
 - In terms of participant eligibility, this should target smaller generators with insufficient scale to invest in trading resources to access the market directly, which is the stated intention of the HLD.
11. We expect that if any alternative options developed or proposed during the course this consultation are to be considered further they should satisfy the above principles and should be published for consultation.

1. Introduction

Energia welcomes this opportunity to respond to the SEM Committee consultation paper SEM-14-106 on the Aggregator of Last Resort (AoLR) Framework which emanates from the I-SEM High Level Design (HLD).

2. Complexity of I-SEM and existing mitigation measures

Given the marked complexity of I-SEM and the increased costs and risks of participation that are envisaged compared with SEM, Energia agrees with the SEM Committee's decision not to preclude the retention of a de-minimis level below which generation can be registered as 'negative demand' and to furthermore allow for gross portfolio bidding from generation in certain circumstances, specifically for small variable generation¹. This will facilitate the current treatment of de-minimis generation at the current threshold of 10MW which is appropriate and effective and will also enable the continued provision of intermediary (or aggregation) services by suppliers. It is important to consider the demand for and design of an AoLR service in the context of these pre-existing mitigation measures.

3. Rationale for AoLR

This consultation follows a decision of the SEM Committee on the HLD of I-SEM stipulating that an AoLR shall be provided for in the new market design. The HLD decision states that "[t]he I-SEM will include a transitional mechanism to help smaller players to access the market in ex-ante timeframes without necessarily needing to invest in trading capability of their own" [para 4.7.1]. It also states that the mechanism "will be designed to avoid distortion of market outcomes, and minimise the risk of crowding out of alternative commercial solutions" [para 4.7.3]. It is important that the AoLR service is designed to meet its stated objectives in the HLD which is to provide a backstop last resort alternative to commercial aggregation or intermediary services for smaller generators to access the market. The AoLR should be specifically designed to meet these objectives.

Commercial aggregation already occurs in SEM and will continue to exist under I-SEM (as provided for in the HLD) in the form of PPAs and intermediary services offered to generators by suppliers, in order to meet the requirements of their respective renewable support mechanisms. It is imperative therefore that, regardless of the framework chosen, an AoLR service does not impede on existing commercial aggregation services. What this means in practice is that an AoLR service must not deter small variable generation units seeking commercial aggregation arrangements in the first instance.

¹ It is a premise of the I-SEM HLD that unit-based generation bidding will help to enhance transparency and competition in the market. However it is important to stress that this is far from a panacea in addressing market power in I-SEM. For further discussion of market power in I-SEM and the limitations of unit-based bidding in addressing this see Baringa Report entitled "Scheduling risk under the proposed I-SEM High Level Design: An Issues Paper" and Energia's response to SEM-14-008 and SEM-14-045.

Energia, like EAI, believes that the stated intention of the AoLR should be, as its name suggests, “*to act as a last resort (or backstop) route to market adopted by smaller variable generation units as a means to gain market access only*”. This is consistent with the I-SEM HLD and should be the over-riding driver of the AoLR design, otherwise there is a risk it will become the aggregator of first resort option for some participants and will grow as a route to market with the AoLR taking greater share.

4. Timing of AoLR consultation

This is the first consultation of the I-SEM detailed design process. Aside from the specification of high level principles and requirements, it is difficult to see how the AoLR Framework can be designed to meet its objectives at this stage without first understanding the I-SEM balancing market and imbalance pricing arrangements; I-SEM’s interaction with renewable support mechanisms; and the likely demand for an AoLR service to provide market access. We therefore suggest that this consultation is premature and should be re-visited, with a cost benefit analysis of each of the AoLR options, when there is clarity regarding the above and other important aspects of the detailed market design.

5. Commercial Aggregation v AoLR

The AoLR must include features that ensure a less favourable route to market than would exist under a commercial aggregation service offering. Most of the options and proposals put forward in the consultation paper, if implemented, could act as a significant barrier to entry for commercial aggregators as it could be very difficult for these parties to differentiate themselves favourably from the AoLR in terms of price (including fees and credit terms), product offering (functionality) and contractual terms (e.g. contract length and risk allocation). There is therefore a significant risk that the AoLR option becomes the preferred option which would clearly distort the market contrary to the HLD. It is imperative that the AoLR is a backstop last resort to prevent scope creep and that the SEM Committee encourages market based mechanisms in the first instance.

6. Demand for AoLR

It is also imperative that there is a material incentive for generators which contract with the AoLR to exit this arrangement and trade under a market based solution as soon as possible thereby mitigating the risk that certain investors would rely on the AoLR as an enduring solution even if there are market based solutions available.

At the AoLR Workshop held in Dundalk on the 19th December 2014 it was not immediately clear to participants that there would be significant demand for the AoLR service. Most existing intermittent renewable generation, and any units commissioned prior to I-SEM go live, will have agreed PPAs and Intermediary Agreements and will therefore not require an AoLR as a backstop. It would be prudent for the RAs, prior to designing the AoLR Framework, to consider the likely uptake of such a service from small generators and to what extent this will not be

fulfilled by commercial offerings in the market. This would serve to ensure that assets do not become stranded and/or unnecessary expense is incurred through an over-engineered solution.

7. Recommendations

Given the premature timing of this consultation (for reasons already stated) the views put forward in this response are necessarily qualified. Of the options presented in the consultation paper, **Energia's preference is Option 3** (the 'mechanistic approach'). This option can provide the service required and is the least likely to act as a disincentive to maintain and develop existing commercial intermediary and aggregator services. Option 2 could be considered further as an alternative but Option 1 should be clearly ruled out on the basis of unduly competing with commercial aggregators as explained further below.

If the AoLR is to be a back stop or last resort option, as stated in the HLD (and to minimise scope creep), the functional design must ensure that market based commercial aggregators can differentiate their product from the AoLR. If the AoLR is designed to provide the full functionality of a commercial aggregator (as per Option 1) this fails to recognise existing commercial arrangements that will endure in I-SEM and it is unlikely that other market based solutions will be developed. The ability to pool risks and trade in different market timeframes are examples of how a commercial aggregator could differentiate its product to that which is offered by the AoLR and would help enable the development of market based solutions. It is difficult to envisage how a commercial aggregator could compete with an AoLR offering Option 1, particularly if the role of AoLR is awarded in an open competition on the basis of the tenderer offering the lowest discount (i.e. the provider offering the most attractive option to potential users), unless such an option is made explicitly less attractive in terms of functionality, cost and contract term.

Should Option 3 be taken forward, as per Energia's recommendation, the following issues would need further consideration:

- Governance arrangements would need to be understood - e.g. who sets trading strategy and who can change it?
- Who provides forecasting information and is the charge for this service cost reflective?
- Further information would also be required in relation to the balancing market to see how this option would interact in the different timeframes.

Notwithstanding the above recommendation, we maintain that the design of the ALoR framework should be deferred and re-visited at a later stage of the detailed design process. Irrespective of which option is taken forward the following high level principles should be adhered to:

- Any AoLR model must not compete directly with the off-take market that currently exists in SEM and will continue to exist under I-SEM and therefore must only act as a route to market, as envisaged in the HLD.
- The AoLR must include features that ensure a less favourable route to market than would exist under a commercial aggregation service offering. Commercial aggregators must be able to differentiate favourably from the AOLR in terms of price (including fees and credit terms); product offering (functionality); and contractual terms (e.g. contract length and risk allocation).
- AoLR should assume market responsibilities (i.e. act as an intermediary) and provide nominations to the TSO.
- As this is not a market issue (option to obtain a commercial off-take contract still exists), the cost and liabilities associated with the provision of this service should be borne by the beneficiaries of the service. .of the service should be borne by beneficiaries of the service. This must include the full cost of procuring wind speed forecasts and the systems required to forecast wind generation output if this is not the responsibility of the generator. There should be no cross subsidisation as this would unfairly disadvantage commercial aggregators
- Establishing the AoLR framework and procuring the service provider should clearly be the role of the RAs regardless of the legislative requirements. The I-SEM project plan has a legislative workstream, any legislation requirements to support the AoLR framework should be progressed through this.
- The TSOs should not carry out this function in house for the reasons outlined in the consultation. The TSO should also not be responsible for procuring this service as there would be material conflicts of interest in them being the counter-party to contract for the provision of these services.
- Participation should target smaller generators with insufficient scale to invest in trading resources to access the market directly, which is the stated intention of the HLD.

We expect that any alternative options developed or proposed during the course this consultation should satisfy the above principles and should be published for consultation before being considered further.

8. Consultation questions

Q1. 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?

No. The potential functions of the AoLR outlined in the consultation are too broad. If the AoLR is to be a back stop or last resort option the functional design must ensure that market based commercial aggregators can differentiate their product from the AoLR. If the AoLR is designed to provide the full functionality of a commercial aggregator (as per Option 1) it is unlikely that a market based solution will be developed. The ability to pool risks and trade in different market timeframes are examples of how a commercial aggregator could differentiate its product to that which offered by the AoLR and would help enable the development of market based solutions.

Q2. 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?

Of the options presented in the consultation paper, Energia's preference is Option 3 (the 'mechanistic approach'). This option could provide the service required and is the least likely to act as a disincentive to maintain and develop sustainable commercial aggregation services. Option 2 could be considered further as an alternative but Option 1 should be clearly ruled out on the basis of unduly competing with commercial aggregators as explained further in the main body of this response.

Regardless of the framework chosen, it is imperative that the AoLR service does not impede on existing commercial aggregation services. What this means in practice is that an AoLR service must not deter small variable generation units seeking commercial aggregation arrangements in the first instance. To incentivise this, commercial aggregators must be able to differentiate favourably from the AoLR in terms of price (including fees and credit terms), product offering (functionality) and contractual terms (e.g. contract length and risk allocation).

Q3. Would you consider providing aggregation services in the new market? If so, would you consider being the AOLR service provider?

Yes. Energia would consider providing aggregation services on both a commercial and AoLR basis.

Q4. 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.

Establishing the AoLR framework and procuring the service provider should clearly be the role of the RAs regardless of the legislative requirements. The I-SEM project plan has a legislative workstream, any legislation requirements to support the AoLR framework should be progressed through this.

The TSOs should not carry out this function in house for the reasons outlined in the consultation. The TSO should also not be responsible for procuring this service as there would be material conflicts of interest in them being the counter-party to contract for the provision of these services.

Q5. 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.

As outlined above, Energia's view is that establishing the AoLR framework should be the responsibility of the RAs. The TSOs should not carry out this function in house for the reasons outlined in the consultation. The TSO should also not be responsible for procuring this service as there would be material conflicts of interest in them being the counter-party to contract for the provision of these services.

Q6. 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?

Given the lack of information in the consultation paper it is difficult to answer this question at this time, however there is significant potential for this to exist.

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

Energia supports the principle of full and timely transparency. The transparency measures proposed do not seem to meet with these requirements.

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

It is difficult to discuss and design performance incentives until the detailed design of the market is progressed. For example the design of the balancing market could have implications in relation to how the incentives should be designed. However we can offer a few comments at this stage:

- The consultation only deals with performance incentives related to Option 1. What are the RAs proposals for incentives under Option 2 or 3?
- If the performance incentive proposed under Option 1 – i.e. “benchmark against the market price” were adopted as a means of selecting the AoLR candidate it would result in direct competition with commercial aggregation services which is contrary to the HLD and the purpose of the AoLR.
- It should be clearly recognised that AoLR performance is materially impacted by AoLR participants. For example to the extent that AoLR participants do not (or more likely cannot) communicate availability in a timely manner or ensure the reliability of their generating units this materially affects the risk, cost and performance of the AoLR. The problem of adverse selection should also be considered in this context.

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

It is difficult to respond to this question in any detail at this stage without more information being provided in the consultation paper. As a general point, the cost of the service should be borne by beneficiaries of the service and not socialised across the entire market.

The consultation paper states that “[t]o sign up to an AOLR, both current generators and potential new entrants would need confidence that the best price for their energy is being obtained”. This would be completely contrary to the HLD and would prevent commercial aggregators from entering the market.

Q.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.

Participation should target smaller generators with insufficient scale to invest in trading resources to access the market directly, which is the stated intention of the HLD.

Q.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.

Small demand participants should not be eligible to participate in the AoLR. The AoLR should only be eligible to variable renewable generation .

Q.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?

Only variable renewable generation should be eligible to participate in the AoLR service.