IWEA response to the Consultation on the Aggregator of Last Resort Framework

30 January 2015

1. Introduction

IWEA welcomes the opportunity to respond to the consultation on the Aggregator of Last Resort Framework. The new market design brings a number of challenges to market participants, and in particular to renewable generators, given the increased focus on day ahead trading and balancing responsibility. IWEA has supported the variation of Option 3 in the High Level Design consultation as we believe, among other things, it represents the best opportunity for more effective operation of Interconnection and therefore reduction of curtailment. A trade-off in the selection of Option 3 has been increased complexity of trading relative to the Single Electricity Market.

IWEA believes the provision of an aggregator of last resort (AOLR) is an essential feature of this new market design to ensure a route to market for small independent renewable generators. However we have a number of concerns in relation to this consultation which are outlined in more detail throughout the response. These include:

- **The timing of the consultation** – IWEA believes there is insufficient information available on the detailed design of the market arrangements to be able to make a complete assessment of the options at this time.
- **The volume of generation expected to use an AOLR** – in the absence of the detailed trading arrangements it is difficult to determine what level of commercial opportunities may be available and whether there will be commercial aggregation services in the market. This in turn will impact on the volume of generation that would use an AOLR service.
- **The cost of the service** – no cost benefit analysis has been provided in relation to the cost of implementation of the different options. The cost of provision of the service and the cost of participation will all have a significant bearing on the selection of the best option and the allocation of the costs.
- **The duration of the AOLR** - IWEA believes that the AOLR should be an enduring feature of the market and not a transitionary arrangement.
- **Functionality** - IWEA believes the functionality of an aggregator of last resort as outlined is appropriate however it should also provide a viable backstop option for generators and provide them with a starting position for negotiation of off-taking contracts and the design of the AOLR should not prohibit the emergence of a commercial aggregator.

Each of these concerns is outlined in more detail below.

2. Key Concerns

2.1 Timing of the consultation

IWEA is responding to this consultation in the absence of detailed information as to how the market design will work. There remain a number of key policy decisions in relation to the market design which will have a considerable bearing on the most appropriate option for the aggregator of last resort, and the effectiveness of that solution in operation. In particular, some of the aspects that will have a significant influence on the required functionality include the following:

- The detailed design of the Balancing Market and imbalance settlement and the level of exposure for wind generators
- The detailed design of the Intra Day Trading arrangements and whether or not it is envisaged that there will be auctions in place
- The treatment of a generators physical nominations
- The De Minimis level in the new market
- The likely volume of generators to use the AOLR
- The interaction of support schemes with the market design

Without sufficient information on each of these, it is difficult to fully assess the impact of the different options and to identify the most suitable option for the aggregator of last resort in the I-SEM. It is also difficult for potential commercial aggregators to design the services they will be providing in the absence of the detailed design of the market. Notwithstanding the above, IWEA wishes to highlight some of the important considerations at this stage.

2.2 Volume of Generators

The number of users of the AOLR will depend on the extent to which other suppliers and potential commercial aggregators operate in the market and offer reasonable contracts to projects trying to access the market. The volume of generators using the AOLR is an important consideration when deciding on elements of the framework, such as if the AOLR will require set-up costs or if existing capabilities and infrastructure can be used. In the absence of detailed market design it is difficult to know how many commercial aggregators will enter the market and when, and hence the demand for an AOLR. We believe costs should be reduced where possible, which we have aimed to ensure with our proposed alternative option.

The majority of projects in the market at the moment currently have PPAs with existing suppliers and it is likely that the suppliers will trade the energy from these generators in the new market design, removing the need for an AOLR for these projects. Notwithstanding this, the AOLR should be designed in consideration of the rather unlikely situation whereby a supplier becomes insolvent.

There are also a significant number of projects which are now out of support. Many of these are utility owned, and it is likely that these will be traded as part of the utility portfolio. A significant proportion of the remaining projects are also De Minimis (<10MW) and treatment of De Minimus projects has not yet been addressed as part of the ISEM project.

However, there will be a growing portfolio of wind generators without renewable support and not covered by either of these groups, who need to be able to access the market. For these projects an AOLR will provide an alternative route to market, and provide them with a backstop position when

negotiating contracts with other suppliers. During the lifetime of the market more projects will be coming out of support and it is essential that there is a route to market for these projects.

The presence of an AOLR will also provide an option for future connecting projects by providing certainty to financial institutions around a route to market for wind generators. The High Level Design decision has stated that Supplier Lite will still be facilitated in the new market design. These projects would then be able to use an AOLR as a backstop, if they are unable to negotiate a better position with another supplier or a commercial aggregator.

For those projects that do use the AOLR there is no certainty in relation to the duration of time they will use this facility. **It is therefore difficult to predict with any degree of certainty the number of users of the AOLR or the time for which it will be required.** There could be times when there is very little demand, or times when the demand is much higher. This has a knock-on impact how costs would be recovered or allocated. Nevertheless, the enduring nature of an AOLR would support investor confidence.

2.3 Cost of Implementation

No cost benefit analysis has been put forward in relation to the different options in the consultation paper, therefore it is difficult to assess the different options from a cost point of view, however under our discussion of the options we have taken a view on which options are likely to be more expensive than others. There is concern in the industry that the cost of participation through an AOLR may be prohibitive, depending on the option chosen. However there is also concern that there may not be any commercial offerings in place at the time of Market Go Live as participants will not have a clear view of the prices in the different timeframes. It is important that whichever option is implemented will not be prohibitively expensive. There will be new projects entering the market and projects coming out of support throughout the lifetime of the market and it is important that the AOLR is in place for these projects as an enduring mechanism.

The AOLR has a role to play in ensuring that renewable energy targets can be met through a route to market for projects that are not otherwise contracted.

There is a false perception that wind farms that are out of support have paid back all their debts and therefore do not need the same level of revenue from the market. Many wind farms are financed over the lifetime of the project which is 20-25 years, and so may have financing arrangements in place after the expiry of the support scheme. There are also ongoing costs associated with wind farms for operation and maintenance, as well as external costs such as significant increasing commercial rates. It is essential that these projects are able to participate and that the market can provide for generators out of support. The long term aim of the wind industry is to be able to reduce reliance on support schemes, however in order for this to be realised, the appropriate market conditions need to be in place. This includes the provision of a viable and bankable route to market for all players. It would not be in the interest of the industry or the consumer for existing wind farms which are out of support to be unable to continue in the new market design as would provide investment uncertainty and ultimately would require additional renewable projects to meet our renewable energy targets.

There are also concerns in relation to the registration of participants and the credit requirements of generators under the different options. Depending on the option selected and how it is

implemented the credit requirements could provide a barrier to entry. This would need to be considered in any analysis of the options.

2.4 Need for an Enduring solution

IWEA welcomes the inclusion of an aggregator of last resort to ensure a route to market for wind generators and we believe this is an essential component of the new market design. However, IWEA is concerned that this arrangement is proposed as a transitional arrangement and not an enduring solution. This seems to place more emphasis on developing a market for market services companies rather reducing barriers to trade in the Day-Ahead Market to generation licence holders. It is essential that there is market certainty in relation to these arrangements. Without this certainty no bank will facilitate 15-year investment reliant on a "transitional" structure, and the transitional nature undermines its very purpose: reducing barriers to entry. It should be noted that some generators will also have finance arrangements beyond the 15 years of support and certainty is also required that there will be a path to market for these. If the regulatory rules around supporting market participation for small players have any uncertainty that they will not carry for the duration of the investment, projects will be unable to secure finance on that basis.

It is agreed that the enduring solution should not hinder the emergence of commercial aggregators, however it should also represent a viable option for generators to participate.

Therefore IWEA proposes that the aggregator of last resort should be an enduring feature of the market. Its success should not be defined by the number of participating generators in the scheme, but rather as a regulatory tool to reduce barriers to participation in the market.

2.5 Functionality

IWEA believes the functionality of an aggregator of last resort as outlined is appropriate, i.e. the functions of the aggregator should be:

- Undertaking trading in the DAM, IDM and BM on behalf of eligible generators
- Pooling of risks across the portfolio
- Assuming market responsibilities (e.g. Signing up to Trading and Settlement Code)
- Submission of nominations to the TSO

IWEA also believes that another function of the AOLR should be to

- Provide a viable backstop option for generators and provide them with a starting position for negotiation of off-taking contracts.

The design of the AOLR should not prohibit the emergence of a commercial aggregator.

3. Comments on the options presented in the consultation paper

As outlined earlier in this response, it is difficult to make a detailed assessment of the different options presented **in the absence of information relating to the detailed design which in itself prevents an understanding of** the volume of generation which will avail of this service. In that context some of the principles which the chosen option should fulfil are that the AOLR should:

- Provide a route to market for renewable generators
- Be a low cost option to ensure viability of the service i.e. that the cost of participation does not outweigh the benefit
- Be an enduring solution
- Allow for commercial aggregation to develop

OPTION 1 - THE PORTFOLIO SETTLEMENT AGGREGATOR

IWEA believes that Option 1 as proposed would have some advantages as follows:

- This option provides good access to the market for generators who are contracted with the AOLR with active trading in DAM, IDM and BM
- There is transparency in the operation of this through portfolio settlement
- Reduced administrative requirements for generators

However there are also a number of disadvantages with this option:

- There is likely to be a high implementation cost associated with this option, in particular if it involves setting up a new trading entity
- Revenues are paid through the aggregator account and generators are paid on a pro-rata basis, which risks cross contaminating the negative effects of poorly performing assets on those who are considered more reliable
- There is concern that this approach could act as a barrier to commercial aggregation.

IWEA believes that the creation of an entity to be the AOLR is likely to be an expensive option. We have put forward another option “Option 4” which outlines how the services of an AOLR could be provided by an existing entity through a tender process. This would help to reduce costs where uptake levels are low, as the service providers involved in the scheme would be carrying out day to day aggregation services in any case. This limits concerns of having stranded assets where uptake is minimal, and would also allow for the AOLR to continue on an enduring basis.

OPTION 2 - INDIVIDUAL SETTLEMENT AGGREGATOR

IWEA believes Option 2 is a development on Option 1 which provides for more responsibility for generators through the provision of a trading strategy. The added functionality addresses some of the concerns in relation to being impacted by other generators who may be more out of balance, however it also adds significant complexity which could also result in increased costs. As stated previously, the cost of the solution, whether paid by generators or spread across the market, is one of the main concerns, and therefore this option may not be appropriate. This approach does not provide a last resort route to market as it would still require significant investment from participants in forecasting and trading capabilities.

OPTION 3 - PASSIVE AGGREGATOR

The Passive Aggregator Approach appears to address the concerns in relation to the cost of implementation. This could be a mechanistic approach which is built into the market systems and would then be an enduring solution. On initial review, some of the advantages of this solution would be the following:

- This could be a low cost option and could be implemented as part of the market systems. This would minimise set up costs as well as ongoing administration costs. However it is essential that consideration is given to how changes would be made and any costs that may be associated with this.
- The passive aggregator could provide an enduring solution.
- Each generator could be settled on an individual basis or alternatively the pooling of risk could be achieved by aggregating all the AOLR generators in market settlement.
- It would be possible for aggregated generators to receive market revenues directly from settlements.
- The AOLR could submit nominations to the TSO on behalf of aggregated generators

There are a number of disadvantages with this option which would also need to be addressed if this option were to be selected:

- It is not clear how this would work in the intra-day market given that there is no clearing price due to the use of continuous trading. The absence of information in relation to the implementation of the intra-day market makes it difficult to see how this option would be able to manage updated forecasts. The introduction of auctions in the Intra-Day timeframe would provide an opportunity for passive trading of wind energy under this option and needs to be given consideration.
- In the absence of a mechanism for intra-day trading, there is concern that this option may not result in efficient outcomes.
- There is concern that this option could be distortive to the market if the bidding of the AOLR can be predicted by other market participants.
- The aggregated generators assume the market responsibilities (signatories to the TSC or equivalent) in their own right. This raises concerns as to what the credit requirements might be for those using the AOLR.
- A mechanistic approach will not be a licenced supplier and therefore there may be difficulties for projects attaining ROCs or REFIT subsidies which both require contracts with licenced suppliers. While this can be addressed to a certain extent by having Supplier Lite status in ROI, this is much more difficult in NI where the process is more challenging.

If the mechanistic approach is selected further detailed consideration would need to be given to the following:

- The process for information flow in and out of the algorithm (forecasting, positions, nominations etc)
- The formula to be used for bidding purposes.

- Mechanisms for Intra Day Trading – consideration should be given to auctions as these will allow for passive trading in the ID timeframe.
- Further information would also be required in relation to the balancing market to see how this option would interact in the different timeframes.
- The process for implementing any changes that may be required during the operation of the AOLR and the associated costs of systems changes which may be required.

New IWEA Proposal: OPTION 4 – Tender for provision of AOLR as required

Another option which could be given consideration is an option similar to that which has been introduced in the UK through the Offtaker of Last Resort (OLR) mechanism. The purpose of the OLR is very different to that of the AOLR in the I-SEM, and as such we would support amendments to this proposal to better suit the needs of the all island system. For example the price level for generators needing to access the AOLR should not be as low as the GB OLR which is priced at a backstop level for supported generators to enable project finance and not a level which is a viable route to market. In particular, the purpose of the OLR is to provide contracts to generators under the CfD, however we would envisage this to be a route to market for participants both in and out of support, and therefore the same type of discount mechanism may not be appropriate. We recommend an in-depth analysis is carried out by a suitably qualified third party to identify the appropriate discount in the context of the I-SEM.

The operation of the AOLR would be along the following lines:

- A generator states that they wish to use the AOLR mechanism
- The RAs carry out a short tendering process to procure an AOLR
- All supply companies with a certain % of the market or more must bid a management fee into the auction (€/MWh)
- Other service providers would be permitted to tender voluntarily
- The lowest bid (bids reflect management fee only) wins the tender and becomes the offtaker/aggregator for the generator.
- The generator is subject to a fixed discount. This serves to standardise the scheme and avoids competition between the AOLR and commercial offerings. Any discount would need to be backed up by a robust economic analysis.
- The management fee which is bid in by the supplier would be spread across market participants.
- Annual contracts could be issued on an rolling basis with the generator committing to a minimum duration of 6 months.
- This should be implemented as an enduring mechanism.

There are a number of advantages to this approach including:

- No new entity is required to be set up as the existing participants provide the service. This reduces the cost of the provision of the service.
- There are no stranded assets in the event that the AOLR is not actually used.

- The energy is traded actively by the supplier, however imbalances are treated on an individual basis rather than aggregated.
- This is an enduring mechanism and can be in place for the lifetime of the market that provides certainty around a route to market both for wind generators out of support and for wind projects under development.
- This can be in place from Market Go Live and removes the uncertainty of commercial aggregators not appearing.

Under this approach there would need to be further consultation on the following aspects:

- The tender process– this would identify the criteria that would require suppliers to participate in the tender process to ensure there is sufficient competition to provide the service. There would need to be an obligation on a certain number of suppliers/aggregators to bid in for the role of AOLR – this could be done based on market share or other criteria which could be consulted on.
- The timelines for tendering - It is essential that the timeframe from declaration of the requirement for a commercial aggregator to the awarding of the contract is minimised to ensure no significant delay.
- The recovery of costs for operation of AOLR – For example, in GB there is a discount applied to the reference price, but the aggregator costs are smeared across the market.
- Any discount that might be applied – For example, in GB there is a discount applied to the reference price to make this option less attractive, however the discount applied in GB would not be appropriate in this instance. There would need to be a cap on the cost that would be allocated to the generator for participation in the AOLR.
- Contract terms
- Detailed governance arrangements - There would need to be measures in place to ensure that the AOLR is trading the energy fairly, for example on a par with other generators in its portfolio. There would need to be transparency in relation to these trading arrangements.

A detailed economic analysis would need to be carried out to ensure that the prices attained by the AOLR and any discounts applied would still be sufficient to ensure that a project can continue in the market. In order to ensure that our renewable energy targets are met it is important that projects out of support can survive in the new market.

4. IWEA Preferred Option

In the absence of detailed design of the intra-day and balancing markets it is difficult to make a detailed assessment at this time. Based on our initial assessment we believe that Option 3 and the IWEA proposed Option 4 best fit the stated principles as they would appear to be the least cost to implement and will provide an enduring solution as a route to market. In selecting the most appropriate solution however we stress a robust analysis would need to be carried out to identify the costs of implementation and participation, as well as the ability of the AOLR to participate in the different timeframes. We also believe an in depth analysis is required to ensure that any option is compatible with existing and future subsidy schemes.

There are a number of considerations that also need to be taken into account during the robust analysis required to identify the most appropriate solution which include:

4.1 Governance

Ultimately the governance arrangements are dependent on the option taken forward. However IWEA does not believe that legislative considerations should impact the preferred structure from being developed.

IWEA believes that the RAs should be responsible for establishing the framework and procuring the service provider for the AOLR. IWEA does however support procurement through the RAs with support indirectly from the TSO. There is a concern that the TSO should not provide the aggregation service as this would impede competition in the commercial aggregator space and there is also a concern that there may be a conflict of interest arising resulting from ownership of the EWIC.

Under Option 3, the Passive Approach, the question also arises as to how the wind forecast would be provided and whether there is a need for governance in relation to the provision of forecast data, and in the provision of nominations to the TSO. The question of how any required changes would be implemented, and the associated costs, also needs to be addressed.

All of the above warrant further consideration.

4.2 Cost Allocation

The final view on cost allocation is likely to depend on the type of aggregator that is selected. There is concern if the cost of participation would outweigh any potential benefit which may arise from aggregation and this needed to be addressed in the detailed analysis and design. The benefit of the presence of an AOLR also arises for other participants who because of the presence were enabled to negotiate better contracts, therefore placing the entire burden on participants may not be fair.

Under the mechanistic approach, the AOLR could be built into the market systems and could be considered a system cost. This would ensure that the cost of participation is not prohibitive, but due to the mechanistic nature of this option, significant improvements could be expected through more active trading, thereby providing a commercial incentive for commercial aggregators to emerge.

Under the proposed Option 4, the cost of the AOLR would be minimised as the service would be provided by those who already have the facilities in place. Therefore there may be a small

management fee associated with this option. Depending on the detailed implementation of the option, the cost could be spread across market participants.

An additional concern relates to the cost of security that may need to be put in place for market participants. Under the existing SEM this has not been a concern for wind generators, however under the new market design with a Balancing Market, the issue of credit cover is more likely to arise, in particular when using aggregation services and for those out of support. This would be a new requirement on some market participants and may be prohibitive to market entry. Consideration needs to be given to how this can be best managed to ensure the route to market is provided.

4.3 Eligibility

The AOLR should be open to all renewable generators, including those both in and out of support.

4.4 Transparency of performance

IWEA welcomes the proposals to publish information on the performance of the AOLR to provide transparency on the operation and to allow commercial aggregators to gauge the market potential. Transparency is an essential requirement for the AOLR. In particular, under any of the options which are not passive, there is a need for transparency of results in relation to cost and performance.

5. Conclusion

IWEA welcomes the opportunity to respond to the consultation on the Aggregator of Last Resort Framework. IWEA believes the provision of an aggregator of last resort (AOLR) is an essential feature of this new market design to ensure a route to market for small independent renewable generators. However we have a number of concerns in relation to this consultation which are outlined in more detail throughout the response. These include:

- **The timing of the consultation** – IWEA believes there is insufficient information available on the detailed design of the market arrangements to be able to make a complete assessment of the options at this time.
- **The volume of generation expected to use an AOLR** – in the absence of the detailed trading arrangements it is difficult to determine what level of commercial opportunities may be available and whether there will be commercial aggregation services in the market. This in turn will impact on the volume of generation that would use an AOLR service.
- **The cost of the service** – no cost benefit analysis has been provided in relation to the cost of implementation of the different options. The cost of provision of the service and the cost of participation will all have a significant bearing on the selection of the best option and the allocation of the costs.
- **The duration of the AOLR** - IWEA believes that the AOLR should be an enduring feature of the market and not a transitionary arrangement.
- **Functionality** - IWEA believes the functionality of an aggregator of last resort as outlined is appropriate however it should also provide a viable backstop option for generators and provide them with a starting position for negotiation of off-taking contracts and the design of the AOLR should not prohibit the emergence of a commercial aggregator.

In the absence of detailed design of the intra-day and balancing markets it is difficult to make a detailed assessment at this time, however the following principles should be considered in the decision on the AOLR framework. The AOLR should:

- Provide a route to market for renewable generators
- Be a low cost option to ensure the cost of participation does not outweigh the benefit
- Be an enduring solution
- Allow for commercial aggregation to develop.

In the absence of detailed design of the intra-day and balancing markets it is difficult to make a detailed assessment at this time. **Based on our initial assessment we believe that Option 3 and the IWEA proposed Option 4 best fit** the stated principles as they would appear to be the least cost to implement and will provide an enduring solution as a route to market. In selecting the most appropriate solution however we stress **a robust analysis would need to be carried out** to identify the costs of implementation and participation, as well as the ability of the AOLR to participate in the different timeframes.