

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

Power NI's Response

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Introduction

Power NI welcomes the opportunity to respond to the SEM Committee's consultation on the aggregator of last resort (AOLR) framework.

One of the success stories of the SEM has been the development of renewable technologies and in particular wind generation. This has facilitated both jurisdictions making significant progress towards achieving challenging renewable targets. Such developments would not have taken place without the existence of a clear unambiguous route-to-market for renewable generators. The policies which facilitated such an expansion of renewable generation should be maintained and facilitated within the new market design, without showing undue preference or prejudice to any classification of market participant.

It is somewhat surprising that the Regulatory Authorities (RAs) have consulted on the AOLR function so early in the I-SEM design process. Power NI considers the timing to be premature.

This consultation has been issued before the full design of the energy markets which an AOLR is expected to operate in are known. In particular the detailed design of the balancing market and imbalance settlement are crucial operational considerations for both the AOLR and any party thinking they may require such a service. Power NI understands that the timing of the consultation may have been driven from the original proposal to have a mandatory day-ahead market however the change decided upon in the High Level Design removes the time criticality of this issue and should afford more detailed consideration.

For a renewable generator, how renewable support mechanisms link to the energy markets is as, if not more, important that the design of the energy market themselves. The lack of clarity in relation to both of these design elements make it difficult to critique specific AOLR options at this juncture.

While Power NI has attempted to assess the proposals put forward by the RAs, without a clearer understanding of the market design and renewable support to go beyond setting general principles carries a high risk of a sub-optimal design or unintended consequences.

General Comments

Irrespective of the timing of the consultation a number of crucial high level design aspects exist in relation to the AOLR.

What is the AOLR trying to achieve?

The consultation paper has provided detailed options regarding potential functions and some insight into what the governance arrangements might be, prior to establishing what the core purpose of the AOLR function should be.

The High Level Design (HLD) decision stated the following in relation to the establishment of an AOLR;

“The 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. This aggregator or offtaker of last resort will help to mitigate particular risks for smaller players in transitioning to a new market design based on their active participation. The existing role of intermediaries will continue to be facilitated.

The intention of any such mechanism would be to facilitate participation of smaller players in the DAM and IDM, through the provision of bidding and settlement transaction services.

The mechanism will be designed to avoid distortion of market outcomes, and minimise the risk of crowding out of alternative commercial solutions.”

The key aspects to be taken from this therefore are that the AOLR should be –

- transitional,
- should assist smaller players accessing the market,
- should not replace the role of intermediaries,
- should avoid distorting the market, and
- should not prevent commercial solutions.

These key criteria should be considered as guiding principles.

The repeated reference to the transitional nature of the AOLR suggests that the SEM Committee want to ensure that the current pipeline of renewable connections continues into the I-SEM. The current arrangements and significant volumes of renewable generation illustrates that the current arrangements have delivered. Intermediary arrangements, de-minimis thresholds and renewable support have ensured that the renewable generation volume has continued to rise year on year.

It is unclear given these proven delivery mechanisms if an AOLR is even required. If however, it is to be designed, it is crucial that an AOLR arrangement does not undermine the existing methods.

Given that so little detail is known about the new market design, Power NI is concerned that the above objectives cannot be guaranteed by an AOLR decision at this juncture. This represents a significant risk for the RAs and market participants generally.

Last resort nature

Given that the high level design states that the AOLR should be transitional and not prevent commercial solutions it is somewhat surprising that as a “last resort” the RAs have not explicitly stated in the consultation that terms offered by the AOLR should be punitive in nature. In short it should be as the name suggests, a last resort.

Parallels can be drawn with other markets and other areas of this market when looking at the last resort nature of the proposed aggregation service. In GB, the recently defined ‘Offtaker of Last Resort’ (OLR), although implemented to fulfil a different purpose, was clearly defined as a last resort option with penal discounts to market reference prices. It is also worth noting the OLR was only considered after it became aware there was a clear and apparent demand for it consequential to the new market structures being fully defined.

Similarly, the ‘Supplier of last resort’ mandates a transfer to standard tariffs in the first instance before availing of any commercially based specific offer.

Specific 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?

Power NI believes the core purpose of the AOLR must be defined before it is possible to fully develop and establish its functions, roles and responsibilities. What problem is the AOLR trying to solve must be the first consideration when defining the specific activities and functions it will fulfil.

The HLD decision states *“The 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.”* This must be the core purpose of the AOLR, i.e. providing a route-to-market to generators where it is not otherwise possible or achievable via traditional market channels.

The last resort aspect of the AOLR should also not be forgotten when formalising its roles. As referenced in the HLD decision paper, the mechanism *“will be designed to avoid distortion of market outcomes, and minimise the risk of crowding out of alternative commercial solutions.”* The RAs should recognise that the primary route to market should be a market based commercial solution and the AOLR should not be designed in such a way that it competes with or prevents potential commercial solutions entering the market. Whilst providing a route-to market, this must be a last resort route-to market i.e. a safety net that seeks to incentivise access through market based arrangements.

The SEM Committee must also be cognisant of any unintended consequences that may arise from the establishment of the AOLR. The new mechanism should not distort or disrupt existing functional areas of the market such as intermediary agreements or Power Purchase Agreements and associated renewable support mechanisms.

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?

When considering what model should be implemented, the overarching objective of the AOLR should be maintained. Any adopted model should be transitional in nature, should provide generators with a last resort or backstop route-to-market and should not distort the market or prevent commercial solutions entering or continuing to function in the market.

In consideration of the above, Power NI believes a model akin to option 3, ‘Passive Aggregator’ should be adopted. As stated in the consultation paper, *“under this option the AOLR could be a mechanistic function, implemented as*

part of the market systems implementation". Without any details of establishment / implementation costs having been provided; this would intuitively, appear to be a lower cost solution for a service that has a yet unidentified demand. Furthermore, given Option 3 can be an embedded mechanistic feature of the new market design, a specific governance framework need not be established, nor is it likely to require license or legislative changes.

In respect of the alternatives, option 1 could be defined as 'Aggregator of First Resort' and would be very difficult for potential commercial aggregators to compete with, subject to the cost of participation not being prohibitive, which was a concern raised at the RA facilitated AOLR workshop. Option 2 is again likely to be high cost and may also be unattractive to generators given the interaction and level of input required from them. This may be perceived as contrary to what the AOLR is attempting to achieve in the first instance.

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

Power NI is a regulated supply company working under a price control and operating solely in Northern Ireland. Prior to considering the provision of such a service, considerable interaction would be required between Power NI and Utility Regulator. This would appear premature at this juncture.

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.

Power NI believes that the responsibility for establishing the AOLR framework and the subsequent procurement of the AOLR service should be that of the RAs. The consultation paper outlines a number of potential issues to work through if the responsibility of the AOLR rested with the TSOs. The most fundamental of these relates to EU legislation and the stipulation that TSO functions must be separate from the functions of supply and generation.

Additionally, as well as being a significant departure from the services currently provided by the TSOs, other potential issues could be raised in terms of licence compliance, in particular non-discrimination clauses.

Even if the TSOs were to appoint a delivery agent these issues would remain as the TSOs would retain overall responsibility and would have to ensure compliance with the associated regulatory requirements.

It would not seem logical, at this time, to look to implement a service that would require the above issues to be overcome, before it is established what the key roles of the AOLR are, whether or not a market solution will be available and/or what the demand for the AOLR is likely to be.

The requirement for legislative changes if the RAs are to procure and regulate the AOLR should not be viewed as an obstacle. Legislative changes will be required for other aspects of I-SEM implementation and the lead time for this must be included as part of the detailed project plan.

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, Power NI's view is that the establishment of the AOLR should be the responsibility of the RAs.

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?

The lack of detail provided in relation to the potential cost of the service, the recovery of these costs and without the functions of the AOLR being formalised, it is not possible to answer this question at this time, although the potential for cross subsidisation clearly exists.

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

A precedent exists in SEM in relation to transparency and the timely publication of market data. This approach should also prevail in the I-SEM, including the AOLR function, with the continued timely publication of non-commercially sensitive / participant specific market data to market participants and others. A transparent AOLR function would also allow potential commercial aggregators to gauge the market.

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 engage in a constructive discussion on the design of performance incentives until the detailed design of the market is further advanced. Recognising this, an AOLR function akin to option 3, should require no incentives given the mechanistic approach under which this option can be implemented. Consideration will have to be given to operational aspects of the AOLR, including

wind forecasts and associated volumes; however, this is a separate performance metric exercise to the design of incentives.

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?

Further insight into what the potential costs of establishing the service might be would facilitate a more informed discussion on this topic. Power NI appreciates this information may not be currently available given the uncertainty around what functions the AOLR will perform and what option might be selected. Again, as highlighted previously, establishing the core purpose of the AOLR at the outset would have facilitated a more focussed discussion on the options, the potential cost of these options and the cost allocation.

As a general point, the costs associated with the AOLR should be allocated to market participants availing of the service and not socialised across the entire market. Wind generators accessing the market via traditional existing means for example are likely to incur costs (either directly or contractually) and as such shouldn't have to fund the access of others. That being said, the cost of participation must not be prohibitive, despite this being a last resort function. This further advocates the implementation of a low cost solution which option 3 would appear to facilitate.

The consultation paper also states *"To 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 appear contrary to the backstop nature of the AOLR and as read, *"best price"* would appear prohibitive in terms of commercial aggregators entering the market.

If option 3 is implemented, it would be anticipated this would incur both lower establishment and on-going transactional costs. Regarding the establishment costs, consideration will need to be given regarding the recovery of these costs, cognisant of the previous made point of not socialising the costs associated with the AOLR function. This option should also reduce the risk of assets being stranded.

It is also worth highlighting that the length of any contract awarded to a potential AOLR entity i.e. if decided to award a longer term contract to recover fixed establishment costs over a longer time horizon, should not be linked to the length of contact awarded to a generator availing of AOLR services. Given the last resort nature of this function, generator contracts awarded should be of a short tenor. Parallels can again be drawn with the GB OLR and the short tenor contracts offered to renewable generators.

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.

Power NI would support the proposed position that there should be no upper limit for wind participation in the AOLR. It would seem discriminatory if the service was only available to some but not potentially all who wished to avail of it. Given this is a last resort service, and should be established as such, it should be self-policing meaning an upper limit should not be a requirement.

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.

Power NI believes the AOLR should be available to all "renewable resources" as outlined in the HLD decision paper. It is unclear whether renewable participants other than wind would wish to avail of such a service as they will typically have more predictable generation profiles.

When implementing an AOLR it is important that the RAs do not limit the route to market options. In the current market a de-minimis threshold exists which allows smaller generators the choice of whether to participate or not.

For small developments which are part of a wider portfolio the current SEM has advantages; for independent developers who wish to avoid participation costs, contracts with Suppliers are available. This choice facilitates diversity in the range of generation developments and removes the barrier to entry which participation would be for small developers. The contracts are also critical in enabling the development to secure the necessary finance.

Power NI believes that the current policy has facilitated the dual goals of generation entry and renewable development. Given the RAs stated position in relation to current policies i.e. current policy decisions should be maintained where possible, Power NI can see no reason why this policy decision would also not transfer to I-SEM.

When the RAs are considering aggregation services, it is important to recognise that for small scale developments which avail of the de-minimis threshold, Suppliers provide an aggregation service. Suppliers provide contracts, a route to market and assume the associated volume and forecasting risk. In many cases it is the contract and financial strength of the Supplier which facilitates the financing of the development.

In our experience, finance providers look to the counterparty and proposed contract before providing the development funds. This may not be available under other arrangements and therefore may adversely impact a developer's ability to secure finance and ultimately the pipeline of new generation. This would

be a significant detrimental unintended consequence should the RAs change the de-minimis level.

The current treatment of de-minimis reflects the physical reality of local embedded generation meeting local demand and reducing larger scale generation requirements. An artificial change to treat de-minimis as negative demand, divorced from a corresponding customer base; distorts the principle of local generation reducing local demand and would introduce a discriminatory two tier generation pricing regime. In addition, it would no longer reflect the physical reality and could potentially be troublesome or even incompatible with EUPHEMIA. “Aggregation Services” therefore should only be considered in relation to renewables who have taken the decision to participate in the market.

Small demand participants (which tend to relate to single, high consumption customers) should not be eligible for participation in the AOLR. Referencing the HLD decision, Power NI’s view is that to include a provision for small demand participants may have a disruptive and distorting impact on market outcomes and the potential for unintended consequences that may not be apparent at this stage of the market design.

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?

Power NI believes only renewable generation should be eligible to avail of the AOLR service. It would be anticipated most; if not all participants looking to avail of AOLR services would be wind generators. If it transpires other renewable technologies with for example more predictable generation profiles sign up to the AOLR, it may warrant, at that time, establishing whether or not specific grouping provisions need to be defined.

Conclusion

As stated above, Power NI considers it be somewhat surprising that the Regulatory Authorities (RAs) have consulted on the AOLR function so early in the I-SEM design process. The timing is premature.

The consultation has been issued before the full design of the energy markets which an AOLR is expected to operate in are known. In particular the detailed design of the balancing market and imbalance settlement are crucial operational considerations for both the AOLR and any party thinking they may require such a service. Power NI understands that the timing of the consultation may have been driven from the original proposal to have a mandatory day-ahead market however the change decided upon in the High Level Design removes the time criticality of this issue and should afford more detailed consideration.

The consultation paper has provided detailed options regarding potential functions and some insight into what the governance arrangements might be, prior to establishing what the core purpose of the AOLR function should be.

The key aspects taken from the High Level Design decision are that the AOLR should be –

- transitional,
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Given these proven delivery mechanisms, it is unclear if an AOLR is even required, however, if it is to be designed it is crucial that an AOLR arrangement does not undermine the existing arrangements that already provide market based routes to market.

Given that the high level design states that the AOLR should be transitional and not prevent commercial solutions it is somewhat surprising that as a “last resort” the RAs have not explicitly stated in the consultation that terms offered by the AOLR should seek to incentivise market solutions. In short it should be as the name suggests a last resort.

While Power NI has attempted to assess the proposals put forward by the RAs and answer the questions posed, without a clearer understanding of the market design and renewable support, to go beyond setting general principles carries a high risk of a sub-optimal design or unintended consequences.