

CER REF 03/049

23 February 2003

Ms Cliona McNally
Commission for Electricity Regulation
Plaza House
Belgard Road
Tallaght
Dublin 24

**Re: Irish Electricity Trading Arrangements Second Options Paper,
PA 24-01-03**

Dear Cliona,

Thank you for the opportunity to comment on your second paper on the proposed electricity trading arrangements.

At the outset we believe Ireland must put in place a trading mechanism which puts a priority on competitive and stable pricing, while recognising environmental responsibilities and maintaining security of supply, in a simple mechanism that is suited to the realities of the Irish market.

Background

Aughinish is a large industrial plant based in Ireland, and selling a global commodity on the world market. To achieve a successful market mechanism the final outcome of the trading arrangements must not erode any competitive advantages of Irish industry.

As you know we also intend to develop a CHP facility that will fully utilise the energy profile of our alumina refinery. We are keenly aware that the structure of the market will directly affect how suppliers will grow in the market and in turn introduce competition. This will directly affect their appetite to enter into offtake contracts with new generators. This will in turn impact on the amount of new generation that will enter the market.

Market Structure General

We welcome the choice of a centralised gross pool as we believe it brings transparency and a single price to the market.

At present aside from the published tariffs there is a lack of price transparency in the market because it is based on a bilateral contract structure. A pool system where all power must be traded will provide a single transparent reference price.

We would like the CER to continue to ensure that CHP and renewables are given incentives within the market trading structure because they bring benefits that are recognised throughout the EU and within the Irish government (energy and environment). The recent re-structuring from pool to

NETA in the England and Wales market has decimated CHP and virtually wound back the clock on the progress made in the previous 10 years. We must not allow Ireland to make a similar mistake by not attending to the detail of the market mechanism prior to implementation.

Pricing Methodology

In relation to the pricing methodology, we believe that the spot market will offer the market price for power based on bidding by available generators. However, this price must also reflect transmission system constraints and congestion costs.

Three options:

Of the 3 options we favour the option of LMP for generation with uniform prices for users.

At the outset it is very difficult to fully evaluate the benefits of locational marginal pricing until the locations and load flows are identified and the information is available in a transparent manner. However we understand that today parts of the transmission and distribution system are seriously congested. There is a sound logic in ensuring that the cost of congestion is passed through to the market in an efficient way that addresses the causes of congestion e.g. encouraging location of new demand or new generation to areas of low congestion.

However we believe that having a locational price for each individual node for demand customers may not be really practicable. We would therefore support the locational price for generators with uniform pricing for buyers. We believe this is the most appropriate structure for Ireland as it

- Provides appropriate locational signals regarding the location of new generators.
- Controls system operator costs.
- Creates the right environment for addressing system security and new investment for future capacity requirements.

More Information Please

We would also call on the CER and Eirgrid to prepare and present a status and impact study of the Irish system in relation to nodes and load flows that highlights the impact of Locational Marginal Pricing.

Interconnector Trader

We support the option as it has the advantage of strong incentives to achieve efficient dispatch on both ends of the interconnector. This must be the primary reason for the interconnector operation within the market trading structure.

Market Dominance

We agree that the Irish electricity market must be moved from its present position of having one large dominant player who dwarfs all other participants. It would be impossible to put a realistic new long term trading mechanism in place that does not address this issue.

Central Trader Option or Regulation Option

The ability to control ESB through regulatory interference would cause concern to new entrants as their would always be regulatory uncertainty e.g. will the Regulator intervene? How long will it take? Unavoidable delays while Regulator argues and determines on complex issues etc.

At this stage it is difficult to determine the overall optimal solution for Ireland however in the absence of certainty we would have a preference for the Central Trader over the Regulatory option.

- Independent from ESB generation and PES
- Hedged contracts between Central Trader on ESB Power Generation to cover generation plant and
- Contract with PES with Tariffs set by PES
- Both of the above will limit the ability of ESB to exercise dominance.
- Central trader will separate ESB Generation from ESB PES thereby removing any possible incentive to act in a manner that would favour ESB's market position.

Future Generation Adequacy

In relation to generation adequacy issues as outlined in your paper, the following are our comments:-

Default Buyer

We see that the problem is no different than where we are today. Market entry will depend on a number of factors however today we are in a transition phase going from a monopoly PES to an open market. The Capacity 2005 Programme has the ESB PES as the obvious "Default Buyer" but would that still be the case in the future? Also, it would be a considerable risk to existing generators if the Default Buyer was government owned and could take non-commercial financial risks as described in the paper for the case of over-generation. Because of this we do not support this option.

SMO Built Plant:

It is difficult to see how the SMO could have an incentive to build an efficient plant as its costs are covered by the customers. Also, it is questionable if the SMO should be in the business of power plant development – the Development Incentive Option at least offers the incentive to the market whilst this option has the SMO taking development and construction risks (and probably technology risk).

We believe that this issue has been addressed by the structural issues and if there is a capacity shortfall issue then it should be addressed at the time. It is wrong to put in place "Safety Net" options at this stage as it suggests that the proposed structure is flawed.

The Development Incentive Option

This could easily be manipulated and the question exists as to who would determine the expected profits and would they be guaranteed? The fact that existing entities would run the auction implies that they would be willing to

purchase new capacity yet be reluctant to build it under normal market conditions. We do not believe that this option is required.

For future generation adequacy we do however support the capacity auction process where the costs become part of the Ancillary Services contracts.

Thanks again for the opportunity to comment. Sorry for the delay. Please give me a call if you have any questions on the above, and we look forward to more information from you on the LMP impact on the Irish system,

Yours Sincerely,

John Ryan
Aughinish Alumina Ltd.