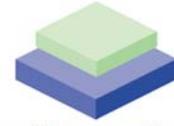


Cer Ref 03/055



**Island Energy Limited**

50-52 Nelson House  
Ballsbridge  
Dublin 4

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

20 February 2003

Dear Ms. McNally,

**RE: Irish Electricity Trading Arrangements -Second Options Paper,  
January 24, 2003**

We are writing in response to the Commission's recent Consultation detailed above. We give our responses to the Consultation below using the numbering system in the original paper.

#### **4.2.1 Pricing Methodology**

*Our preference is for Option 2: LMP for Sellers & Uniform for Buyers*

##### **Reasons:**

1. Locational Market Prices (LMP) is one of the SMO's tools to balance the grid. By assigning incentives (and disincentives) to generation locations, the SMO provides a price signal, which ultimately translates into cost benefits to all users via a more economical transmission grid.
2. Uniform prices for buyers would streamline and simplify bidding and settling in a centralized market.
3. The CER should encourage the SMO to design the 'order of dispatch' of all generators in a way that not only considers unit price, but also location.

## 5.1 Market Dominance

*Our preference is for Option 2: Regulation by the CER*

## 5.2 Generation Adequacy

### 5.2.2 Safety Net Options

*Our preference is for Option 2: Development Incentives*

#### **Reasons:**

1. The SMO (Eirgrid) currently publishes the annual *Generation Adequacy Report* and is therefore ideally placed to be responsible for adequate generation at all times.

Through a competitive process if necessary, the SMO should arrange and contract for the construction of reserve and peaking capacity by the private sector, on a continuous basis. Ideally, this would be new, quick-to-construct, economic Open Cycle Gas Turbine (OCGT) plant, with an ability to be converted to high-efficiency combined cycle (CC) operation at a future date. Aero-derivative OCGTs in the 30 to 50 MW range have efficiencies of around 40% and could compete in the mid-merit market. Accordingly, generators should be allowed to enter the merchant market when they perceive it to be more appropriate, either in OC or CC mode.

The SMO could guide such reserve and peaking capacity to be located at any of the many weaker points of the grid (similar to what Eirgrid has outlined in *Forecast Statement 2001/2 to 2007/8*). This would distribute generation across the Country and would reinforce the Irish grid without the significant expenditures required when generation is concentrated in Dublin.

Environmental drivers are increasing the amount of wind generation in Ireland, with the inherent uncertain availability of generation and low load factors. In order to avoid capacity distortion, the SMO may want to explore using OCGT plant as back-up generation for wind power. Care should be taken to continue to separate green from brown power.

As reserve capacity and peaking plants will not be constructed on the basis of price signals from a centralized market, we believe the capacity payments mechanisms should be used instead.

The capacity payment could be sculpted to reward availability at the peak, however, it should not be payable for any period that generators self nominate. The capacity payment could be set as a BNE OCGT capacity price.

It should be noted, that a system comprising of only base load plant is not necessarily the most economical or sustainable, since the demand is not base load alone and there would be too much capital invested.

We believe the size of the ultimate reserves should be maintained by the SMO in the range of 15 – 20% of total installed capacity and should only be dispatched when required by the SMO . Aside from reassuring all players that sufficient capacity will always be available, it is also an innovative method of attracting new entrants.

We recommend the SMO should be given the legal charter to contract for reserve and peaking capacity and to collect the necessary revenues from all users to pay for it. This could be done through an ancillary services type arrangement as discussed in section 4.4.2 of the Consultation Paper.

2. We do not believe the SMO should actually be building power plants (Option 3), simply because it is unlikely an adequate risk/reward mechanism could be created within a state owned institution to ensure costs are controlled and schedules are adhered to. We believe the risks for cost and schedule over-runs should be placed with the private sector.
3. We believe the Default Buyer option (Option 1) is altogether wrong, including the proposed 2005 option, mostly for the reasons listed under 5.2.2 A.

In addition, we believe the Default Buyer option distorts the merchant market in that subsidized generators under such a scheme could sell power at a lower bid price (in order to get dispatched), at the expense of existing generators. This will lead to a distorted market and discourage new entrants.

Thank you for giving us the opportunity to respond to this consultation.

Yours Sincerely

Jochen Schmitz  
Director  
Island Energy Ltd.