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**Thomas Quinn**
Commission for Energy Regulation
The Exchange Belgard Square
North Tallaght
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8th February 2016

Dear Sir/Madam,

**Re: I-SEM Capacity Remuneration Mechanism -- Consultation Paper**

The Demand Response Aggregators of Ireland ("DRAI") is a recently-formed association of ten Demand Side Unit (DSU) and Aggregated Generating Unit (AGU) providers in the SEM. Our purpose is to provide a single voice on policy and regulatory matters of common interest and we very much look forward to working with you into the future. I hope that you will consider this response in your deliberations as we believe there is a significant role for DSUs and demand-side participation in any future Market arrangements in Ireland.

## Why DR/DSUs are important

DR/DSUs are capable of responding to signals from the system operator within an hour and therefore provide an effective means of reducing the demand requirement, which can assist in balancing the system and avoiding constraints. Facilitation of DR/DSUs increases demand flexibility and improves overall system stability by:

- providing reliable distributed capacity to the system;
- contributing to avoided investment in peaking plant by delivering peak load reduction;
- providing flexibility to mitigate the uncertainty of wind output;
- helping mitigate transmission and distribution network constraints.[1]

[1] Single Electricity Market (SEM) (2011), Demand side Vision for 2020 Decision Paper, SEM/11/022.

Effective integration of DR/DSUs into the market structure will provide flexible, cost-effective capacity and in doing so complement thermal plant and renewables capacity. In addition, the participation of DR/DSUs can reduce the market power of conventional generators in the wholesale market, leading to more competitive outcomes.

In the past, inefficient diesel plant could run for hours in anticipation of high retail price signals or system demand (Peak lopping in NI, WPDRS in ROI), even though such system demand did not always materialise. The SEM has been successful in positioning AGUs and DSUs correctly in the merit order, ensuring this capacity is available to the system operator to dispatch when needed, and thereby avoiding the need to run the inefficient diesel plant unnecessarily. This is a substantial improvement, both economically and environmentally. The DRAI would therefore fully support the carryover of this aspect of the SEM model into the I-SEM, as the alternative would result in reverting to expensive load curtailment and would also see the unnecessary operation of diesel generation capacity.

**Facilitation of DR/DSUs in the I-SEM**

Fundamentally, the DRAI expects that DR/DSUs/Demand side capacity will become increasingly important in the design of the Irish electricity system and believes that the regulators need to give further consideration to how DR/ DSUs[2] can be facilitated when developing the new I-SEM Market arrangements.

Across Europe, DR/DSUs are increasingly recognised as an effective and highly efficient means of balancing the supply of electricity with consumer demand, and within the I-SEM the requirement to balance an increasing proportion of variable wind generation is expected to be an increasing challenge. In Ireland the delivery of the 2020 and 2030 renewable energy targets is projected to result in one of the highest penetrations of variable non-synchronous generation on any power system in the world and is expected to create very challenging future operational scenarios for the grid system operators[3]. It is therefore paramount that this advanced and progressive electricity system is supported by appropriate Market arrangements within the I-SEM to encourage the growth of demand-side participation and other system balancing measures.

Whilst the DRAI recognises that flexible dispatchable generation (peaking plants/OCGT) is effective at providing real-time balancing of renewable generation variability in the today's electricity system design, we expect that DR/DSUs will have an increasing role in delivering system balance in the future: to continue to rely on conventional plant with ever lower utilisation factors would be unaffordable. The DRAI therefore believes that the regulators need to be mindful of this growing potential in order to ensure that the Market arrangements within the I-SEM provide adequate support for DR/DSU participation into the future.

In this consultation response, we begin by providing some general comments on the approach taken in the design of the Capacity Remuneration Mechanism (CRM) in the most recent consultation paper, followed by specific reference to a number of key points made in the SEM-15-103 CRM Consultation Phase 1 Decision Paper. The DRAI view point is then expressed in response to a series of questions which directly affect DR/DSUs, which also include suggestions as to how the CRM can be designed to work to effectively incentivise DR/DSUs.

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[2] The term 'DSU' has been used throughout this letter. It should be understood to refer to both DSUs and AGUs as appropriate. The term 'DR' refers to Demand Response as provided by DSUs and AGUs

[3] EIRGRID GROUP ANNUAL RENEWABLE REPORT 2013 Towards a Smart, Sustainable Energy Future

**General comment**

The DRAI are supportive of the approach taken to the design of the I-SEM CRM and in particular:

- Agree that the assessment criteria for the detailed design of the CRM are appropriate. Specifically the DRAI support the need for an efficient Market design which aims to achieve the most economic overall operation of the power system.
- DRAI do, however, have a very real concern that under the proposed Market arrangements for the I-SEM CRM, the responsibilities for Reliability Option (RO) payments will be diluted to such an extent that the RO will cease to provide benefit (value) to the Market. This is because the current proposals allow generators regardless of their reliability to bid for ROs, and since unreliable plant are not exposed to any meaningful downside (penalty) there is no risk associated with non-delivery of capacity. This is despite the fact that the stated objective of an RO is to remove unreliable plant from the CRM. Specifically, we are concerned that within the proposed Market design:-
  - The penalties and risk of not being available to deliver capacity appears low;
  - The Stop-loss limits on the RO payments will be set too low;
  - Reliability Option Difference Payment may not be triggered in the first few years of the I-SEM;
- Therefore under the proposed arrangements there are few – if any – periods whereby the capability of non-reliable generation will be tested. Consequently, the Market design as proposed will facilitate unreliable plant and potentially exclude reliable capacity including AGUs and DSUs.
- In the case where the proposed arrangements are adopted, the DRAI consider that it will be necessary to include a claw-back of capacity payments if – in the absence of RO Difference Payments – a generator fails availability testing.

**SEM-15-103 CRM Consultation Phase 1 Decisions**

The DRAI welcomes most of the decisions contained within the SEM-15-103 detailed design paper, and in particular the proposals outlined in Option 4B. We do, however, have concerns that there may be instances whereby capacity providers are exposed to unreasonable risks, as they will not be eligible to receive energy payments to offset their difference payment liabilities. Specifically, we note that within the design of Option 4b, 'Capacity providers who are providing reserve or other system services in accordance with TSO instruction will have the relevant part of their RO commitment settled with reference to their reserve/system services income'.

In addition, the DRAI note that the 'hybrid option' as described in the I-SEM CRM decision paper will 'Apply an RO difference payment, only when the demand reduction is not delivered when the Strike Price is exceeded by the MRP'. This implies a new method of determining (at a Market level) failure to deliver demand response. We are concerned that its implementation will add complexity and also additional risk to DSU revenue streams. The DRAI request that this is fully defined and an opportunity to consult on this mechanism is afforded to relevant parties.

In relation to de-rating, the DRAI is supportive of the rationale behind de-rating, and recognise that historic forced outage rates for relevant technologies can be effectively applied to conventional generators. However, the DRAI argues that there is no intrinsic forced outage rate for DR/DSUs, since the performance of specific DR/DSUs is a result of the specific programme rules. The DRAI also recognise error in the Market design in GB which has adopted a de-rating value for Demand Response from an unrelated programme with very different rules. Aggregators within the DRAI effectively impose their own de-rating as they never offer the full "nameplate" capacity of their portfolio. To ensure reliability of response, aggregators analyse their portfolio and calculate the requirement necessary to meet a stated capacity obligation. For this reason DR/DSUs should not be subject to further de-rating.

The DRAI also consider that Market risks should also be allocated in a fair and reasonable manner, and should be no larger than necessary to incentivise efficient operation. It is important that the Market design does not present some or all participants with unmanageable risks, as these risks will result in costly risk premiums which will ultimately be passed through to end customers. We are specifically concerned that since DR/DSUs are not eligible to earn explicit energy payments, any demand response from a DR/DSU will result in suppliers being unexpectedly long in the energy Market. On the assumption that balancing Market prices are higher than day-ahead prices, i.e. when DR/DSUs are being dispatched, this situation will be favourable to the supplier. Consequently, in the case where DR/DSUs are dispatched regularly, a vertically integrated supplier providing a DR/DSU service will have an advantage over independent aggregators. Although the DRAI understand that whilst this situation is necessary in the short term to facilitate the launch of the new Market in 2017, it is unacceptable in the medium term and we therefore request a firm timeline for full energy Market participation by DR aggregators.

Finally, DR/DSUs in Ireland are at the early stages of market development and are therefore predominantly developed and operated by relatively small market actors (aggregators) with limited resources. Participation in a Market with an overly complex structure would require substantial resources which are beyond the capabilities of these new market entrants. Failure to factor in demand-side participation in the initial I-SEM design may inadvertently force its exclusion due to the complexity of the proposed market structures.

The responses below are intended to specifically address the important aspects of CRM (Consultation 2) design, which are specific to DR.

**INTERCONNECTOR AND CROSS-BORDER CAPACITY -- QUESTIONS:**

A. *Which of the approaches to the treatment of cross border capacity do you prefer and why? (For the Provider Led and Interconnector Led approach, please specify whether you prefer the "Performance based" or "Availability Based" variant).*

**Provider led**

The DRAI consider the *provider led approach* would result in a difficult and complex solution as it would necessitate the potential for a multi-zonal approach to the auctions to release I-SEM ROs.

**FTR led**

The DRAI also question the value of the *FTR approach*, under which the participants in the I-SEM are the parties that hold the rights to any financial benefit of trade arising from the cross border flows at the Day Ahead stage – through FTRs.

The DRAI recognise that the FTR approach delivers revenue to offset the Reliability Option Difference Payments, since the owner of the interconnector asset will, in the first instant, receive a payment based on the difference between the GB and I-SEM prices (i.e. congestion revenue), and this payment is then passed to the holder of FTRs. We are however concerned that it may still be insufficient to cover the cost of Reliability Option Difference Payments, in the case where:

- The price in GB is also high (higher than the RO strike price); or
- RO is called in the intra-day or balancing timeframe – which is when it would be expected to be called.

Furthermore, the DRAI question the value in the FTR led approach, which will lead to the application of the RO at the day ahead stage, but not in intraday and balancing market timescales. Particularly, since the latter market timescales are arguably more critical, as scarcity tends to occur at or shortly before physical delivery, the FTR does not provide a complete solution. The DRAI also have concerns for the use of the FTR as it is a financial product, and there is therefore no guarantee that the holder of the FTR will have any influence over physical delivery. Most importantly, the DRAI consider the use of such a financial product would violate the principle that ROs, which are required to be physically backed.

**Interconnector led**

Fundamentally, the DRAI are strongly of the view that interconnector and cross border capacity trading is an untried complexity that should not be introduced at the initial stage of the I-SEM. More specifically, we are concerned for the proposals, under which GB based capacity already participating in GB CRM could take up an RO in the Irish market at marginal cost (as their costs are already recovered in the GB market). The DRAI consider that this situation would place GB based capacity at a major advantage compared to local plant whose total CRM income is derived from Irish RO's. Furthermore, the consultation paper fails to demonstrate how the addition of cross border capacity trading would deliver enhanced security to the Irish market. The DRAI therefore request that the inclusion of interconnector and cross border capacity trading is postponed until an advantage can be demonstrated and verified, and agreement is reached that Irish capacity can participate in the GB capacity market on the same terms from the same entry date.

**Performance-based vs availability-based model**

Although the DRAI do not consider any of the approaches outlined in the consultation paper to contain a perfect solution as they each have their weaknesses, we do acknowledge that the strengths of the delivery-based variant (performance-based model), which will clearly identify the non-I-SEM participants that have under-delivered and seek appropriate payments from those providers. We also agree that the *availability-based approach* is weaker in identifying non-I-SEM participants that have under delivered. Furthermore, since international experience (US) of availability-based CRMs has demonstrated that generators can structure their offer data so that they appear available, but do not actually run when required, such an approach could be considered vulnerable to gaming. **Therefore, notwithstanding the shortfalls identified in the performance-based approach, the DRAI consider the performance-based option to offer the most feasible solution.**

*Performance-based model*

In a performance-based model the participant's obligation is not based on their availability to perform but on the actual flows at the relevant interconnector(s). The DRAI consider that in the case where capacity payments are made to non-local resources, it is important to have a performance assessment that is equally as strong as that for local resources.

*Availability-based model*

The DRAI do however consider that an availability based obligation would be more appropriate than deliverability based obligation for non I-SEM capacity providers. Since it will mean that non-I-SEM capacity providers are subject to penalties (i.e. Reliability Option Difference Payments) only for failure to generate or offering to generate and not related to the flows on the interconnectors.

*F If there is a preference for the "Hybrid" approach:*

- *Should this be paired with the "Delivery Based" or "Availability Based" provider led approach?*

The approaches laid out under the provider or hybrid options indicate that there are many inherent uncontrollable risks, and since there is no known experience of this approach working elsewhere, its adoption would be expected to introduce a high level of uncertainty into the Market. The only experience of non-local resources participating in capacity markets is in the US, but in this case, the capacity resource must be dispatched by the Market, which is not possible cross border within the I-SEM. Finally, since it is recognised by all parties that provider and hybrid schemes won't work with interconnector to France, which could operate just 4 years after Market start, the introduction of such approaches is clearly not viable for the I-SEM.

**SECONDARY TRADING -- QUESTIONS:**

*A) Do respondents agree that direct secondary trading of Reliability Options should be permitted?*

**Yes. The DRAI consider direct secondary trading of ROs (including ex-post volume reallocation) to be an essential mechanism required within the Market arrangements to facilitate Demand Response.** This is because DR/DSUS are expected to have limited access to energy Market revenues initially, which will mean limited access to the cash-flows that underlie "back-to-back" financial arrangements. We do however also believe that secondary trading will continue to be very useful for all participants in the Market once DR/DSU have greater access to energy Market revenues.

In particular, due to the complexities associated with split market approach, a third party is unlikely to want to take on an option where settlement is dependent on whether the primary RO holder sells energy into the DAM, IDM or the BM. Therefore the DRAI consider direct secondary trading will provide a better option for the original RO holder than "back-to-back" trading.

The DRAI also argue that in the case where an aggregator has several DSUs, it is only the aggregate performance of all those DSUs that should matter. Therefore, if a specific DSU under-delivers during a scarcity event, and another DSU over-delivers such that the total delivery meets the obligation, then no penalty should be payable. Without energy market revenues, the performance of the aggregate group has to be supported administratively -- In the UK, ex-post "Volume Reallocation" is used to monitor the aggregate performance.

The DRAI agree with the potential benefits listed in the SEM-15-014 consultation paper and therefore support the inclusion of a provision for direct secondary trading of ROs in the I-SEM.

*B) Should secondary trading of Reliability Options be via an organised secondary platform? If so, which one of the options is preferred?*

**The DRAI support the Mandatory Centralised Market option**, which establishes a centrally funded Market place for secondary trading of ROs, where only trades enacted through this Market place will be recognised in the settlement of ROs.

The DRAI also agree that the "mandatory centralised Market" option will be best for competition, and that the creation of a centralised Market will increase transparency over the secondary value of ROs. We also agree that this transparency and liquidity will reduce new-entrants' uncertainty over future costs and revenues – ultimately leading to lower costs to consumers.

The DRAI does not support the Optional Centralised Market approach, which also seeks to establish a centrally funded Market place for secondary trading of ROs, since it does not preclude the emergence of competing market places, or the bi-lateral trading of ROs. This DRAI considers that this solution will incur the costs associated with marketplace establishment, but may not deliver transparency of benefits.

In addition, the DRAI does not support either the "No Centralised Market" option or the "No Centralised Market for go-live" option.

*C) Do respondents believe that "back-to-back" trading to lay-off exposure to difference payments should be permitted?*

The DRAI does not support the introduction of "back-to-back" trading as it compromises the transparency of the Market, this is because it is not clear where the performance is expected to originate. Conversely, with secondary trading, the central register makes it quite clear who has the obligation to perform.

*D) With respect to the creation of a centralised Reliability Option secondary market platform:*

*V. Should a secondary acquirer of a Reliability Option start from a zero position against each "stop-loss" limit, or should the loss transfer?*

Fundamentally, the DRAI consider that stop-loss limits on secondary trading should not create artificial barriers to the change of aggregator process, i.e. it shouldn't make the RO inherently more or less valuable through different effective amounts of stop-loss available for the remainder of the RO term.

The DRAI support the option whereby the "stop-loss" limit continues to follow the participant (see section 4.4), since, under this approach only the annual option fee revenue received by the participants in the secondary trade changes. This option is considered logical and supportive of Demand Response, as the "stop-loss" limit would continue to be the same multiple of the RO holder's annual option fees, with the annual option fee revenue being altered by participants increasing or reducing their volume of ROs held.

## DETAILED RELIABILITY OPTION DESIGN: QUESTIONS

### Reliability option contract length

*A) Principle of Longer Term Reliability Options:*

*I. Do respondents agree that plant requiring significant investment should be able to avail of longer term Reliability Options?*

**The DRAI are in support of short term ROs as they consider the shorter time period will provide more efficient entry and exit signals than the alternative long term RO.** We also believe that long term ROs have the potential to lock consumers into buying a particular volume of generation capacity, and agree that this places an additional risk of over-procuring on consumers.

We would however agree that plant requiring significant investment should be able to avail of longer term ROs. For instance, new DR/DSU capacity will typically require investment on behalf of the Aggregator and the IDS (installing monitoring and control equipment to generators and switchable load), to ensure reliable and timely response to TSO dispatch instructions. Such investment would not generally be recovered within a single year term, therefore without multi-year ROs new reliable DR/DSU capacity is unlikely to become available to the Market.

*II. Do respondents agree that existing plant should be restricted to reliability options with a term of 1 year?*

The nature of the DR/DSU market is that Aggregators are required to offer multi-year terms to IDSs, to provide a level of certainty to IDSs (and indeed the Aggregator) and therefore reduced risk of return on their capital investment. However, Aggregators can only offer IDSs the longer term contracts if they in turn have back-to-back ROs of a similar term. Only permitting one-year term ROs might destabilise the existing DR/DSU capacity and damage the development of new additional DR/DSU capacity.

*III. Do respondents believe that longer term Reliability Options should only be available to new-build plant, or should also be available to existing plant where significant investment is being made to enhance or maintain its capability to provide capacity?*

As mentioned above -- the DRAI consider that longer term ROs should be made available to existing plant, in cases where significant investment is required.

The DRAI question whether Option 2 (different length) will deliver the most efficient option, since this will be dependent on getting the price-duration trade-off right. We would therefore argue, that when the balance is sub-optimal, the result will transfer of a significant level of risk from strike participants to consumers. It is also important to note that since the risk will not be transferred from other participants, Option 2 will not create a level playing field – unless this risk transfer is correctly priced when comparing offers for short and long-term contracts. In addition, although the DRAI recognise that longer ROs could be expected to reduce the capacity price of new entrants and therefore lower the auction price, they are also likely to increase the risk of future stranded costs and reduce competition in subsequent auctions. We therefore consider that any short term increase in competition due to longer contract length would be outweighed by less competition in the longer term.

In relation to the point raised regarding the State Aid Guidelines, which envisage that the auction price for capacity will tend to zero when there is a surplus of that capacity, and the implication that prices would only go "high" in annual auctions where new capacity is required. The DRAI argue that this approach will reflect the value of the capacity, and do not agree that it would not give a stable revenue consistent with lowering the cost of capital for new entrants. We also question why the Regulators consider the approach is likely to create difficulties in maintaining the stability of end-user tariffs.

**The DRAI members are mostly therefore in favour of (Option 1a, Pg. 60), in which all ROs are the same length (all short/medium), as this approach is the most adaptable option, which will deliver the most efficient, least risk solution.** We would also like to draw attention to the fact that this option has been proven internationally, in New York and Western Australia, and has been selected for the Italian market (all 3 years). Longer-term options could be offered when TSO long-term forecasts suggest that it would be prudent to encourage further major investment, which is not the case at present in Ireland.

*C) Maximum available Reliability Option lengths*

*I. Do respondents have a view on the appropriate maximum Reliability Option lengths that should be available to new-build and upgraded plant?*

The consultation paper makes reference to the current GB energy Market conditions, under which project finance lenders are unlikely to take any merchant risk, meaning that the revenues supporting debt service must be supported by an agreement. The DRAI would like to point out that this reluctance to take any merchant risk seems unique to the GB, which is perhaps due to the high level of political control over the electricity markets. We would also like to draw attention to other markets, such as PJM, which has benefited from significant investment in new generation capacity, without offering more than 3 years of capacity price certainty.

**Stop-loss limits**

*G) Please provide views on the appropriate levels for the each of the proposed stop-loss limits.*

**The DRAI supports the view that reliability should be rewarded within the I-SEM CRM, and therefore would have a preference for relatively high stop-loss provisions, which do not protect owners of unreliable capacity**. We believe that this approach would send the right signals to the capacity providers and since unreliable actors would be subject to considerable financial risk they would need to have a high level of confidence in their delivery before taking on an obligation (purchasing an RO). There are important lessons concerning stop-loss limits in GB, where the limit is set at 1x the annual capacity fee. This approach encourages all existing plant participate regardless of their reliability, as in the worst case scenario these actors will not receive any financial penalty for not participating.

The DRAI recognises the need to strike an appropriate balance between incentivising capacity providers to perform under all circumstances and not exposing capacity providers to excessive risk. Excessive risk exposure would either be priced into auction offers (which would add to customer bills) or deter investment (which would threaten system security). We would also like to draw attention to the new DECC GB proposals, which include an innovative feature where a provider who has hit the stop-loss limit continues to be incentivised to deliver if there are yet more events.

**Commissioning Window and Implementation Agreements**

*H) Is a period of four years from the Auction Date to the start of the first Delivery Year appropriate?*

The DRAI recognises that the choice of how far out the auction is held could affect the mix of plant which comes forward to compete in the auction, and that a shorter period such as T-1 could favour existing plant and DR/DSUs, while a longer period such as T-4 could favour a new CCGT or storage plant while disadvantaging DR/DSU units. **We are therefore supportive of a short time period between the date of a Capacity Auction and the start of the first delivery year under the RO**.

*U) Do respondents agree that the level of the performance bond should be based on a pre-estimate of the cost to the market of non-delivery of contracted capacity?*

The DRAI support the introduction of an obligation on capacity providers / new entrants within the Implementation Agreement to report any known shortfall in the contracted capacity as early as practicable. We also agree that it may be sensible to apply this principle more widely, rather than follow the GB route of more detailed tailoring of termination fees and the associated regulations and rules to try and provide incentives for all outcomes. Indeed, we would advocate avoiding the GB approach of adopting weak penalties, and then trying to compensate for this laxness by requiring expensive paperwork and excessive testing.

**LEVEL OF ADMINISTERED SCARCITY PRICE (ASP): QUESTIONS**

*Do you agree that the definition of full load shedding should be based on the actual (as opposed to forecast) events that give rise to an Eirgird Red Alert (frequency drop, voltage drop, or involuntary load reduction)?*

The DRAI agree that the Eirgrid Red Alerts are a good starting point, and that only actual events should be recognised, not forecasts. However:

- Deviations in system frequency should only be counted where they lead to involuntary load shedding – i.e. beyond any contracted ancillary services.
- Low system voltage levels should only be counted where the system operator has induced them deliberately in order to reduce demand.

This is because the point of scarcity pricing is to price emergency actions by the system operator to improve the balance of supply and demand. If these actions were unpriced, then the actions would cause prices to fall, despite imposing costs on consumers. A frequency or voltage excursion that is properly handled by ancillary services does not cause inconvenience to consumers, and so does not need to be priced.

*A) Which of the options do respondents prefer (and why) for the enduring level of the Full Administered Scarcity Price (FASP)?*

*I. VoLL;*

*II. EU Consistent (e.g. with GB);*

*III. Euphemia Cap; or*

*IV. Existing SEM PCAP;*

**The DRAI support the introduction of the "VoLL" option, as we consider it to be the most equitable, since it maintains incentives on customers (via their Supplier) to reduce their load if prices go above their specific VoLL.** Furthermore we recognise that the design of the I-SEM ROs mean that this effect is retained – as Suppliers will retain the full benefit of selling back power they have purchased at the Day Ahead stage.

We are also interested in the the inclusion of an non-binding warning of anticipated scarity and suggest that a period of 8 hours would be appropriate.

*E) If you favour a different level of Full ASP, either for an introductory period, or after any introductory period, please indicate the level and justify your response.*

The preferred level of Full ASP will depend upon whether DR/DSUs will have energy Market access. If DR/DSUs are granted energy Market access then high scarcity pricing would present an opportunity for DRAI members as well as a risk. However, in the case where DR/DSUs are not given energy Market access then the Full ASP will only increase risk for DRAI members and we would not support this approach.

More generally, the DRAI support the theory behind the (LoLE) generation security standard used for the I-SEM, and therefore support the use a FASP set to the same level as VoLL. We also support the introduction of ROs and recognise their value in protecting Suppliers against excessively high prices.

*G) What should the value of X in Figure 12 be?*

Administered Scarcity Pricing starts to apply when there is insufficient available capacity to maintain the target operating reserve. The DRAI therefore considers that the value of X should be based on a specific tolerance metrics linked on attributes the end customer values, such as the number and duration of blackouts. We also note that Administered Scarcity Pricing will not apply at times when there is sufficient available capacity, but it cannot start/ramp-up fast enough leading to a short term reduction in operating reserve. This is in contrast to the approach taken in the US, where the ASP is applied based on the level of available generation that is not producing (i.e. the generation does not need to be online).

**TRANSITIONAL ISSUES: QUESTIONS**

*A) Which of the suggested options (annual auction, block auction, do nothing) do you prefer?*

**The DRAI consider the introduction of an annual auction (Option 1) for capacity to be the simplest solution and are supportive of this option.** We do however recognise the value in (Option 2), which should result in more optimal procurement, and facilitate swift progress towards normal auction cadence.

*B) If you prefer the do-nothing auction, do you believe this should be accompanied by relatively low levels of Administered Scarcity Price?*

The DRAI fervently oppose the introduction of Option 3 (Do nothing) as this would mean Capacity Providers would receive no Capacity Payments during the transition period and consequently have a severely detrimental impact on demand response providers. We also have concerns relating to the view that energy-only markets are feasible, and consider that there is an important trade-off in the Market arrangements, as an increase in the volatility of capacity prices will result in the application of a higher risk premium to the financing of new projects. Consequently, a system which produces more volatile capacity prices will tend to have higher capacity prices on average. The DRAI therefore argue that the best (least cost) outcome for consumers is likely to be achieved via a system which produces more stable capacity prices.

We look forward to hearing from you and would welcome the opportunity to discuss matters relating to the I-SEM CRM and how they could potential assist the development of the DR/DSU market within the context of the All Island electricity Market.

Yours sincerely,

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PATRICK LIDDY
DRAI Chairman