

GB Wholesale Markets Team  
OFGEM  
10 South Colonnade  
Canary Wharf  
London  
E14 4PU

[EMR\\_CMrules@ofgem.gov.uk](mailto:EMR_CMrules@ofgem.gov.uk)

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Dear Sirs

**Five Year Review of the Capacity Market Rules – First Policy Consultation**

This consultation follows in your open letter of 11 September 2018.

**General feedback**

We do not believe that the process for notifying potentially interested parties of the open letters was adequate. The open letter was only published on your website and sent to your subscribers and therefore only those parties who were aware of the forthcoming consultation had an opportunity to comment. In previous email correspondence with OFGEM we understand that the EMR Delivery Body was made aware of the consultation, however, they chose not to make their registered users or those parties who had taken part in prequalification process aware of the consultation. As a result we believe that we were excluded from the consultation. We only became aware of the consultation having occurred was that there was a reference to it within the Department for Business, Energy & Industrial Strategy's response to the General Court of the Court of Justice of the European Union's judgement in the Tempus Energy case (Case T-793/14).

We, therefore, do not believe that there was a sufficient attempt to make the consultation on the contents of the open letter widely known which probably explains why there was only a very limited number of responses compared with the number of organisations who appear on the Capacity Market register.

We have been involved in undertaking consultations on the Development Consent Orders for two generating stations and many other large development projects. We had to contact a large number of statutory bodies, statutory undertakers, regulators, local authorities, placed notices in local and national newspapers. We also had to actively seek out people/groups/businesses who could have been interested in our

proposals including direct mailing to individual households and businesses. In essence we had to make the existence of the consultation known as widely as possible to ensure that nobody was excluded from giving their views. Under the requirements of the Planning Act 2008 permission would have been rightly refused if we had merely published the consultation on our website and to subscribers as you only look for a website and subscribe if you know that a consultation has been launched. We believe that the government and agencies should follow the consultation rules that are imposed on the private sector.

We are responding to this consultation but as a result of the exclusion from the open letter consultation we will be making wider comments and would respectfully ask that our comments are considered.

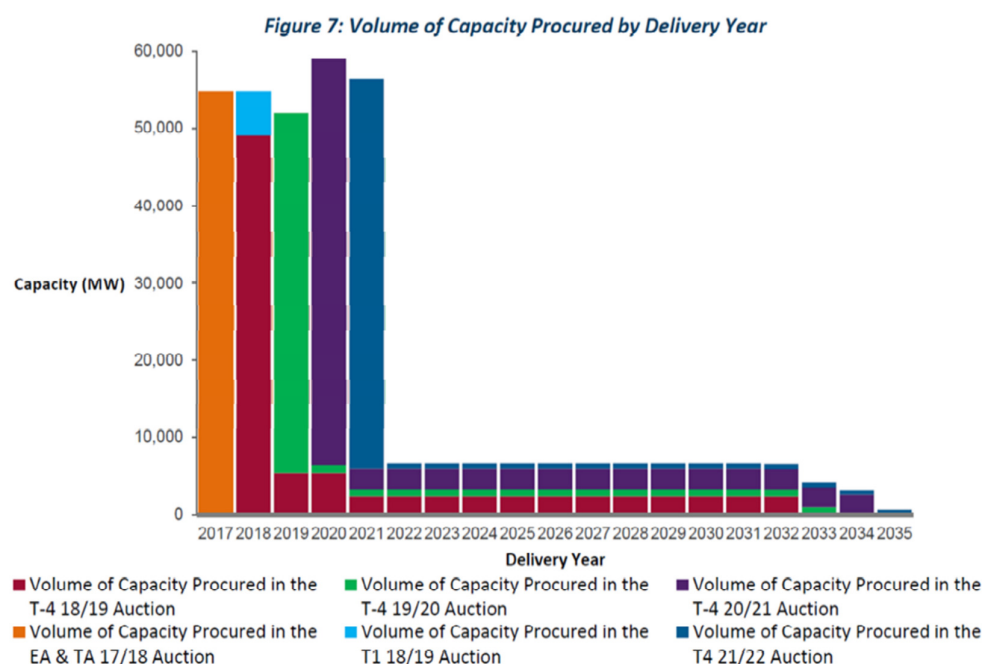
### Question 1, 2 & 3

Regulation 78 sets three objectives when making amendments to the Rules

Paragraph 1.1.1. – promoting investment in capacity to ensure security of electricity supply

The growth of renewables reduced the load factors of existing generating stations and affected their viability and the viability of other potential new generating stations needed for energy security. The CM was devised to provide a support mechanism to make up for the reduction in load factor whilst the need for conventional generation was still required.

Below is a graph taken from a report by the UK Government on the outcome of all of the past CM auctions.



It clearly shows that the vast majority of CM contracts go to existing generators which were built prior to the CM becoming operational. The investments decisions on these assets were determined by market conditions at the time which would also have considered the increase in the deployment of renewable technology which would potentially result in reductions in load factors. Despite this potential reduction the investments decisions were taken with a 20-35 year horizon and new capacity was built prior to the implementation of the CM.

The theoretical load factors would potentially be skewed upwards by many of the large existing generators who also had supply businesses. This enables them to secure the revenue of their existing generation assets by utilising long term Power Purchase Agreements (PPAs) as they had a direct route to market for the electricity, i.e. they would supply to customers a certain minimum kWhs over a particular time which they would secure from generating assets in their ownership. Many of these existing assets are still to this day generating for between 6000 to 7000 hours annually (load factors of between 70% and 80%) which is much higher than anticipated by the UK Government when devising the CM.

The decision for an existing generator to keep their facility open is not based on a CM payment. It is based on the profitability of the generating activity, the spark spread, the age and running hours of the equipment and the number of startups over the life of the equipment. It should therefore be possible for the UK Government, with assistance from National Grid and the EMR Delivery Body to determine the likelihood of each of the current generating assets from being available to provide capacity at some future date and then apply an appropriate risk weighting.

For each MW of capacity, with a wholesale price of electricity at £50/MWh the annual revenue generated is between:

6,000 hours x £50 = £300,000 and 7,000 hours x £50 = £350,000.

For each MW of installed capacity, with a derated capacity of 95%, the income from the CM based on the last T-4 auction is:

1 MW x 95% x £8.40 x 1,000 = £7,980.

Therefore the revenue received from the CM represents only 2.25-2.5% of the total revenue and would not represent the reason why the owner of the asset decided to keep the existing asset operational. There are many other factors which would determine whether or not the generating facility remains open and provides the security required. Additionally, at times of system stress the price of electricity will substantially increase (Prices of £1,250/MWh have been achieved) which provides a strong motivation to generate and further reduces the importance and necessity of the CM payment.

This argument is even more compelling for the existing nuclear generating assets. In 2011, with the exception of Sizewell "B" all nuclear power stations were planned to

cease generation by 2023. The UK Government subsequently issued extension permits for 5GW of nuclear capacity to enable them to continue to generate until 2024. Fuel costs are practically zero and therefore operators of nuclear generating assets will generate for as many hours annually for as many years possible to recoup the high capital costs and the decision to remain open will not depend on the very low CM payment compared with the total revenue.

The CM is clearly dominated (amount of generation capacity as opposed to number of generators) by the major existing generators who will keep their assets operational whether or not they have a CM contract. Therefore these operators will take part in the CM auctions and remain in the auction until it has cleared as the CM payment represents “free money” and it reduces the price to a level which is below the price required for a new generating assets, particularly for a new entrant who has no supply business and who cannot obtain a PPA from a competitor. By keeping out new capacity there is greater likelihood of spikes in power prices due to less competition from which the existing operators will benefit.

This is anti-competitive behaviour and demonstrates that there is no market failure for the continued operation of existing generating assets until they become economically obsolete for reasons beyond the CM payment.

From the graph above, there is clearly market failure for new capacity as very limited new generating capacity is securing CM contracts and therefore the CM needs to be amended to deal with this market failure and at the same time stop rewarding the major existing generators for making capacity available which would be available regardless of the CM payment.

We believe the CM payments made to operators of existing generating stations, which have not had investment so as to extend their operational life, cannot comply with the CM rules.

This argument does not exclude the contribution that these existing generating assets have on the security of supply. The amount of capacity required in any subsequent auction should be determined having first determined the likelihood of each of the current generating assets from being available to provide capacity at some future date and then apply an appropriate risk weighting (above the line). This would result in a CM which would only pay for capacity (below the line) which would not otherwise be available without a CM. The amount of capacity being procured by the UK Government would be lower than has been procured to date and maybe zero. The price at which the auction closes would likely be higher due to less entrants, but it would be on a substantially lower total capacity. It would remove the anti-competitive advantages and would enable the market to deliver the required level of capacity by supporting investment.

We believe that without these changes the CM is not in the common interest and provides unnecessary benefits which should not arise from a State aid payment.

Therefore the CM rules do not promote investment in capacity as potential investment is “priced out” by existing operators who have an unfair advantage. If the CM rules are required to promote investment changes need to be made which enables new capacity to compete equally

#### **Question 4**

The proposed makeup of the CM Advisory Group is weighted towards maintaining the status quo and protecting vested interests. To promote balance and proper debate a greater number industry nominated parties including a cross section of participants in the CM from large to small including participants who have not been successful in CM auctions.

#### **Question 7**

We agree that reducing the administrative burden of prequalification is beneficial to the process. We have prequalified successfully on two separate occasions and therefore our experience is positive, however we believe that the following amendments would assist the process without diminishing its veracity:

- Allow information previously submitted in prequalification processes to be transferred to subsequent prequalification processes to enable the applicants and NGESO to concentrate on material changes only.
- Allow NGESO to have more discretion over submitted information which is clearly correct but fails due to failure to comply exactly with the CM Rules for example, “Ltd” instead of “Limited”.

#### **Question 9**

We believe that the requirement to submit proof of Planning Consent prior to the relevant auction is necessary otherwise there is a risk that a participant could win an auction and then may not be able to subsequently deliver the project. This would mean that another consented project which did not win an auction may have been disadvantaged and/or the relevant planning authority may feel obliged to grant a planning consent which may not otherwise have been granted and/or the scheme which is relied on by the CM cannot be delivered.

We believe that it would be unfair if participants who had spent considerable time and money prior to participating in the CM due to the current rules competing on equal terms with participants who haven't yet received planning consent particularly due to the limited duration of the planning consents, prior to implementation and therefore the number of CM auctions that a participant can take part in prior to consents expiring.

#### **Question 10**

We agree with the proposal.

## **Question 11**

We agree with the proposal.

## **Question 31**

To change the rules to penalise/further de-rate distributed connected assets would be unfair particularly to those parties who have invested significant time and money in securing land and planning consents/Development Consent Orders based on the connection neutrality of the CM.

There are four aspects to consider prior to considering a further de-rating of distribution connected assets:

- What occasions are system stress events likely to occur and in those circumstances how much of the output could potentially be constrained? For example, system stress events are more likely to happen at times of low renewable generation output. If the full output can be exported at times of low renewable generation it would be unreasonable for there to be a further de-rating of distribution connected assets.
- The De-rating factor would have to be bespoke for each and every connection/generator as the amount and likelihood of constraint and therefore the contribution of a generator to assist in a system stress event would be unique.
- A further de-rating would give a commercial advantage to National Grid in transmission and system use charges and therefore they will be keen for this to occur. Transmission connected assets would also have an advantage in the level of CM payment that they could accept for the same level of investment. Distribution connected assets need a specific voice in any CM Advisory Group to balance the need for new generation on both distribution and transmission connections. It would also reduce the potential of smaller generators to participate due to higher upfront costs of a transmission connection. Existing larger generators would gain an unfair commercial advantage which would ultimately lead to less system security by less capacity being built.
- Distribution connected assets tend to be sized to meet local demand and therefore they are more efficient and flexible than large transmission connected assets which rely on bulk transmission of power over long distances.

## **Further Comments**

We would have expected to see proposals for reducing the time between applicants from having to submit security deposits/letter of credit and the relevant auction.

For the T-4 auction for delivery year 2021/22 the obligation to place credit cover was only two weeks prior to the original planned date for the auction. The auction date

was subsequently moved by six weeks but a two week period prior to the auction was considered sufficient to enable applicants to enter the auction. For the T-4 auction for delivery year 2022/23, credit cover had to be in place on 16 November 2018 if the CMU successfully prequalified following prequalification results day. With the auction scheduled for 5 February 2019 this meant that applicants had to provide credit cover for over 2½ months before the auction and much longer from when an event of default could occur at which point the security deposit could be drawn upon. Providing the level of credit cover required for this length of time is very expensive despite it providing no benefit to the Settlement Body. It is particularly expensive for new build CMUs who are unable to secure the credit cover against the asset that is yet to be constructed and results in a commercial advantage to existing CMUs.

The proposed timetable for the next T-4 auction for delivery year 2023/24 is an auction date of 5-6 March 2020. For this auction the deadline for placing credit cover is 15 November 2019, over 3½ months prior to the auction. This period gives a substantial advantage to existing operators and will exclude some potential applicants from being able to participate. Existing operators with substantial generating assets and balance sheets are able to secure letters of credit at a low cost. New entrants are not able to secure letters of credit and have to place cash on deposit. Placing cash on deposit for 3½ months prior to an auction is very expensive and will be cost prohibitive to some. Other than reducing the number of potential participants and giving an advantage to existing generators there can be no reason for such a long period of time to be required.

In the interests of promoting investment and maximise competition from having the maximum number of participants we would propose that the time between placing credit cover and the auction should be a maximum of four weeks. This is longer than was originally proposed but substantially shorter than currently proposed. Any longer is a disincentive to invest and although interest is paid on the money it falls substantially below the cost of providing the money to merely sit in a bank account from which neither side can benefit.

If the time period is not reduced substantially an explanation for the current proposal should be stated with the ability for interested parties to make comments and observations on the explanation. At the moment it appears to be arbitrary date which does not take into account the cost of money particularly for new entrants.

## **Conclusion**

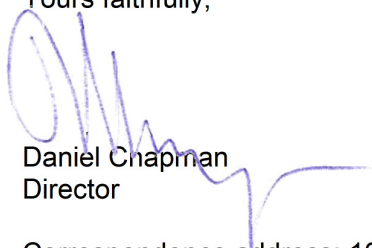
If the dominance of base load stations was reduced, as was anticipated by the introduction of the CM, then there will be a greater likelihood of more competition from generating assets with more flexible equipment with short startup times. This type of asset would be complimentary to the expansion in the amount of renewable generation which could be constructed by freeing up capacity in an already congested electricity network particularly used in conjunction with active network management.

We have no other comments regarding this consultation.

We trust that our comments will be considered on their merits and will not be discounted due to the weight or number of other comments from powerful lobbying groups or other vested interests seeking to maintain the status quo.

The CM needs to deliver new build CMUs from a diverse range of suppliers. This will ultimately open the electricity market to true competition which will ensure that the near monopolistic power of the existing major generating companies (measured by capacity) is reduced and supply companies have more choice from whom to buy the electricity that they supply to homes and businesses. As the vast majority of the price of energy bills is the cost of the energy, only a small proportion relates to the CM payment, and therefore the total cost can be reduced with more competition.

Yours faithfully,



Daniel Chapman  
Director

Correspondence address: 104 Park Street, London W1K 6NF

Email: [danielchapman@skeltongroup.com](mailto:danielchapman@skeltongroup.com)