Drax Group PLC

Drax Power Station

Selby YO8 8PH

28 May 2019

Ofgem

10 South Colonnade, Canary Wharf, London E14 4PU

Attention of Johannes Pelkonen, Harry Parsons and Chris Thackeray

Sent by email to: EMR_CMRules@ofgem.gov.uk

Dear Sir/Madam,

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

Drax Group is a UK based energy company with businesses spanning generation and retail. Drax owns and operates a portfolio of flexible, low carbon and renewable electricity generation assets, providing enough power for the equivalent of more than 8.3 million homes across the UK. The assets include Drax Power Station, based at Selby, North Yorkshire, which is the country's single largest source of renewable electricity. Drax also owns a number of open cycle gas turbine (OCGT) development sites and plans to repower its remaining coal units by converting them into combined cycle gas turbines (CCGTs). These plans will allow Drax to play an important role in supporting a flexible power system that can reliably support wind and solar power generation, however both the OCGTs and CCGTs require support under the Capacity Market to take a final investment decision.

Drax also owns two retail businesses, Haven Power and Opus Energy, which together supply renewable electricity and gas to over 390,000 UK business premises. They are actively engaged in helping business customers with their energy needs, improving efficiency and switching to renewable products.

Please see below our answers to the consultation questions.

Question 1: Do you have any views on the interactions between the CM and other wholesale markets; such as forward markets, the balancing market, and markets for ancillary services?

Ofgem, alongside Government, will have an important role to play in creating the structures and frameworks that will stimulate the necessary investments to allow Britain to meet the energy trilemma (security of supply, decarbonisation and affordability). To ensure 'whole system' outcomes, it is important that market design, delivery mechanisms and regulatory frameworks are aligned,

optimising synergies where possible. Today, the main mechanisms fostering decarbonisation and ensuring security of supply do not consider the growing needs for system flexibility, stability and resilience. Addressing these needs in isolation increases whole system costs for GB consumers.

We believe that, as a priority, a clear, long-term strategy combining system adequacy and system stability needs to be developed, placing more emphasis on the interactions between the CM and the Ancillary Services markets. To achieve this, Ofgem should incentivise the ESO to act in the long-term interest of consumers and provide the ESO with greater confidence over its ability to pursue a mix of short-term and long-term procurement mechanisms. This would reduce risks for consumers and, at the same time, provide clearer investment signals.

To this end, we believe that the procurement of system support/ancillary services must be brought in line with the Capacity Market timescales. Procuring services such as reactive power, inertia/stability or Black Start close to real time, does not change materially the levels of participation. It increases price risks for consumers and fails to provide adequate investment signals. If stackable, long-term ancillary services contracts were tendered and awarded ahead of the Capacity Market auction, then this would ensure capacity is procured in the right locations to support the system and enable flexible assets to bid more keenly in the capacity auction. This would promote efficient investment decisions and drive down costs to consumers.

The pace of change in regard to the ESO's Product Roadmaps has been disappointing to date. Repeated delays in reforming procurement practices for system support services have set back investment decisions and resultant consumer benefits. At a very basic level, we have yet to receive clarity on future Balancing Service product design. In a similar vein, progress by the distribution network operators in their transition to Distribution System Operators has been slow. This transition will increase visibility of network constraints and will allow for more efficient investment in areas where required.

Network charges also require attention. Distortions remain between transmission and distribution connected market participants. Plus, energy flows over interconnectors continue to receive favourable treatment when compared to the charges applied to market participants located in GB. Action is required to level the playing field as part of Ofgem's work on network charging reform and the Cap and Floor regime.

There are a number of issues that remain to be resolved in the wider market as regards interconnectors:

- Robustness of assumptions on firm delivery: further work is required to consider how interconnector flows will interact (coordinated effects) across Europe, particularly as access to thermal generation and increased deployment of intermittent technologies continues across the continent
- Interactions with the Cap and Floor regime: Given the Capacity Market is a scarcity price discovery tool, the mechanism should not be open to projects that are in receipt of a guaranteed floor payment, which negates the need to compete on the same basis as other market participants – those projects with an active Cap and Floor or CfD arrangement should not be permitted to participate in the Capacity Market or, at the very least, should be required to pay back Capacity Market payments where they exceed their permitted "floor" revenues
- Charging arrangements: Energy flows over interconnectors are not charged comparable transmission network access and usage costs to those faced by GB-based generators – action should be taken to level the playing field as part of Ofgem's wider charging reform work

Question 2: Do you have any evidence that design choices in the CM are driving inefficient outcomes in other markets?

As these markets (capacity, low carbon, power and balancing services) cannot function in isolation from one another, it is clear that the lack of alignment in the procurement of these separate requirements for whole system operation will not produce the most efficient outcome.

Question 3: Do you have suggestions for how these markets can be better aligned and how any inefficiencies can be mitigated?

Please see our response to question 1.

Question 4: Do you have any views on whether the proposed membership of the CM Advisory Group is appropriate, the form of participation from industry, along with any further points regarding meeting frequency and function?

We support the incorporation of a CM Advisory Group to assess proposals before Ofgem consults on them, with a view to making the Rule change process more efficient and transparent. We support Ofgem retaining its decision-making power and agree that it should not delegate any of that power to the Advisory Group. We understand that Ofgem would refer all rule change proposals it receives to the committee for consideration, and that they would advise on priorities and make recommendations on individual proposals. Ofgem however would make the final decision as to whether or not to take a proposal forward for consultation. We support monthly meetings however we query whether this would be overly-burdensome for smaller participants. In order to ensure that the CM Advisory Group takes the views of the full spectrum of industry participants into account, we suggest that the Group be open to taking views from market participants who are not on the panel. The meetings of the Group should be required to be fully transparent.

The membership should however be drawn from representatives of capacity engaging in the Capacity Market. It may be preferable to allow trade associations to join, or restrict the larger individual companies to a fixed period of membership to ensure there is no bias. Ideally the committee would want representation from all sectors participating in the CM, however it is not clear if this is practicable. At the very least, there should be a requirement for all members to act independently of their employer (see for example the requirements for Industry CUSC Panel Members).

We would welcome clarification on the proposed window for submitting proposals as it may mean that the bulk of the Advisory Group's activity falls shortly after this window and that meetings do not need to be held on a monthly basis throughout the year. We would also welcome there being a greater period of time between finalisation of the Rules and the start of prequalification so that applicants have a greater period to time to assess the changes and the impacts on their assets/projects. We would also welcome clarification on whether Ofgem plans to continue to consult on a minded-to and then a final position for all rule changes.

We would point out that this does not cure what we believe to be fundamental issues with the rule change process, namely that some changes require regulatory changes which takes parliamentary time. Moving elements of process contained in the Regulations to the Rules and identifying those areas in the Rules that relate to systems administered by the EMR Delivery Body and EMR Settlements Body and moving them into subsidiary documents that enable an industry change process without the

need for a formal Rulebook change would, we believe, streamline the change process by avoiding the need for parliamentary time for relatively minor issues and ensuring system based problems can be resolved efficiently.

Question 5: Do you believe the proposed framework and function of the CM Advisory Group is appropriate and would better facilitate the efficient operation of the CM Rules change process?

Broadly, yes. Please see above.

Question 6: Do you have any feedback on our proposal to move to an 18-month implementation timescale; consulting on rule amendments which would subsequently be implemented the following Delivery Year?

We acknowledge that, under the current regime, the time period between Rule change consultation and implementation is short and creates IT challenges for the delivery body. However, we believe that delaying implementation of all amendments by a year may mean that the Capacity Market is less able to respond to market developments and this may create adverse unintended consequences. We support a two tier approach, where non-urgent amendments are delayed by a year but there is still a process to resolve urgent issues through an urgent Rule change process that can implemented in the period before prequalification. We note that this means effectively that the Rules will change twice a year, with some changes being deferred, however we would not support moving to an 18 month implementation timescale for all changes.

Question 7: Do you have any views on the proposed process, the implications of the change to the Prequalification procedure and whether it would be a positive change in removing an administrative burden?

We support the proposals set out in paragraph 3.11 of the consultation, to enable applications to roll over the details for a CMU from one year to the next. We think however that it should not be left to applicants to determine what is a material amendment, but rather that the delivery body should give detailed guidance which enables applicants to understand where a change to the CMU would require a new application.

We also suggest some further improvements to the prequalification process. There should be a system which allows applicants to appeal issues of interpretations of the Rules to Ofgem. There should also be an opportunity for applicants to correct minor errors, e.g. typos, without this leading to prequal failure. We also continue to support the removal of Regulation 69.

Question 8: Do you believe the current length of the Prequalification window is appropriate and if allowing Prequalification submissions to take place throughout the year would be beneficial?

The prequalification window is short which puts pressure on applicants and the delivery body, particularly where this falls over the Summer period. We would support a longer prequalification window however we think that allowing prequalification submissions to take place throughout the year could create problems for applicants where CM Rules are being updated at the same time. We think there is already significant complexity in working out which vintage of Rules apply to which capacity agreement, and that this could be exacerbated if prequalification and Rules changes are occurring simultaneously.

On the above point, we think it would be extremely helpful if Ofgem could publish a definitive set of Rules for each auction and that Capacity Agreement Notices link specifically to those terms as it is not always clear what vintage of Rules applies to which capacity agreements.

Question 9: Do you have any feedback on the options presented in relation to the submission of planning consents and if there are any alternative options that we have not yet considered?

We support the proposal to halt the coming into force of the end of the deferral option for planning consents. We support Option 2. Our concern with Option 1 is that it could encourage speculative applications. Having planning approval before the auction gives a greater level of delivery assurance than requiring it after agreement award. Option 2 strikes the right balance.

We strongly object to Option 3, as set out in our response to Ofgem's open letter on the 5 Year Review Call for Evidence in October 2018. Where projects are involved in a DCO process, this is a lengthy and complex process, making it difficult to align the DCO application with the end of the prequalification window, particularly when prequalification and auction timelines differ year-on-year. A DCO typically takes 18 months to 2 years to complete and whilst the CM prequalification windows typically takes place during Q3, the precise prequalification timeline is not easily predictable and could result in a project missing prequalification by a matter of days. Allowing projects that are close to obtaining DCO consent to participate encourages competition in the CM and is in the best interests of the consumer.

Question 10: Do you have any feedback on the amendments to the Prequalification data items listed in Table 1?

We support the delay or removal of the items listed in Table 1.

Question 11: Do you believe that removing progress reports and the associated ITE assessments in all cases except those outlined, alleviates the regulatory and administrative burden, while still providing the necessary levels of assurance?

Yes, we support the reduction of expensive regulatory burden on New Build projects and support the proposals put forward by Ofgem in paragraph 4.7 of the Consultation to remove the requirement on participants to submit progress reports and associated ITE assessments.

Question 12: Do you have a view on which of the sub paragraphs of Rule 9.2.6(d)(i) – (ix) should only apply to Eligible Secondary Trading Entrants and which to the other categories of Acceptable Transferees?

To ensure liquidity in secondary trading, the group of acceptable transferees should be as wide as possible. We also think the drafting is particularly complex in this area and it would greatly assist if this could be re-worded and simplified.

Question 13: Is it appropriate to allow all parties who have prequalified for the CM for that year to become prequalified for secondary trading? Are there any unintended consequences?

We support allowing any CMU that has prequalified in any delivery year to be able to secondary trade as we believe this will increase liquidity in secondary trading. We believe that the Rules around secondary trading are complex and that it would be preferable to have a new Rule dealing with the process for bringing "old" prequalification information up to the required level, rather than layering additional complexity into Rule 9.2.6.

Question 14: What form should a register of Acceptable Transferees take? How should it be populated? And who should be responsible for maintaining it?

We believe that the register of Acceptable Transferees should be maintained by National Grid as delivery body, as they are responsible for publishing the Capacity Registers.

Question 15: Do you agree that it would be desirable to allow obligations to be traded between parties in amounts greater than or equal to 0.5MW?

Yes, we support lowering the minimum trading threshold to 0.5MW as this will assist smaller participants.

Question 16: Do you believe the current time period of five Working Days before the date of the trade by which applicants must submit a request to trade is appropriate or should this period be reduced? Do you have any suggestions on a revised length of this period?

We support the reduction of this time period to 2 Working Days, which should assist short term obligation management.

Question 17: Do you believe that the current period of three months in which NGESO have to notify a Secondary Trading Entrant of the Prequalification decision is appropriate or do you feel this should be shortened? Do you have any suggestions on a revised length of this period?

We support a significant reduction in the length of time it takes NGESO to prequalify a potential Secondary Trading Entrant and think that it should be six weeks or possibly less. The sooner that a Secondary Trading Entrant is able to trade, the more liquidity in the market increases. We also support that this should be "no more than" period of time, so that if NGESO can do it quicker, it should be able to. We would point that NGESO is able to prequalify thousands of applicants/CMUs during the 2 month prequalification window and therefore even 6 weeks to do a similar process for a Secondary Trading Entrant seems disproportionately long.

Question 18: Do you agree with adding a provision for the time frame over which NGESO must respond to requests for a trade?

Yes, it is helpful for the timeframes for the step in the process to be clearly defined, to assist parties to plan trading activity.

Question 19: Do you think it is appropriate to extend the defined trading window to the results day of the T-4 Auction for the relevant Delivery Year?

Yes, parties should be able to trade from results day of the T-4 for the relevant Delivery Year. Only allowing trades to be effected after the T-1 auction for the relevant delivery year places an unnecessary restriction on trading and hampers liquidity.

Question 20: Does it continue to be appropriate for Transferors to be required to meet their SCM prior to engaging in trading?

We sympathise with a New Build CMU that wishes to transfer its obligations but is made to wait to meet its SCM before doing so, particularly where this could force a distressed capacity provider into termination. However, we share the concern that removing this requirement altogether could

encourage speculative applications. On balance, we think that this requirement should be lifted, as it would increase liquidity for secondary trading which in turn ensures security of supply.

Question 21: Does it continue to be appropriate for Transferees to be required to meet their SCM prior to engaging in trading?

A New Build CMU is only liable for payments if it has met its Substantial Completion Milestone. It therefore fits that a Transferee should be able to demonstrate that it is capable of delivering capacity and be renumerated for so doing before it is able to take on a secondary trading obligation. Moreover, a transferee should only be able to take on a volume of capacity to the extent that it is able to deliver that capacity. Meeting SCM requires a CMU to deliver at 90% of its capacity obligation and therefore it should only be able to take up on an obligation up to the level it has demonstrated.

Question 22: How should we address the risk of a trade being withdrawn where a Transferor is terminated after a trade has been registered?

We agree that allowing a party to trade out of termination is in the interests of the CM. A trade should be allowed to occur notwithstanding that a Termination Notice has been issued.

Question 23: How should we address the transfer termination risk where a partial or full Capacity Agreement is traded for part of, or the entire duration of a Delivery Year?

If a capacity agreement has been partially transferred for a full delivery year and the transferor is subsequently terminated, the transferee holding the partial obligation should not be terminated. This is a major barrier to secondary trading liquidity as it is impossible for a transferee to mitigate this risk. It is also in the interests of the CM to preserve security of supply. We suggest that if an agreement is partially transferred for a full year, a new CAN could be awarded to the transferee to reflect the amount of capacity transferred and the CAN of the transferor reduced by the same amount.

Question 24: Are there any amendments that could be made to the SPD framework following a secondary trade, specifically relating to partial agreement trades?

We support a clarification of the Rules to provide that if part of the capacity in an agreement is transferred for part of a delivery year, SPDs are only required to the extent of the capacity it has taken on.

Question 25: Do you believe the options presented related to SPD data submission are suitable and are there any options we may not have considered in order to help mitigate the impact on capacity providers?

We do not think that the proposal for providers to self-validate their metered data goes far enough in a situation where a CMU fails its testing requirement as a result of a technical dataflow error between the data aggregator and EMRS. We acknowledge that this will identify potential issues but if this is close in time to the end of the period for submitting SPD data, this may not give time for a CMU to run again and re-submit data. We believe there should be a carve-out that requires that if there is a dataflow issue that is out of a CMU's control which results in a CMU's payments being suspended, when resolved, the CMU should be reimbursed for those missed payments.

Question 26: Which aspects of a CMU configuration do you think should not be able to be amended following Prequalification?

No comment.

Question 27: Is there any other data that would be useful to add to the CMR and why?

We support the inclusion of the details set out in 6.23 of the consultation on the Register. In addition, we think it would be useful to show the amount by which a CMU has traded all or part of its obligation, i.e. the amount of de-rated capacity that a unit holds. Any Secondary Trading Entrants or CMUs that take capacity should also be included on the Register.

Question 28: How should the ALFCO formula be adjusted for Interconnectors when their output is affected by actions by NGESO?

No comment.

Question 29: Should system to generator intertrips be included as a RBS in Schedule 4 to relieve providers of their obligations when affected by such an intertrip?

Yes we support this, however we foresee that the current list of RBS may cease to be appropriate as the ESO evolves the products and services it procures and it may be preferable to specify that any service where the ESO requires a CMU not to generate or to turn down should be captured as a relevant balancing service. Any instruction given by National Grid ESO ("the ESO") to a capacity provider outside of the scope of the CM must be prioritised without penalty. The appropriate action from any energy resource when instructed by the ESO is critical to system security. Therefore, a CMU being available, is being at the disposal of the ESO to maintain statutory limits, and this should be recognised as providing security of supply and not incur penalties.

Question 30: How should we differentiate between firm and non-firm connection agreements at the Distribution level?

We agree with the potential issues identified in the consultation that could result from non-firm distribution connected CMUs participating in the CM on the same basis as a firm connected CMU. Where a supply is interruptible, that asset is more likely to be curtailed when the network is constrained. We think however that further analysis is required here and suggest an expert group should be established to consider the contribution of non-firm assets to security of supply and how to appropriately de-rate such assets, in a similar way to the work was done for renewables participating in the CM. A CMU does not currently have to specify whether its connection is firm or not and this should also be addressed so that connection arrangements are clearly classified and de-rated appropriately.

Question 31: How should Distribution-connected generators with non-firm connection agreements be de-rated to accurately account for their contribution in a stress event?

See above.

Question 32: Do NGESO's current financial incentives on demand forecasting accuracy, dispute resolution, DSR Prequalification, and customer and stakeholder satisfaction drive the intended behaviours by NGESO?

We believe that the financial incentives framework should move away from the use of targeted mechanistic incentives towards a broader, evaluative approach, in line with the new ESO regulatory framework. The new framework should set out in a clear manner principles, outcomes and behaviours expected by NGESO. As is the case for the ESO, it should also include a requirement for a Forward Plan, which will set out specific performance metrics to demonstrate how each of the roles and principles will be fulfilled.

The move towards broader evaluative incentives combined with ambitious performance metrics should reduce risks that come with mechanistic approaches, such as potentially gameable incentives for demand forecasting accuracy. It should also encourage the NGESO to take a wider approach towards enabling a range of new market participants to engage with in the CM rather than focussing specifically on DSR Prequalification. The framework should place more emphasis on incentivising the NGESO to achieve a higher standard of customer service. This should involve considering the appropriate level of the incentive, as well as introducing a more comprehensive process for gathering feedback on customer satisfaction, similar to process introduced with the Performance Panel for the ESO.

Question 33: Do the financial incentives listed above remain fit for purpose?

See above (question 32).

Question 34: What behaviours and outcomes should NGESO's financial incentives drive? What form should these incentives take?

As elaborated in our response to question 1, we believe that NGESO should be incentivised to adopt a long-term, holistic approach towards addressing system needs. This would involve placing more focus on the interactions between the ancillary services markets and the CM.

In addition, we consider that financial incentives should enable the NGESO to strike a balance between applying CM rules effectively during the prequalification process and maximising liquidity and competition in the respective auctions. Also, as mentioned above, greater emphasis should be placed on incentivising the NGESO to achieve a higher standard of customer service, including making the necessary IT improvements to transform customer experience.

Question 35: Do you agree that a demand forecasting accuracy incentive remains appropriate?

See above (question 32).

Question 36: Do you agree that the dispute resolution incentive should be based on a proportion of Prequalification or Reconsidered Decisions overturned by the Authority rather than on the absolute number?

Yes, we agree that the dispute resolution incentive should be based on the proportion of Reconsidered Decisions overturned by the Authority. The level of overturned Decisions chosen should consider wider objectives that also drive efficient outcomes for consumers, such as the overall liquidity of the auction.

Question 37: Do you agree that the DSR Prequalification incentive should be replaced by an incentive intended to drive NGESO to aid smaller providers, new entrants, and innovators navigate the CM?

As elaborated in our response to question 32, we consider that the incentives framework should move away from the use of targeted mechanistic incentives towards a broader, evaluative approach. Good customer service should be at the heart of that framework and a baseline requirement. The incentives framework could reward NGESO only if it exceeds the baseline requirements in this area.

As part of this, the NGESO should be incentivised to aid a range of smaller providers, new entrants, and innovators to navigate the CM, rather than focussing specifically on DSR Prequalification. This would reflect better the diversity of new technologies and business models.

Question 38: Do you agree that an incentive on NGESO's customer service and stakeholder engagement remains appropriate? What form should this incentive take?

Driving excellent customer service and stakeholder engagement should be at the heart of the incentives framework. Good performance in this area should be a baseline requirement. The incentives framework could reward NGESO where baseline requirements are exceeded. The incentive should be comprehensive enough to cover end-to-end customer experience. The incentives need to be aligned with the ESO's incentives framework, which provides a more thorough and robust process for collecting collect feedback and evidence compared to the current method use to gather feedback for the EMR Delivery Body.

Question 39: Do you agree that the incentives on NGESO for delivering the CM should be aligned with NGESO's incentive framework? Should the CM incentives be incorporated into NGESO's incentive framework in the longer term?

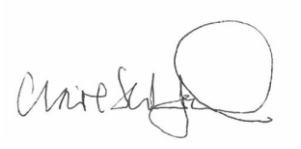
We support the alignment of the CM incentives with the NGESO's incentive framework. Further analysis and evidence would be needed to inform our view on whether full incorporation of the CM incentives into NGESO's incentives framework would be in the interests of GB consumers.

Question 40: Does the separation of the EMR Delivery Body from NGESO continue to remain appropriate given the separation of NGESO from the rest of NGESO plc?

Further analysis and evidence would be required to inform our view on whether full incorporation of the CM incentives into NGESO's incentives framework would be in the interests of GB consumers. A prerequisite for a potential integration would be to ensure that the necessary measures restricting access to commercially sensitive information were put in place.

If you have any queries on any of the above, please do get in touch.

Yours sincerely,



For and on behalf of Drax Group PLC