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Dear Adam,

Energy Market Reform: Statutory Consultation on changes to the Capacity Market Rules

Drax Power Limited ("Drax") is the operating subsidiary of Drax Group plc and the owner and operator of Drax Power Station in North Yorkshire. The 4,000MW station consists of six separate units which together produce around 7-8% of UK generation, mainly fuelled by coal. However, largely in response to the policies implemented by Government to meet its climate change objectives, Drax is currently embarking on an ambitious project to convert at least half of this capacity to 100% biomass with two units already converted.

We welcome this opportunity to comment on the proposals and Ofgem's minded-to decisions. Our answers to the questions raised by the consultation can be found in the Annex, along with additional comments on a select number of the proposals detailed in the consultation document.

We wish to highlight that we believe the Qualifying Capital Expenditure period start date for both New Build and Refurbishing CMUs should be set at the relevant Auction Results day. This will maximise competition in the auction and ensure economic efficiency in the Capacity Market arrangements. This is because it will ensure that Capacity Market participants only consider future costs and as such take investment decisions on the merits of the specific economic opportunity presented. These changes should be implemented in 2015 and should apply for the 2015 Capacity Market Auction.

If you would like to discuss any of the views expressed in this response, please feel free to contact me.

Yours sincerely,

By email

Cem Suleyman
Regulation and Policy

Annex

Q1. CP06, CP25, CP34, CP41 and CP50: Qualifying Capital Expenditure for New Build CMU: We invite stakeholders to provide us with information, and factors, backed up with evidence as far as possible, that we should take into account in considering: When should the Rules be amended to introduce the period for qualifying expenditure of 77 months prior to the start of the relevant delivery year?

The rules as initially drafted were determined so as to prevent an investment hiatus ahead of the first Capacity Market Auction. The conditions underpinning the previous Qualifying Capital Expenditure (QCE) period start date definition have ceased to apply and new arrangements are required to promote the efficient and competitive procurement of capacity. We consider that a QCE period start date should be no more than 77 months (absolute maximum) prior to the start of the relevant delivery year and ideally should be far shorter.

To maximise effective competition in the auction we consider that QCE should only refer to future costs, not historic costs. It is a well understood economic principle that costs once sunk should not influence future investment decisions. This ensures that economic actors take investment decisions on the merits of the specific opportunity presented. In addition, to allow historic costs to be eligible as QCE would appear to be inconsistent with the Environmental and Energy State Aid Guidelines.

The four year ahead auction was introduced to provide all technologies, new and existing, the ability to take part in the auction. It should not therefore be necessary for projects to need to recover historic costs to allow participation in the auction. As such our preference is for the implementation of a change in 2015 that would set the QCE period start date on the relevant auction results day, i.e. spend will only qualify between Auction Results day and the start of the Delivery Year. This will provide a QCE period of approximately 45 months for the 2015 auction.

In addition, Ofgem may wish to consider discussing with DECC how best to schedule the auction in future years so as to ensure that an appropriate QCE period is set. We note that the current Regulations allow the 2015 auction to take place as late as July 2016. We consider that approximately 45 months should be the minimum appropriate QCE period.

Q2. CP01, CP07, CP25, CP34, CP41 and CP50 Qualifying Capital Expenditure for Refurbishing CMU: We invite stakeholders to provide us with information, and factors, backed up with evidence as far as possible, that we should take into account in considering: (i) Should the starting point for qualifying refurbishing expenditure be prequalification results day or auction results day? (ii) Should this new starting point apply from 2016?

We consider that the same arguments made above with reference to the treatment of sunk costs for the QCE for New Build CMUs also apply to Refurbishing CMUs. In addition the new requirement introduced by DECC to mandate an additional declaration to the Prequalification Certificate¹ means that in practice capacity providers should only consider future costs as part of their QCE. As such we consider that the start date for the QCE period should be auction results day and this should be implemented in 2015. This will ensure consistency with the QCE period starting date for New Build CMUs, facilitating a level playing field and thus effective competition.

Q3. CP69: Do you have any views on whether and how the Rules should be amended to prevent applicants being able to provide a calculation of connection capacity close to the value of entry capacity in the manner described in CP69?

We have no comments to make on CP69 and we have no strong preference either way.

¹ Capacity Market (Amendment) Rules 2015, Amendment of Exhibit A p82

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/418103/Capacity_Market_Amendment_Rules_2015_-_draft_for_publication.pdf

Q4. CP74: Do you agree that duration bid amendments should only be allowed to reduce during the auction?

We believe it would be premature to make any changes related to duration bid amendments. Such changes should only be made once DECC has decided whether it will implement a Price Duration Curve methodology.

Q5. CP46: Do you believe that DSR CMUs should be able to add, remove and reallocate CMUs? Please explain your answer. Do you think there are potential downside risks to this, as we describe above? If so, how would you suggest we mitigate these downside risks?

This depends on clarifying under which circumstances such an option will apply. For example replacement of failed units may be prudent, but there may also be the potential for units to be swapped to circumvent the testing provisions.

Q6. CP24: Do you have any reasons or evidence for why we should not also include OC.6.7 as a form of load reduction in the definition of Involuntary Load Reduction (in addition to our proposal to make the amendment suggested by CP24)?

If the change is made it should only apply from the 2019/20 delivery year as parties will not have been able to take into account the increased risk of system stress events in their bidding strategies for the 2014 auction.

Q7. CP49: Do you have any evidence to show that CHP is failing to prequalify or that there would be benefits to allowing embedded generation to bid as a DSR component?

We do not have any views of this question.

Comments on other specific proposals

CP23 – proposal to remove requirement for a Legal Opinion on the legal status of the applicant

We don't believe it is possible to use last year's legal opinion as it will be specific to the year in which it was submitted. As such we believe that Ofgem should reconsider its initial decision and approve the proposal.

CP31 – proposal to give the Delivery Body discretion in determining CMU prequalification

We strongly agree with Ofgem's initial decision that this proposal should be rejected.

CP05, CP10 and CP15 – proposal to publish bidding round data and auction round results

We strongly disagree with Ofgem's initial decision to reject this proposal. Whilst of course transparency is not an end in itself, we consider that providing enhanced transparency of auction price development would aid effective competition. Creating subsets of market participant, e.g. those that have price sensitive information and those that do not, is not conducive to promoting competition. If all parties have access to the same price sensitive data in similar timescales, i.e. those participating in the auction and those that are not, then the arrangements are likely to promote a more efficient wholesale market. This approach would also be consistent with the treatment of inside information under REMIT.

CP51 & CP53 – proposal to raise the termination fee for New Build CMUs from TF1 to TF2

We continue to believe that there should be equivalent termination fees for existing and new plant. The level of termination fee for new build prior to financial closure is too low and is likely to promote inefficient entry to the auction. Increasing the TF1 level to that of TF2 will promote effective competition by ensuring only those projects that are able to make a firm commitment bid in the auction. This is required to ensure there is no distortion of the market price discovery process, which is the aim of the auction.

CP76 – proposal to add a method of price indexation for total project spend

We consider that it would be helpful to clarify this. Changes which improve clarification, only requires a minor amendment to the Rules; however, the benefits are much greater in that they provide certainty, improve understanding and deliver less complex arrangements. For example, there should be clarity and consistency on how the three and fifteen year minimum £/kW thresholds are to be indexed.

CP29 – proposal to add Ofgem and the CMA to the list of bodies that can be provided with Capacity Market Confidential Information

We believe that it would be sensible to add the CMA to the list of bodies in Exhibit C considering that it is a body which has the power to compel disclosure of confidential information. We do not understand the reasoning for not doing so and request that Ofgem clarifies its justification.

Further Comments

In addition, we note that the amendments to Exhibit A (Form of Prequalification Certificate) in the Draft Capacity Market (Amendment) Rules 2015 appears to require a further minor amendment. The text appears to be missing square brackets around the insertion, which is required in order to provide an option in making a refurbishment declaration. As drafted, it appears that all parties would be required to prequalify as a refurbishing plant, regardless of whether they plan to bid for three year contract or not.