05 May 2015

Dear Mr. Cooper,

Green Frog Power welcomes the opportunity to comment on Ofgem's decisions and response to industry Capacity Market Rule change suggestions. In future years, with more accommodating timetables, we look forward to increased industry engagement with Ofgem in the development of the Rule changes to ensure that the complexities are fully fleshed out.

While we can see that, in some circumstances, implementing changes for the 2015 auction is impractical, we think that Ofgem should, in general, implement changes as soon as possible. Where the requirement for a change is recognized, it is difficult to see why the change should be delayed, if for no reason other than to avoid confusion about policy intent.

Yours faithfully,

Graz Macdonald
Head of Regulatory and Policy Analysis
Green Frog Power Limited

Question 1: 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 delivery year?

We agree it is important to limit the period over which capital expenditure can apply toward a longer-term agreement. In deciding the time period that should apply, we think the following factors should be taken into consideration:

i. The length of time used in the 2014 auction, taking into account the reasons for that choice
ii. The number of months that is in keeping with the spirit of the intent of longer-term agreements.
iii. How long it takes a plant to be built, taking into account that the capacity market is a forward looking mechanism, intended to incentivise investment. It is not designed or intended to reward past investment.
iv. The number of months that will limit the ability of auction participants to attempt to manipulate an auction outcome

We understand that the reason for the existing period was to accomodate expenditure that occurred after the announcement of the capacity mechanism and to account for the time it would take to develop the capacity market (just over two years from the announcement to the beginning of the first prequalification period). DECC have stated that the date chosen was for this purpose.

The intent of longer-term agreements is to enable larger levels of capital expenditure required for major works and/or new build. These longer-term agreements reduce the regulatory and capacity market price risk that would be associated with shorter agreements, thereby enabling projects to clear at a lower price than they otherwise would.

Taking the two above considerations into account, it would seem fair that the first capacity auction would permit a plant to include expenditure that was incurred over

a longer period of time – starting from when they could have been reasonably assured that their project would be derisked by a longer term agreement in the capacity mechanism.

However, after completion of the first auction, we think conditions have changed.

A project that has spent a significant amount of capital over the past seven years and yet still remains unbuilt is not likely to be a project that will be in the best interests of consumers to further develop.

For a project that spent a significant amount of money over the past seven years and is built – it begs the question of why a longer-term agreement was not won in the 2014 auction – all expenses are sunk, and the only option now for operation in the first delivery year is through the T-1 or secondary trading. As these options are risky and do not offer the option of a 15-year agreement, then it seems that any plant in this situation has already had a chance to indicate that it does not require a 15-year (or possibly even a one-year) agreement to deliver the capacity.

In fact, we think that any plant that partook in the auction but left without an agreement determined that they were unable to provide capacity at the clearing price. Given that past expenditure is a sunk cost in economic analysis (certainly from a competitive standpoint), it seems that any plant that did not already take an agreement must have felt that they were better off without an agreement (and a 15-year income stream) than they were with a 15-year income stream.

We do not agree with the 2017 start – why delay? We think that the qualifying date should be moved for the 2015 auction. Though from a purist perspective we think that 48 months is more than sufficient, we accept that timings might be more fluid, or auctions could be delayed, or other unforeseen circumstances may warrant some flexibility. For these reasons we think that the window should be shortened to 12 months prior to the T-4 prequalification window

Question 2, 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?

Green Frog Power think that Auction Results day is the appropriate starting point for qualifying expenditure. The Applicant knows that the project is viable and financeable on Auction Results day. We think that a forward-looking approach for the Capacity Market, to the extent practical in such a complex environment, is the underpinning policy intent and that this is best achieved by permitting expenditure that is incurred after the auction is won.

We are not certain why Ofgem is proposing to delay the implementation of this proposed rule to the 2016 auction or later. We think that staggering the rule changes for Refurbishing plant (DECC's changes for the 2015 auction and Ofgem's changes at a later date) will serve no clear or useful purpose.

Question 3, CP69: Do you have any views on whether and how the rules should be amended to avoid the possibility of applicants being able to provide a calculation of connection capacity close to the value of entry capacity in the manner described in CP69?

We agree that this issue should be addressed. Under the current rules it is possible that some parties are being rewarded more handsomely than others by virtue of long-standing Connection Entry Capacity (CEC) Agreements. However, we note that this is only likely to occur where a plant carries a higher Transmission Entry Capacity (TEC) than CEC, which is most likely to happen where TEC costs are zero or negative.

In our view, the optimal solution is to permit Applicants to choose their own capacity to include in the capacity mechanism, capped by the highest generated outputs over the previous two or three years. We think the testing and penalty risk

is sufficient to limit the slim potential for over-stating capacity. An extra protection could be to require that the testing needs to be completed up to the non-derated capacity level. The risk of under-representing capacity is very low, given the lost Capacity Market revenue this strategy would incur.

Question 4, CP74: Do you agree that duration bid amendments should only be allowed to reduce during the auction?

We are aware that DECC are working on a Price Duration Curve design. Until this design has been made public, we are unable to definitively answer this question.

The above comment notwithstanding, we think it best to permit parties to increase or decrease the duration of their bids as the auction price descends. This will permit bidders with different preferences for higher price/shorter duration or lower price/longer duration etc., to optimise their bidding strategies and facilitate aggressive competition.

Question 5, 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?

Though not yet finalised, we believe that the trading mechanisms within the Capacity Market Rules, combined with the ability for DSR CMUs to choose their deratings should be sufficient risk management tools for DSR CMUs and will keep DSR on an even footing with generation CMUs.

Question 6, CP24: Do you have any reasons or evidence for why we should not also include OC6.7 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)?

We do not agree that an Emergency Manual Disconnection (OC6.7) should be included in the definition of Involuntary Load Reduction. It is not clear that OC6.7 is related to a System Stress Event, but rather than an isolated event unrelated to overall sufficiency of supply.

We cautiously agree with the CP24 proposal to include Automatic Low Frequency Demand Disconnections (OC6.6). We agree that OC6.6 is likely in keeping with the policy intent. However, we think that this Rule change should not apply for the first Delivery Year. With the auction completed, bidders will have assessed their risk of System Stress Events on a different definition and we believe it would be against the spirit of policy intent to alter the risk profile after capacities have bid on their obligations.

Question 7, 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?

No comment.

Other comments:

Proposal CP19

Energy UK proposed to add to the Rules a definition of the word “day”. Ofgem have rejected this proposal based on their view that a common understanding of the word “day” is sufficient. We do not believe that this is true in the context of the electricity market, where the “day” starts at 11pm. Therefore we ask Ofgem to reconsider this decision.

Proposal CP27

E.ON proposed that generating units that are legally required to close prior to the Delivery Year should not need to meet the prequalification requirements of a Mandatory CMU. Ofgem have decided to reject this proposal based on their opinion that the administrative burden is not significant and that the information provided to National Grid is useful for their supply side analysis.

We worry about the justification that Ofgem has provided for rejecting this proposal (though we are indifferent to whether this proposal is accepted or rejected). We think that if data is to be spuriously gathered for the purposes of analysis, that the requirement to provide this data for this purpose should be made explicit in the Regulations.

Otherwise, it appears that Rules (and Regulations) ostensibly intended for a particular purpose, are hijacked for other uses. Even though this particular information provision may not be particularly problematic from a data collection and/or privacy concern (i.e., LCPD opt-out data are publically available), the use of data collection considerations as a primary, or indeed even a secondary reason for otherwise redundant rule retentions is problematic, and sets a potentially unacceptable precedent.

Proposal CP03

RWE proposed that an Agent should not be restricted from acting for more than one Applicant CMU. Ofgem have rejected this proposal, citing confidentiality concerns. We disagree that there needs to be confidentiality issues should an Agent represent more than one Applicant. If, for example, an Agent were acting for several generating CMUs in the same way that a DSR aggregator acts for several components of DSR CMUs. While this adaptation would be similar to the Rule adjustment made by DECC allowing aggregation of generating CMUs by a dispatch

controller, we think that the distinction of dispatch controller is unnecessary, as private contractual terms should be sufficient, given that the “Agent” would be exposed to penalties through Capacity Agreements.

Proposal CP23

Energy UK proposed that the requirement for a Legal Opinion should be removed. The argument provided was that the Legal Opinion was only valid for the day it was made and that obtaining it involved significant costs for all Applicants.

Ofgem rejected this proposal based on their view that it is vital for determining eligibility. We are not certain that this is required for determining eligibility. We are however certain that requiring a Legal Opinion every year adds costs and complexity for what appears to be little gain. It is our understanding that legal opinion has been offered to some industry participants suggesting that the Legal Opinion as submitted during Prequalification is not necessarily valid in the following Prequalification. Therefore parties will incur costs of repeating this costly exercise year after year for little or no discernible benefit.

Ofgem have rejected a number of proposals that suggested clarifications of the Rules. The reasons given for the rejections are predominately that Ofgem felt that clarity was not required. We would request that these rejections are reconsidered on the basis that the clarity is not universally agreed. Some examples are:

- CP21 regarding clarification of requirements for opt-out notifications
- CP55 regarding the clearing algorithm in the event of a zero clearing price. Though DECC has stated their preference, we do not agree that a statement is sufficient, as it can get archived or lost through time.
- CP76 regarding the addition of a method for indexing total project spend
- CP14 regarding the most recent Capacity Report