Rupert Steele OBE
Director of Regulation

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5 May 2015

Dear Adam,

EMR: Statutory consultation on changes to the Capacity Market Rules pursuant to Regulation 79 of the Capacity Market Regulations 2014

Thank you for the opportunity to respond to the above Consultation. We welcome the fact that Ofgem is proposing to implement a number of Capacity Market (CM) Rule changes under Regulation 79 of the Capacity Market Regulations.

In particular, we strongly support Ofgem's proposal to address the time period during which capital spend might count as 'Qualifying Capital Expenditure' for a New Build CMU. The current position (i.e. a start date of 1 May 2012) was clearly set as a transitional trigger for the first CM auction and we agree that this needs to be replaced by a future-proofed qualifying period. It is important that the enduring approach should make sense within the context of the design of the capacity mechanism, and that any transitional issues for particular projects dealt with separately. Accordingly, we consider that the 77 month period is much too long; it would be better to address any transitional issues by delaying the new rules until 2016..

More generally, we note that Ofgem's approach is to make limited changes taking into account that it was the first year of the Capacity Mechanism and not all of the CM Rules have been tested as yet. As a result, a number of important issues are proposed not to be pursued at this stage. We think it could have been helpful to have held a workshop where the case for the various proposals could have been debated and would like to suggest that in future this step is inserted between the nomination of rule changes and Ofgem's consultation. We would also suggest that, where improvements can be identified, it is not always necessary to wait for the Rule in question to be tested.

Specifically, we remain of the view that our proposals in the following areas should be implemented:

<u>Capacity Agreements – Strengthening the disincentive for non-delivery of New Build CMU</u>

In being minded to reject our CP51 and CP53[1] proposals, it is suggested in the Consultation document that existing arrangements are yet to be tested, and that these proposals do not indicate a loop-hole that needs to be filled has been found.

1 Both of these proposals suggested changes to the Termination Fee regime for New Build CMUs.

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- However, we do not consider that a problem has to actually come to fruition before changes to the Rules will be contemplated. The possibility that speculative projects may win contracts (and whether the existing measures to prevent this are sufficient) is something which should be addressed based on the foreseeability of the problem. We consider that effective operation and administration of the CM means that the aim should be to prevent problems from occurring rather than simply reacting to them.

- In this context, we welcome the indication from DECC in its response[2] to its recent Consultation on possible changes to the CM Regulations and/or Rules that it plans to consider the possible strengthening of the incentives around delivery through a further consultation in the autumn.

Pre-qualification Information – alternatives to conventional TEC considered adequate by Delivery Body (CP52)

In being minded to reject our CP52 proposal, it is suggested in the Consultation document that permitted connection agreements for the Capacity Market should be made to reflect existing arrangements not anticipated arrangements.

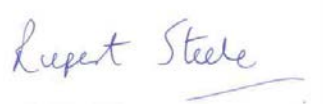
- However, by locking in the existing connection arrangements, the current Rules could prevent innovation since any party wanting both a new type of connection and a capacity agreement would need to await a specific CM rule change before accepting the new arrangement with NGET. Moreover, the current Rules do not allow for circumstances where the TEC changes over time.

- Our proposal suggested that during pre-qualification participants could, in conjunction with National Grid, demonstrate to the Delivery Body that it would have adequate access to the system prior to the commencement of the relevant Delivery Year. We consider that this approach would deal with the issues above without affecting the robustness of the process.

Lastly, since raising our change proposals it has also come to our attention that there is no system to transfer CMUs from one legal entity to another after pre-qualification and before Capacity Agreement Notices are issued, even within group companies. This means that there may be a period of five months of a year where a CMU transfer is not possible. We believe this is very restrictive and merits further consideration to allow for a more efficient operation of the CM.

We have provided our responses to the specific questions in the attached Annex. Should you have any questions in relation to our response, please do not hesitate to contact me.

Yours sincerely,



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[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/412934/Government_Response_to_Feb2015_consultation_on_amendments_to_the_CM_Reg.pdf, Page 19

ANNEX A

Electricity Market Reform (EMR): Statutory consultation on changes to the Capacity Market Rules

SCOTTISHPOWER RESPONSE

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?

We understand that the 1 May 2012 date is based on the timing of the decision to re-introduce a capacity mechanism in to the GB market and the fact that some investors had just committed to new build projects. Whilst we supported the rationale for the '1 May 2012' approach, the implied 77 month time period is not related to expected project expenditure timescales. We do not believe that it was ever the intent for the 77 month period to be considered as part of an enduring solution. We believe that the vast majority of the expenditure (the exceptions being buying land, developing consents and obtaining connection agreements) will occur in a four year period between the T-4 auction result day and the delivery year.

As per our proposal CP50, we believe that the hard coded date of 1 May 2012 for accounting for the total amount of qualifying capital expenditure for New Build CMU should be replaced by a reference to the pre-qualification date for the T-4 auction. However, we also consider that there should be no time bounds on the inclusion of costs associated with buying land, developing consents and obtaining connection agreements (if needed to meet the £250/kw threshold), as they can occur many years earlier.

Given, the spirit of the original 1 May 2012 commitment, the outcome of the first capacity auction, we believe that the rule change should be implemented no later than in time for the 2016 auction. This should allow any transitional issues for investors who had just committed at 1 May 2012 to be dealt with.

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 agree that these changes should be made. Further, we consider that the changes should be made in time for the 2015 CM auction so as to coincide with the introduction of DECC's changes to the CM Rules which will prescribe Directors' Certification in respect of the requirement for a Capacity Agreement exceeding one year. In our view, the starting point for 'Qualifying Capital Expenditure' for Refurbishing CMU should the auction results

day since we believe that this type of investment will only be made once participants have certainty that a CM Agreement will be awarded.

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?

This is a problem that we have considered, and, from our own experience under the original process, we recognise that there is not a straightforward solution. Accordingly, we support the suggestion that Ofgem should undertake further work in this area before deciding on any action. Wherever possible, Ofgem should engage with the industry as their thinking in this area develops further.

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

We consider that any changes to the Rules in this area should not be made before DECC's own work relating to Price Duration Curves is concluded.

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?

Although DSR CMUs are smaller in size, we believe that it is important that the exit and entry of components of CMUs is transparent to the market. Accordingly, we believe that appropriate transparent trading arrangements for components of DSR CMUs should be put in place.

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)?

We agree this change should be implemented. However, some specific Emergency Manual Disconnections should be excluded to avoid overstating the Load Following Capacity Obligation and capacity providers paying non-delivery penalties where there is no true system stress event.

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 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; others may be better placed to comment.