

RESPONSE TO OFGEM STATUTORY CONSULTATION ON CHANGES TO THE CAPACITY MARKET RULES, MAY 2017

Eggborough Power Limited ('EPL') owns and operates Eggborough Power Station, a 2,000 MW coal-fired power station in Yorkshire. In 2015, EPL was purchased by Energetický a Průmyslový Holding ('EPH'), a major European energy and utilities group based in the Czech Republic. Eggborough Power Station holds a Capacity Agreement for the 2017/18 Delivery Year. In 2016, EPL announced a project to develop a new CCGT on the Eggborough site, replacing the existing coal-fired coal power station from the early 2020s.

We welcome the opportunity to respond to Ofgem's consultation on proposed changes to the Capacity Market Rules. We have provided comments below on those proposals where we do not agree with Ofgem's minded to decision or would like to offer additional comments.

CP190 – Removal of ability to defer provision of Relevant Planning Consents

We do not consider that this change should be implemented as there is evidence to suggest that the ability to defer the provision of Relevant Planning Consents at prequalification increases liquidity in the auction and reduces the overall cost of the Capacity Market to consumers, which is not recognised in the CP190 proposal or Ofgem's analysis. We have the following comments on Ofgem's position:

1. *'we have received new evidence which suggests the costs of deferral outweigh any benefits'*

If this evidence has been received, it is not presented in National Grid's Rule change proposal or Ofgem's consultation document. The National Grid proposal simply states that, if CMUs which had deferred provision of Relevant Planning Consents in the 2016 prequalification round and did not subsequently provide these consents had been prevented from prequalifying, 'the Delivery Body expects to have saved in excess of 500 hours work'.

However, our analysis of the Capacity Market Registers suggests that the ability to defer the provision of planning consents has led to increased participation of CMUs in all capacity auctions to date and, as some CMUs which utilised the ability to defer the provision of planning consents eventually received a Capacity Agreement, this has led to a lower clearing price than if these CMUs had not participated in the auctions.

Ofgem asserts that 'While in theory allowing participants to defer submitting planning consent until after prequalification may increase participation, evidence suggests this does not happen in practice'. However, this is not consistent with the evidence we have seen. For example, the Capacity Market Register shows that in the T-4 auction for the 2020/21 Delivery Year, 439 CMUs with a total derated capacity of 8,766.738 MW utilised the ability to defer provision of planning consents, which is equivalent to 47% of all new build capacity that prequalified for the auction. 1,834.974 MW of the capacity which had deferred provision of the Relevant Planning Consents eventually secured a Capacity Agreement. This capacity included the only new CCGT to receive a Capacity Agreement (Kings Lynn A).

We have used publicly available data to calculate the increase in clearing prices in the previous three auctions that would have resulted from CMUs not being able to defer the provision of planning consents (see tables below). Our analysis suggests that the auction clearing prices would have increased by between £0.37/kW and over £2.00/kW.

We estimate that the ability to defer the provision of Relevant Planning Consents under Rule 3.7.1(a)(i) has therefore resulted in a total saving to consumers of £203 million to date. Even if there had only been a £0.01/kW increase in the clearing price in each auction had these CMUs not participated, this would represent a £2 million increase in cost to consumers.

To compare with the evidence provided by National Grid in its Rule change proposal, we estimate that the saving to consumers resulting from the ability to defer the provision of planning consents during the 2016 prequalification process (T-4 and early auction) is £82.75 million, compared to an additional administrative burden of 500 hours on the Delivery Body. For the cost of deferral to outweigh any benefits, the cost of the Delivery Body undertaking additional prequalification activities would need to be over £165,000 per hour. We doubt that this is the case; but, if it is, Ofgem should undertake an immediate review of the cost-effectiveness of the Delivery Body's operation.

Calculation of the increase in clearing price that would have resulted without Rule 3.7.1(a)(i)¹

Auction	Maximum capacity withdrawing in final round (MW)	Drop in clearing price in final round (£/kW)	Implied increase in clearing price in final round (£/kW/MW)	Successful capacity deferring planning consents (MW)	Estimated increase in clearing price without deferral of planning consents (£/kW)
2015 T-4	199.185	2.00	0.01004	298.746	2.00
2016 T-4	6,509.391	2.50	0.00038	1,834.974	0.70
2017 EA	1,462.283	3.05	0.00209	178.384	0.37

NB: data on CMUs utilising Rule 3.7.1(a)(i) is not available in respect of the 2014 auction.

Calculation of saving to consumers associated with Rule 3.7.1(a)(i)

Capacity contracted in each auction by Delivery Year (MW)				
Delivery Year	T-4 2019/20	T-4 2020/21	EA 2017/18	
2017	-	-	54,433.634	
2018	-	-	-	
2019	46,353.569	-	-	
2020	982.520	52,425.302	-	
2021	982.520	2,648.756	-	
2022	982.520	2,648.756	-	
2023	982.520	2,648.756	-	
2024	982.520	2,648.756	-	
2025	982.520	2,648.756	-	

¹ eg. in the 2016 T-4 auction, 1,835 MW of capacity which deferred provision of planning consents eventually secured a Capacity Agreement. If this capacity had not participated in the auction, a similar quantity of capacity which withdrew above the clearing price would have to have been procured instead. 6,500 MW of capacity exited in the final round of the auction, causing the clearing price to drop by £2.50/kW in that round. Using a simple average, each additional MW of capacity that could have been procured in that round would have cost £0.00038/kW. Replacing the 1,835 MW of capacity in that round would therefore have increased the clearing price by £0.70/kW.

2026	982.520	2,648.756	-
2027	982.520	2,648.756	-
2028	982.520	2,648.756	-
2029	982.520	2,648.756	-
2030	982.520	2,648.756	-
2031	982.520	2,648.756	-
2032	982.520	2,648.756	-
2033	969.600	2,615.359	-
2034	-	2,615.359	-
Total	60,095.929	89,441.092	54,433.634
Increase in Clearing Price without Rule 3.7.1(a) (£/kW)	2.00	0.70	0.37
Total saving to consumers associated with Rule 3.7.1(a)	£120,191,858.00	£62,608,764.40	£20,140,444.58

2. *'the majority of conditionally prequalified applicants who chose to defer planning consent submissions in the most recent round ultimately failed to submit them and therefore failed to prequalify for the auction'*

Our analysis of the Registers shows that for the 2016 T-4 auction 439 CMUs with a total capacity of 8,766.738 MW utilised the ability to defer planning consents during prequalification. 268 CMUs with a total capacity of 4,555.113 MW did not eventually submit the required planning consents by 22 Working Days before the auction, meaning that 52% of the capacity that utilised Rule 3.7.1(a)(i) failed to prequalify. As 46% of the capacity that utilised Rule 3.7.1(a)(i) went on to participate in the auction, we do not accept Ofgem's argument that 'there is little benefit in practice' to the use of this Rule.

It should be noted that the fact that a CMU failed to provide evidence of its Relevant Planning Consents does not necessarily mean that it had failed to obtain these consents by the deadline. All new build CMUs have the ability to withdraw from the auction without penalty up to 10 Working Days before it begins and some may have utilised the planning consents deadline as an opportunity to withdraw from the auction for other reasons (for example, new information on the likely outcome of the CMP264/265 modifications). So long as the ability for new build CMUs to withdraw from the auction before it begins remains, there is a risk that the Delivery Body may have to spend time and resource prequalifying plant which will not eventually participate in the auction. As the level of capacity that may participate in the auction will remain subject to change until 10 working days ahead, we do not agree with National Grid's assertion that removing the option to defer the provision of planning consents will 'provide an earlier indication of liquidity for all auctions'.

We do recognise, however, that there is a risk that some CMUs which utilise the ability to defer provision of Relevant Planning Consents may never stand a realistic chance of obtaining those consents by 22 Working Days before the auction. We are not in a position to quantify this risk, but we consider it to be low relative to the benefits of

allowing all New Build CMUs the option to defer the provision of planning consents. However, we consider that, if necessary, this risk could be mitigated through the following amendments to the Rules:

- (a) Requiring any applicant utilising Rule 3.7.1(a)(i) to declare at the point of making its capacity market application that it has submitted a planning application for the Relevant Planning Consents and to provide evidence of this. This would prevent “speculative” plant from conditionally prequalifying; or
- (b) Applying a financial penalty to any CMU which makes the statement under Rule 3.7.1(a)(i) but never provides copies of the Relevant Planning Consents by 22 working days before the auction. This would discourage applications where there was not a realistic chance of the applicant securing the planning consents by the deadline.

3. *‘Participants planning to enter Prequalification should be aware of the need to submit planning consent...and should do this in sufficient time to allow them to prequalify’*

We agree that all applicants should be aware of the requirements of the Capacity Market Rules. However, potential applicants are currently working on the assumption that the ability to defer the provision of planning consents will be available to them based on Ofgem’s clear decision last year that allowing CMUs to defer the provision of consents is in the interests of consumers.

The ability to defer the provision of planning consents ensures not only that more CMUs are able to participate in a capacity auction, but also that new build projects have sufficient time where necessary to vary planning consents that may be several years old to incorporate the latest available technology.

If planning consent is only required under the Town and Country Planning Act, this process can be completed in a matter of months. However, plant over 50 MW must go through the more complex Development Consent Order or Section 36 variation processes. The Development Consent Order process, for example, takes circa 18 months from the point of application to decision, excluding pre-application activities. Given these timescales, it is possible that plant may have entered or be entering these planning processes with the expectation that they can utilise the ability to defer provision of Relevant Planning Consents when prequalifying for a capacity auction. This could affect any plant planning to participate in the 2017 and 2018 capacity auctions for the 2021/22 and 2022/23 Delivery Years. Given the nature of the respective planning processes, plant over 50 MW will have less flexibility to accelerate or amend their planning timescales compared to plant below 50 MW and will therefore be disadvantaged compared to smaller new build projects as a result of Ofgem’s proposed Rule change.

Although we consider that it is not appropriate to remove the option to defer provision of planning consents, we suggest that, if Ofgem does choose to implement CP190, one of the following amendments must be made

- (a) the ability to defer the provision of Relevant Planning Consents until 22 working days before the auction is retained for those plant which submitted an application for those planning consents before July 2017 (ie. before the revised Capacity Market Rules are published and on a timescale where the applicant could have expected to utilise Rule 3.7.1(a)(i) for a future auction); or
- (b) Rule 3.7.1(a)(i) is only removed from auctions occurring in 2019 onwards.

CP226 – Deferral of Distribution Connection Agreements

We consider that this proposal should be implemented. It is not equitable that distribution-connected plant is able to defer providing its connection agreements at prequalification when transmission-connected plant is not able to do so.

CP229 – Penalty for failure to carry out refurbishments

We consider that preventing plant from participating in T-1 auctions in the circumstances described is the best solution. Although a financial penalty may discourage plant from using refurbishing contracts as free option, the penalty would have to be set a high level (at least £25/kW) to prevent the possibility that securing a capacity agreement in the T-1 auction could recover the penalty and still result in a higher clearing price than the T-4 auction.

CP180 – Termination of individual CMU components

We note that this proposal addresses a similar concern to CP228, ie. how to incentivise continued delivery of capacity where one component of a CMU has failed. Ofgem considers that this risk can be addressed through volume reallocation and obligation transfer. We do not consider that volume reallocation can be relied upon to mitigate these risks as it is only available in limited circumstances. Although secondary trading could mitigate these risks, only a small pool of capacity is likely to be eligible to take on capacity agreements and there may be limited incentive for these plant to participate in the secondary market.

CP216 – Capacity Market Notices

The current arrangements regarding Capacity Market Notices (CMNs) do not provide clarity to the market on how long such notices are expected to remain in force. Although relevant data is available on BMRS, the different threshold for triggering a CMN compared to system warnings can cause confusion. We therefore support the idea that the SO should update the CMN in each Settlement Period to state whether it is still in force and for how long it is currently forecast to apply.

CP182 – Transfer of Capacity Agreements following the T-4 auction

We agree with the proposal that transfer of Capacity Agreements should be allowed following the T-4 auction rather than following the T-1 auction. This would allow CMUs to resolve issues related to the delivery of their Capacity Agreements at earlier stage as the details of their operation in the Delivery Year become clearer or should circumstances change.

CP169 – Satisfactory Performance Days in Summer

We do not agree that this change should be implemented. The amendments to the Rules proposed by Ofgem would massively increase the risk associated with scheduled outages to generating units under the Capacity Market. We consider that the existing penalty regime for non-delivery during System Stress Events is sufficient to encourage generators to remain available in the Summer whenever possible.

Maintenance requirements at power stations mean that it will not be possible for Capacity Committed CMUs to be available throughout the Delivery Year as envisaged by Ofgem as there will typically be extended periods during which a generating unit is unavailable due to maintenance work. A generating unit requires a major scheduled outage every few years. These outages can last several months and are normally carried out in the summer period. It is therefore possible that, where a CMU consists of

a single generating unit, this may be unavailable for the majority of the period May to September in some years.

Generators already bear the risk under the Capacity Market that one or more System Stress Events could occur during these outage periods and that penalties would be incurred for non-delivery, a loss of up to two times a CMU's monthly capacity market revenue in each month. Non-delivery or unavailability during the Summer therefore does already have consequences and generators will seek to minimise the time for which they are unavailable. Although it is theoretically possible to manage this risk through secondary trading, this is unlikely to be viable due to the capacity of the CMUs seeking to transfer their agreements (a typical coal unit, for example, is 500 MW and many generators will be undertaking outages simultaneously) and the small pool of generators able to take on an obligation through trading (only operational generating units that do not already hold a capacity agreement for that Delivery Year).

Ofgem's proposal would require CMUs to demonstrate additional Satisfactory Performance Days in the Summer where no output has been delivered in System Stress Events in two or more summer months. Failure to do this by the end of the Delivery Year would lead to the loss of all Capacity Payments for that year. The result of this for a CMU which is a single generating unit could be that if that CMU undertook a major outage between July and September and System Stress Events occurred in two of those months, the CMU would receive no capacity market revenue for that year. The timing of outages close to the end of the Delivery Year means that there may be insufficient opportunity for a unit to be returned to service to demonstrate full output before the end of September, especially as outage periods may need to be extended where unexpected issues are identified during the work.

The only risk mitigation available to a CMU would be to run at full output on six days prior to its outage to meet the additional summer Satisfactory Performance Days requirements in case they should be triggered during the outage. We do not consider that this is a sensible outcome as it would lead to many generators running out of merit at the start of the Summer. Alternatively, generators may be encouraged to move outages into months in which they would not normally occur, perhaps even at the start of the Winter, as there would be more time to meet the additional Satisfactory Performance Day requirements should they be triggered. This could increase security of supply risks in certain months. The proposal may also lead to generators seeking a higher clearing price in capacity auctions to offset the increased risk of lost revenue and could even disincentivise CMUs from participating in the capacity market in those years in which they expect to have lengthy outages, reducing liquidity and increasing the clearing price.

We are also concerned that the Rule change proposal would apply to CMUs which already hold a Capacity Agreement for Delivery Years from 2017/18 onwards, retrospectively changing the balance of risks in the Capacity Market. These CMUs may already have begun outage planning and could have factored outage plans into their capacity market bids. These CMUs could therefore be adversely affected by such a change to the Rules without opportunity to reflect any additional costs in their CM bids.

NB: It is our understanding that the Rules regarding Satisfactory Performance Days require a CMU to demonstrate the full derated capacity contracted in a capacity auction, ie. the Auction Acquired Capacity Obligation, rather than the Load Following Capacity Obligation as stated in the consultation document. We therefore do not agree that it is easier for CMUs to demonstrate Satisfactory Performance Days in Summer.

CP228 – Changes to Capacity Obligation if satisfactory performance has not been demonstrated

We note that the effect of CP228 would be similar to Ofgem’s own proposals in Of15, ie. to reset a capacity obligation by reference to the actual demonstrated performance of a CMU where performance falls below that originally envisaged at prequalification. We therefore do not agree with Ofgem’s rationale for rejecting this proposal.

Of15 – Calculating connection capacity

We support the principle that applicants should be able to choose their own connection capacity. It is important that these new rules regarding connection capacity reflect all possible circumstances and are applied uniformly across all CMU types and technology.

We have some concerns about the testing regime proposed by Ofgem:

- The proposed testing period is 18 to 30 months ahead of the start of the Delivery Year. We consider that this is too far in advance to meaningfully reflect a CMU’s capability in the Delivery Year due to possible changes in performance in the intervening period.
- Testing in advance of the Delivery Year would pose challenges to plant which are not operating in the same way during the test period as they intend to in the Delivery Year (for example, plant which is fully or partially mothballed, operating with reduced Transmission Entry Capacity, intending to undertake refurbishment or improvement works, or new build plant which is not yet commissioned).
- Although testing in advance of the T-1 auction allows for any resulting shortfall to be made up in that auction, it is not clear how plant that secures a Capacity Agreement in the T-1 auction would be tested. Under Ofgem’s proposals, different testing rules may need to be developed for capacity which is successful in the T-1 and T-4 auctions, which would not be desirable.

We therefore suggest that testing in the Delivery Year may be preferable to testing in advance of the T-1 auction. The existing Satisfactory Performance Day rules could be adapted to require a demonstration of connection capacity rather than derated capacity. We consider that, given the penalties that could be incurred for under-delivery against the stated connection capacity, there is limited incentive for CMUs to overstate connection capacity and therefore there is a low risk that too little capacity may be available in the Delivery Year once downward adjustments have been applied.

Power stations with more than one generating unit can choose whether to enter those generating units into the Capacity Market as individual CMUs or aggregate them together into a CMU consisting of two or more components. The testing regime could create an incentive for generators not to aggregate units in this way as doing so could restrict the connection capacity that could be demonstrated due to the amount of Transmission Entry Capacity (TEC) held. This problem could be solved by testing the connection capacity of CMU components separately rather than testing the connection capacity of the entire CMU.

For example, if a power station has two generating units each with a CEC of 500 MW but only holds TEC of 900 MW, it could prequalify two CMUs each with a connection capacity of 500 MW. These CMUs would be tested separately and each could demonstrate an output of 500 MW (even though under normal circumstances the two units together could never export more than 900 MW). However, if it aggregated the two units into one CMU, the connection capacity would be capped at 900 MW as the CMU would never be able to generate beyond this level in normal circumstances and so could not demonstrate a higher output. We do not consider that this would be an equitable or

sensible outcome, especially as not aggregating generating units may lead to generators requiring a higher clearing price.

We also have some concerns about the penalty regime proposed by Ofgem. We agree that connection capacity should be reset by reference to the output demonstrated during tests and that penalties should be applied where this output falls below a certain level. However, we are not clear how the proposed 97% threshold for applying penalties has been derived.

We consider that any penalty threshold must account for the difficulties in demonstrating maximum possible output in the testing period (eg. due to atmospheric conditions) and unexpected plant issues which cannot easily be rectified ahead of the testing period (eg. where a long lead time item needs to be replaced). Furthermore, it must be recognised that the maximum output of new build plant will degrade over time and it will not be possible to demonstrate the same connection capacity in the fifteenth year of a Capacity Agreement as in the first.

We therefore consider that a lower penalty threshold should be set and that financial penalties should only be applied where demonstrated capacity falls below 90% of the initial capacity obligation. Although this is a lower threshold than that proposed by Ofgem, we consider that the provisions to reset a capacity obligation in line with demonstrated capacity will discourage applicants from overstating connection capacity during prequalification. The 90% threshold is also consistent with the Substantial Completion Milestone for New Build CMUs.

Although we agree with the proposed application of a £35/kW penalty where demonstrated capacity falls below the threshold level, we have concerns about the fact that penalties could continue to be applied once all capacity market income has been lost. In Ofgem's example, total capacity market income can become negative (ie. capacity providers would overall owe money to the Delivery Body) when demonstrated capacity falls too low. This is inconsistent with the current requirements of the capacity market, where if a CMU fails to demonstrate satisfactory performance, the maximum penalty is the loss of all capacity payments for that Delivery Year. We therefore consider that the penalty regime for connection capacity should operate so that overall Capacity Market income is floored at zero and never becomes negative.