Department of Energy & Climate Change

CM Auction Parameters

August 2013 Expert Group

Scope

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This paper updates :

i. Net CONE

ii. Auction Price Cap

iii. Price Taker Threshold

iv. New/Existing/Refurbishment Definition

v. Net Going Forward Cost

vi. Volume to Contract

Net CONE

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- Gross CONE estimated at £47/KW
- Reliability Standard = 3hrs/year
- Scarcity price is £6000/MWh
- **So Net CONE = £29/KW year**

However note significant uncertainty around:

1. Uncertainty about Gross CONE –payback period & hurdle rate
2. Investor ability to bank on scarcity rents
3. Market power

- After first auction, Net CONE could be based on a coordination of administrative estimates and clearing prices set by new entry

Price Cap

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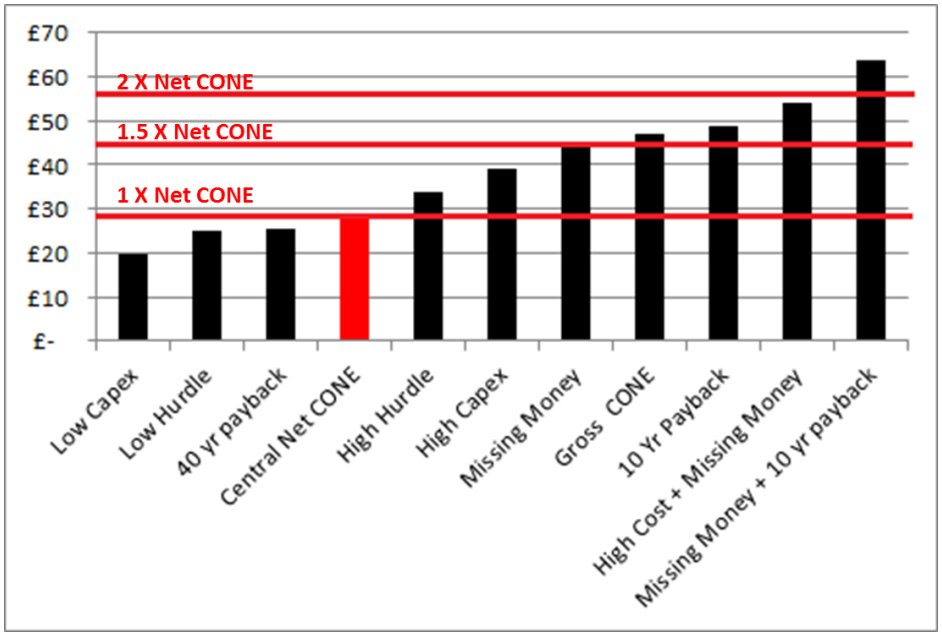
- 1.5 X CONE sufficient for some scenarios – e.g. no scarcity rents, high capex, high hurdle rates
- 2 X CONE more appropriate if there is a credible risk of a number of the assumptions being wrong



Q1: Do you agree with the recommendation to set a price cap of 1.5 X CONE?

Price Taker Threshold

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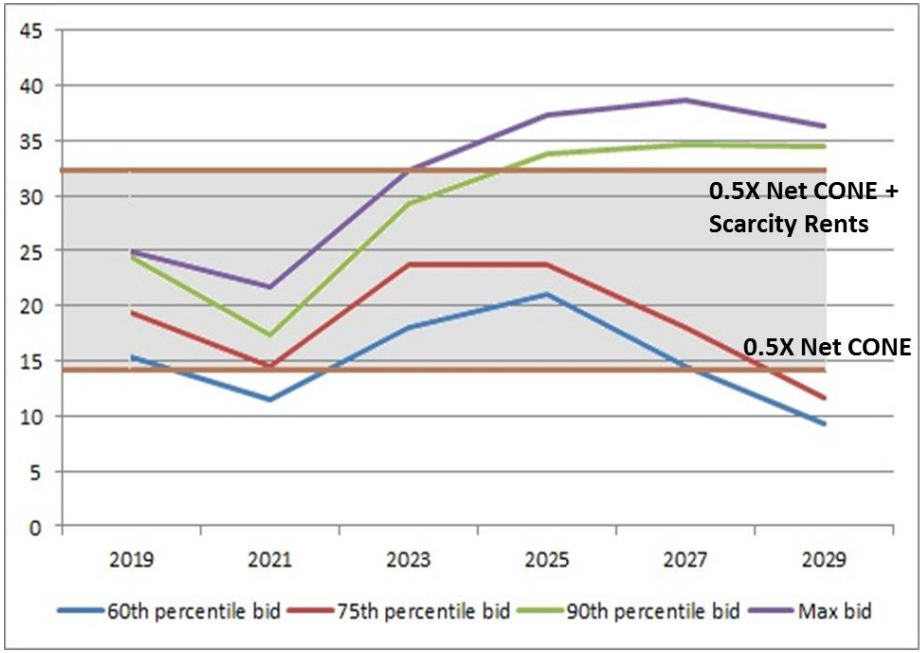
Proposal remains to set it at lesser of

- 70% last price set by new entry
- 50% Net CONE (£14.50)

DDM shows about half of plant need more than this – but only a small minority should need to if we account for scarcity rents



Q2: Do you agree with the recommendation to set a price taker threshold at 0.5 X CONE?

New / Existing / Refurb Definition

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Proposal is to use Capex thresholds:

- £125/KW if you're reducing emissions (=Refurb, 3 yr contract)
- £250/KW if you're increasing productivity / building new / repowering plant (=New 10 yr contract)

- Threshold based on costs of SCR (£125-150) and of new OCGT build (£249-377)

Q3: Do you agree with the proposed use of thresholds to define new and refurbishing plant?

Q4. Do you have a view on whether we should offer 3 or 5 year contracts to refurbishing plant?

Net Going Forward Cost

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Issue identified in the Gaming Study is whether to set explicit requirement for parties to bid into the Auction on basis of Net Going Forward Costs. E.g. condition could be specified as:

- *"Generation units must offer a 'fair' price in to the auction. That is, the capacity price offered, on the basis of reasonable estimates, must not lead to generation units earning more than a reasonable profit from entering the Capacity Market.*

This could strengthen Ofgem's competition enforcement tools – and is equivalent to measure in Transmission pricing.

However there are some risks attached:

- Difficult for Ofgem to provide guidance as methodology is subjective
- Without statutory guidelines may introduce regulatory risk for participants

Q5: Do you think a licence condition on generators should be added to require them to bid a 'fair price' into the auction?

Volume of Capacity

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Paper sets out how we can mitigate risk of procuring wrong amount of capacity:

1. Governance process for the analysis
2. Slope of the demand curve
3. Use of T-1 auction
4. Adjustment in following year's auction

Capacity and energy market interactions

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- DECC consider that the Capacity Market will dampen prices in the energy market via an increased capacity margin

- However, alternative modelling approaches show the energy price being affected as a result of participants changing their bidding behaviour in the Capacity Market

Q6: **Do you agree with the position that the presence of capacity payments does not change how providers will be expected to price into the energy market?**