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National Infrastructure Commission
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Dear Sir,

I am aware that you are currently looking at aspects of the energy sector and write to highlight some of the concerns we have around the current market design.

We are also members of Energy UK and have fed into their response, but thought it worth pointing out some of our particular concerns too.

As an overview I think it fair to say that the results of the second capacity auction have confirmed the fears of many. The interventions of recent years, including the fundamental design of the capacity mechanism itself, have created a market that is not stimulating sufficient investment. Any investment that is forthcoming, is focused on generation types inconsistent with Government and EU policy objectives.

We believe there are several areas that need to be scrutinised to get us closer to being an efficient and fair market conducive to investment, as had originally been intended. At an overview level, we believe that Government policy must aim to create a long-term, stable environment based on market-based mechanisms that will address the 'energy trilemma' by creating proper market mechanisms that allow these objectives to be met.

We are encouraged by the initial commitment of the new Government to move to a less intervention, more market-based approach and are keen to help them address the current challenges. In particular, we believe the following aspects need urgent attention:

Market design

- The current capacity market design is generally accepted as being flawed and is characterised by vested interests seeking bespoke solutions. As a result, it fails to encourage new build of the type required by the market (ie new CCGTs) and, more worryingly, is failing to give meaningful incentives to existing CCGTs to remain open.
- The in-built distortion between new build and existing capacity, the artificial encouragement of coal stations to refurbish and the failure to address how the capacity market interacts with other distorting incentives for embedded generators have left a market that is encouraging new build diesel generators over CCGTs and failing to stop existing CCGT stations from closing.
- The capacity market needs changing radically and urgently if the UK is to avoid a capacity crisis. We are encouraged by the Government's latest consultation in this respect, but would urge that any design changes focus on providing a market that allows a proper pricing of firmness and flexibility across all generation types, and that minimises the subjectivity available to the system operator.

Interconnectors

- Whilst we understand the desire for greater inter-connection across Europe, this must be done in a way that does not distort price signals to other generators. Unfortunately, due to artificial 'subsidies' such as the absence of carbon pricing and distortions around transmission charging, inter-connectors are not competing on a level playing field with other types of generation.
- This naturally makes the market far less attractive for new investment in conventional gas generation. As an example, new-build interconnectors can bid into the capacity market in direct competition with new build CCGTs, whilst the certainty of energy output that they provide at key times is clearly different as energy through an interconnector will flow in either direction depending on price signals (so could actually deliver negative generation at times of crisis). This should be compared to the generation certainty provided by existing or new CCGTs.

Flexibility

- Demand side and embedded generation provide many opportunities for increasing the flexibility of the system but there should be a level playing field across all technologies and additional impacts, such as grid costs borne elsewhere, must be included in any cost benefit analysis.
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- In addition, one form of generation should not have access to sources of revenues that others can't compete with (eg triad avoidance, STOR contracts, etc) whilst then competing in the same capacity market. Given these distortions, it should come as no surprise that new diesel engines are winning capacity contracts ahead of new CCGTs, despite the fact that they have a much higher average running cost and produce far more pollution. This same effect is also suppressing the clearing price of the capacity market, threatening the sustainability of existing, efficient CCGTs.

Storage

- The barriers for storage appear to be mostly technical and economic and we don't believe that subsidies in any form are warranted, as any UK subsidies will have minimal effect and are likely to give negative returns for the UK tax payer due to the global nature of storage development.

I hope that these points will help with your thinking and would be happy to discuss them further with you, or one of your team, should you find that useful.

I can be contacted at [\[email address redacted\]](#) or on [phone number

redacted]. Yours faithfully

Kevin McCullough
CEO
Calon Energy Limited