

## Rail Delivery Group

**Response to:**

**DECC Consultation on further reforms to the Capacity Market**

**31<sup>st</sup> March 2016**

# Rail Delivery Group Response to DECC Consultation on further reforms to the Capacity Market

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## Background

The Rail Delivery Group (RDG) was established in May 2011. It brings together Network Rail and passenger and freight train operating companies to lead and enable improvements in the railway. The purpose of the RDG is to enable Network Rail and passenger and freight train operating companies to succeed by delivering better services for their customers. Ultimately this benefits taxpayers and the economy.

In the context of energy, RDG's member companies combine to consume approximately 3.3 TWh of electricity per year (around 1% of national consumption), under the largest single electricity contract in the UK (between Network Rail and EDF). RDG also facilitates an electricity procurement scheme for the majority of passenger Train Operating Companies (the EC4T Scheme Council), and represents their collective interests as large electricity consumers.

## Introduction

RDG welcomes the opportunity to respond to this consultation. Electricity Market Reform (EMR) represented a significant change to the energy market, intended to provide a stable framework for meeting the 'energy trilemma'. From a consumer perspective, it is concerning that just two years into the process that remedies are being proposed on such a short timescale, as well as other policy changes related to EMR that are outside of the scope of this consultation. The consultation document outlines that the capacity market review has delivered a message that "*regulatory stability is crucial*". However, the proposed early introduction of the capacity market (Q23) represents another potential shift that creates uncertainty for those paying for the costs – electricity consumers. RDG's response outlines where this proposal has been underdeveloped with regards to consumer issues. RDG does not have a view on the other questions in the consultation document, which are of less direct relevance to our member companies.

### **Q23 Do you agree with the proposal to run an early capacity auction for delivery from October 2017 to September 2018?**

As large electricity consumers, RDG members understand the importance of meeting winter peak demand for electricity. A reliable supply of electricity is essential to the running of reliable train services, particularly at busy times of the day. RDG recognises that in the case of the four year ahead auction, precise targets for capacity will rely on a value for money analysis, which is an important provision for consumers given that the costs of the capacity market will be met directly through electricity bills as a pass-through charge.

However, the proposals contained in the consultation document for the early capacity auction do not sufficiently address the potential impact on consumer costs. The consultation document states

that an impact assessment on the early capacity auction will be published at a later date, but this should have preceded any consultation to allow stakeholders to properly evaluate the proposals. In considering an early capacity auction, it is essential that value for money and consumer costs are also prioritised in the decision process.

In its impact assessment, DECC should be transparent around the projected net cost to consumers of an early capacity auction versus reliance on the existing Contingency Balancing Reserve (CBR) in 2017/18. It should also be made clear the expected shortfall in generation that justifies an early capacity auction. Additionally, the consultation document warns of the risk of under-buying capacity, but makes no reference to the potential costs of overbuying for the proposed 2017/18 auction; there should be an explicit trade-off that protects consumers from higher costs. At present, the consultation document does not develop these points.

Given that the Capacity Market is expected to shift generation away from the wholesale market (as it will be funded by a pass-through charge for consumers<sup>1</sup>), there is a further issue of distorting the wholesale electricity price. Train Operating Companies, like most large electricity consumers, purchase electricity on the forward market, where the traded horizon typically extends up to five seasons (~30 months) ahead. Buying electricity ahead of delivery is an essential tool for large consumers to manage price risks and improve financial planning. For Train Operating Companies, risk management is especially pertinent given the closely defined financial terms of franchise agreements with Government, and an obligation to run train services which prevents reaction to price changes.

The pass-through costs of the Capacity Market cannot be hedged in advance by consumers, unlike the 'commodity' cost of electricity. Therefore, proposing early introduction of the Capacity Market so close to delivery will distort the market for large electricity consumers, who by necessity must plan costs years ahead. The consultation document states that "*if allowed to grow too large, [CBR] can cause distortion in the market*". Market distortion caused by an early and sudden introduction of the capacity market must also be a factor in these proposals.

Undoubtedly there are myriad factors affecting electricity prices, and consumers must be mindful of the costs and benefits of hedging future electricity. That said, the impact of policy changes must be carefully considered when they will alter the electricity market on such a short timescale, where the consequences for consumer costs may be material.

In summary, we believe that the proposals to bring forward the capacity market to 2017/18 cannot be taken forward without the publication of an impact assessment, with a subsequent consultation, that fully considers value for money for consumers. In conducting this impact assessment, we wish for DECC to:

- Outline the expected costs of the capacity versus the existing SBR mechanism;
- Demonstrate the expected shortfall in 2017/18 generation capacity that would justify an early capacity auction;
- Consider the risks of overbuying capacity for 2017/18; and
- Factor in the impacts on large consumers of distorting the wholesale market/ shifting costs to a pass-through on such a short timescale.

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<sup>1</sup> It remains to be seen the extent that this will be a net gain or loss to consumers, which in itself is a concern.

For enquiries regarding this consultation response, please contact:

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