Proposal for a Capacity Market Rules Change

Reference number *(to be completed by Ofgem):* **CP364**

Name of Organisation(s) / individual(s): EDF Energy	**Date Submitted:** 30 July 2021
Type of Change: ☒ **Amendment** ☐ **Addition** ☐ **Revoke** ☐ **Substitution**	**If applicable, whether you are aware of an alternative proposal already submitted which this proposal relates to:** N/A

Proposal summary *(short summary, suitable for published description on our website)*

We propose that secondary trading for a Delivery Year be allowed from the conclusion of the relevant T-4 auction, rather than the conclusion of the relevant T-1 auction.

We seek this as an urgent change to the Rules.

What the proposal relates to and if applicable, what current provision of Rules the proposal relates to *(please state provision number)***:**

The proposal would amend references within the Rules to the timing of secondary trades and transfers of Capacity Agreements. This would primarily affect Rule 3.13.1 and Rule 9.2.5(a). To account for secondary traded obligations in the capacity auctions, Rule 3.3.3, 5.5.11, and the definition of 'Bidding Capacity' in Rule 1.2.1 would also need to be amended.

Description of the issue that the change proposal seeks to address:

Under the current Rules, the terms for secondary trades can be agreed between parties in advance but cannot be executed or officially recognised by the Delivery Body until the conclusion of the T-1 auction for the relevant Delivery Year. This means that the target capacity set for the T-1 auction does not take account of any potential secondary trades which could occur ahead of the Delivery Year.

This potential issue has been known for some time and has previously been raised by EDF and other participants. With the decision by EDF to not return Dungeness B power station (DNB) to the market, and move straight to defueling, addressing this issue has become material and urgent. For reference, DNB holds Capacity Agreements for Delivery Years including 2021/22, 2022/23 and 2023/24 (~1GW total per year) which EDF are seeking to secondary trade.

The Secretary of State sets the target capacity for T-1 auctions, taking account of advice from National Grid ESO. This accounts for expected capacity gaps within that Delivery Year, including:

- known' non-delivery, i.e. terminated Agreements; and
- 'assumed' non-delivery based on 'market intelligence', even if the Capacity Agreement is still in place for that Delivery Year.

As such, National Grid ESO assumes capacity which has not yet had a chance to be secondary traded as non-delivery and includes additional capacity in the T-1 auction target to replace it. For example, National Grid ESO has assumed that DNB represents non-delivery for 2022/23 due to the recent winter outages /

defuelling plans, so the target capacity for the upcoming T-1 auction (4.5GW) includes ‘replacement’ capacity for DNB. This means that the DNB capacity will effectively be procured twice for the same Delivery Year: once in the T-3 2022/23 auction, and again in the upcoming 2022/23 T-1 auction. The T-1 auction target capacity also includes other plant which is assumed as non-delivery (3.2 GW of generation capacity excluding nuclear). Under the current Rules, it is not known how much of this capacity is intended to be secondary traded after the T-1 auction.

The current Rules cause the following issues in the market.

Significant additional costs to consumers
Procuring capacity in a T-1 auction after it has already effectively been procured in a previous auction results in a direct additional cost to consumers. For example, if the T-1 2022/23 auction includes replacement capacity for EDF’s DNB, and the clearing price matches the 2021/22 auction (£45/kW), the cost to the consumer would be an additional ~£45 million. This is clearly a significant sum and could be repeated for every T-1 auction where non-delivery capacity which could have been secondary traded beforehand is included in the target capacity. If secondary trading could be allowed before the T-1 auction, this capacity would not be considered as non-delivery, and there would be no additional cost to the consumer to procure it again.
In addition, removing non-delivery capacity from the T-1 auction target could result in a lower overall clearing price and a lower total cost to the consumer for the auction.

Inefficient operation of the Capacity Market
The current Rules prevent the market from balancing non-delivery risks as there is intervention (via the T-1 auction) to secure capacity which has not had the chance to be secondary traded at that time. The Rules also reduce the transparency of trades which may have been agreed commercially between parties but not officially executed. The Secondary Trading Guidance (version 3.2) published by National Grid ESO states that “the first step of the process takes place outside of the EMR DB Portal” and “the EMR Delivery Body does not need to be involved in the commercial decisions of the Secondary Trade”. If secondary trading were allowed to occur from the conclusion of the T-4 auction, the trades would be published on the Capacity Market register and become public information. The trades would also be known by National Grid ESO at an earlier time and allow for a more accurate estimate of the level of non-delivery in the relevant Delivery Year. This would improve the setting of T-1 auction parameters and lead to a lower target capacity requirement.

Commercial impact to Market participants
If secondary trading cannot commence until after the T-1 auction, the cost of securing a trade with a transferee is effectively set by the T-1 clearing price. The future T-1 auctions are predicted to have higher target capacities (as for the 2021/22 T-1 auction), resulting in higher clearing prices. If the cost of securing a secondary trade exceeded the Termination Fee for a CM party, it would be more cost-effective for the party to terminate the Capacity Agreements (e.g. for a 1GW Capacity Agreement this equates to £15 million cost per year for Satisfactory Performance failure, or £35 million cost per year for cancelling TEC). Allowing secondary trading from the T-4 auction instead would result in a more cost-effective option and reduced commercial impact for participants.

Alternative solutions
We do not consider that there are any suitable alternatives for solving the above issues. We note that transfers of a Capacity Agreement under Rule 9.2.4(b) can be undertaken after the relevant T-4 auction, but these are only applicable if ownership of the entire CMU is changing. This option is not appropriate for CMUs which experience unforeseen operating issues (such as DNB) as the ownership of the CMU would not be changing.
We have also reviewed the proposal on secondary trading outlined in section 3.3 of the ‘Capacity Market: Improving delivery assurance and early action to align with net zero’ call for evidence (published 26th July 2021). This proposal would apply to CMUs which get terminated prior to engaging in secondary trading, which is not our intention with DNB.
We consider that the most appropriate time to allow secondary trading would be from the conclusion of the T-4 auction, rather than any other time between the T-4 and the T-1 auction. This is because unforeseen issues with operating plant can arise at any time and allowing secondary trades from the conclusion of the T-4 auction would give Capacity Providers the most time to arrange them before the Delivery Year. We propose that secondary trades should be allowed from this time until T-6 weeks before the T-1 auction.

This would be three weeks before the publication of the updated Auction Parameters for the relevant T-1 auction. We consider that this would allow sufficient time for National Grid ESO to account for the secondary trades covering the relevant Delivery Year within the T-1 target capacity.

In summary, we consider that the above proposal is necessary, and we request that it be considered as an urgent Rules change. To have maximum impact, the Rules would need to be changed with sufficient time before National Grid ESO makes the final determination of the 2022/23 T-1 auction parameters. The updated auction parameters are due to be published on 25th January 2022 (T-3 weeks from the T-1 auction start date). T-6 weeks before the auction start date (as proposed above) would be 4th January 2022 for the closure of secondary trading. Therefore, the Rules would need to be amended in time for trades to occur and then for National Grid ESO to assess their impact before making recommendations to the Secretary of State in time for the publication on 25th January 2022. This implies a Rules change in place by the end of October 2021.
The Change Process for the Capacity Market Rules Guidance published by Ofgem (version September 2016) states than an urgent proposal must be in accordance with Ofgem's principal objectives and the Capacity Market Rules Change objectives. This includes addressing inefficiencies in the operation of the Capacity Market and protecting the interests of existing and future consumers. As set out above, our proposal meets the criteria for consideration as an urgent Rules change as it relates to an imminent issue regarding the upcoming T-1 2022/23 auction, and it would improve the efficiency of the mechanism, reduce commercial impacts to consumers, and reduce commercial impacts to Capacity Market participants.

If applicable, please state the proposed revised drafting *(please highlight the change)***:**

3.13.1 A Secondary Trading Entrant may submit an Application at any time from the Auction Results Day for the relevant ~~T-1~~ T-4 Auction up to the end of the relevant Delivery Year, other than during the Prequalification Assessment Window for any Capacity Auction.

9.2.5 Transfers of a Capacity Agreement:

(a) under Rule 9.2.4(a) can only be effected on the Capacity Market Register after the T-4 Auction for the relevant Delivery Year has concluded and before the date which is T-6 weeks before the start of the T-1 Auction for the relevant Delivery Year, or after the T-1 Auction for the relevant Delivery Year has concluded (or, in the case of an SA Agreement, after 30th May 2017) and provided that:

…

We also note that under the current Rules, there is no risk of a CMU Transferee gaining its own Capacity Agreement through a T-1 auction after gaining an Obligation via a secondary trade. Our proposal to allow secondary trading after the T-4 auction would introduce this risk and need to be mitigated through the Rules (i.e. to prevent a CMU from effectively holding two Obligations in the same Delivery Year for a total volume greater than its de-rated capacity). This could be introduced through the prequalification exclusions set out in Rule 3.3.3. Part (a) would also need to be amended to allow a CMU to hold two Agreements (one obtained via secondary trade and one via the auction) so long as the total Obligations did not exceed that CMU's de-rated capacity.

3.3.3 An Application may not be made for a CMU for a Capacity Auction if:

(a) that CMU, or any Generating Unit or DSR CMU Component comprised in that CMU, currently has a Capacity Agreement, or is part of a CMU which currently has a Capacity Agreement, for the Delivery Year for which the Capacity Auction is to be held, unless (subject to Rule 3.3.3 (g)), that Capacity Agreement was obtained via a secondary trade.

…

(g) that CMU is already subject to a Capacity Obligation resulting from a secondary trade which is equal to or greater than the De-rated Capacity of the CMU for the Delivery Year for which the Capacity Auction is to be held.

The Rules would also need to be amended to allow a CMU to reduce its Bidding Capacity if it prequalified for an auction and then gained a Capacity Obligation for that relevant Delivery Year through a secondary trade before the auction took place. This would be especially necessary for Existing CMUs which are Price

Takers and could not withdraw from the auction after prequalification. This could be addressed through the following amendments:

5.5.11 By no later than the date falling 10 Working Days prior to the commencement of the first Bidding Window, an Applicant for a Prequalified DSR CMU may issue a notification to the Delivery Body nominating the capacity (in MW) that it wishes to bid into the Capacity Auction with respect to that DSR CMU provided that such capacity is no greater than the product (in MW to three decimal places) of the DSR Capacity of such DSR CMU and the De-rating Factor ("the original derated capacity") less the aggregate of the Weighted PTCO for the DSR Components comprised in that CMU, for the relevant Delivery Year.

1.2 Definitions

Weighted PTCO means for a Generating Unit or DSR Component, the figure given by the following formula:

$$Weighted\ PTCO = \frac{maxPTCO \times Unit\ De\text{-}Rated\ Capacity}{CMU\ De\text{-}Rated\ Capacity}$$

where:

maxPTCO is the maximum Physically Traded Capacity Obligation on the T-1 Prequalification Results Day held by the CMU, which includes the Generating Unit or DSR Component, which was either:

(a) prequalified for the T-4 auction for the relevant Delivery Year; or
(b) was subsequently prequalified as a Secondary Trading Entrant for the relevant Delivery Year by the start of the T-1 Prequalification Window;

Unit De-Rated Capacity is the De-Rated Capacity for the Generating Unit or DSR Component; and

CMU De-Rated Capacity is the De-Rated Capacity for the CMU which includes the Generating Unit or DSR Component.

Bidding Capacity means, for a Bidding CMU, the maximum of:

(a) its De-rated Capacity less the aggregate of the Weighted PTCO held by each Generating Unit or DSR Component comprised in the Bidding CMU from their inclusion in a CMU that was either:
    i) prequalified for the T-4 auction for the relevant Delivery Year; or
    ii) was subsequently prequalified as Secondary Trading Entrant for the relevant Delivery Year by the start of the T-1 Prequalification Window.

    or;
(b) zero.

To execute the above, the Delivery Body would need to track CMU Components to match them between the T-4 and T-1 auctions.

Analysis and evidence on the impact on industry and/or consumers including any risks to note when making the revision - including, any potential implications for industry codes:

Impact on consumers

As outlined above, we believe that the proposal would have a very material net benefit for consumers (10s £m based on our assessment) as it could significantly reduce the cost of the upcoming T-1 2022/23 auction and subsequent T-1 auctions.

Impact on participants
We believe that the proposal would have a net benefit for participants who operate within the mechanism as all Capacity Providers could benefit from the option of earlier secondary trading. In addition, the proposal would improve transparency on traded capacity for future Delivery Years and provide the market with a chance to balance non-delivery risks before intervention is needed via the T-1 auction.

Impact on the Delivery Body
The Delivery Body has stated that the process for allowing earlier secondary trading within the EMR Portal would be relatively easy. The relevant part of the Portal for secondary trading is currently restricted by the Delivery Body until the T-1 auction for the relevant Delivery Year concludes. If secondary trading was to be allowed from the conclusion of the T-4 auction, the Delivery Body would simply grant Capacity Providers access to the relevant part of the Portal at that time instead.
Despite the ease in the process for allowing earlier access to secondary trading, the Delivery Body has also noted that secondary trading has numerous interactions with other parts of the system such as prequalification and the auction process. The Delivery Body would not know the full extent of the changes required to the system until they did a full impact assessment of the Rules change.

Details of Proposer *(please include name, telephone number, email and organisation)***:**

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