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Interactions between CM and EBSCR

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Capacity Market and Cash Out

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- There are a considerable number of interactions between the CM and cash out:

  - Both CM and cash out reform aim to reduce "missing money" in current energy market
  - CM penalties and Cash Out both provide dispatch incentives
  - Measurement of "energy delivered" must allow for realities of dispatch decisions in real time – e.g. system balancing, participation in BM
  - Participants want consistent definitions between the CM and BSC – e.g. on how stress events will be calculated – to minimise complexity

- DECC and Ofgem have worked closely together on each policy to ensure consistency of measures.

Role of CM and Energy Market

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- The CM aims to reduce the risk for investors from collecting all their revenues in the energy market, and instead offers a separate, more certain revenue stream. It also addresses the concern that cash out prices may be insufficient to incentivise the required investment if market players overly discount their exposure to low probability but high impact capacity shortages.

- Cash-out reform on the other hand focuses on improving the incentives in the energy market itself, including the incentives for flexible generation.

- Both cash-out reform and the CM are likely to affect investment decisions.

- However, it is unlikely that cash-out reform would have a large impact on investment decisions in the short term, but is more likely to affect them in the medium to longer term as the price signals work through the system.

- DECC supports Ofgem's Future Trading Arrangements review in considering wider reforms to improve energy market signals and competition – such as considering the case for a Balancing Market to help parties to better value scarcity rents.

CM Penalty Regime and Cash Out

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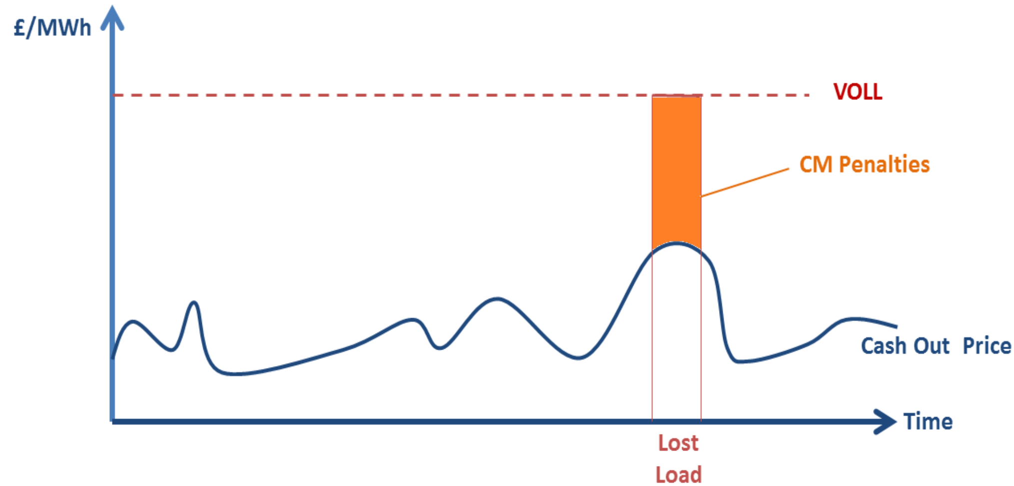
- To some extent CM penalties replicates incentives provided by cash out – e.g. for plant to be reliable / flexible

- This means that having strong penalties in both mechanisms could put too much risk on participants, potentially discouraging independents

- So CM penalty regime is set at "VOLL – Cash Out. This formula ensures that the combined incentive for participants to be available at times of system stress across both CM and cash-out is always VoLL.



- However CM penalties serve additional role over Cash Out – e.g. discouraging unreliable capacity from seeking to take on obligations. Penalties – coupled with physical checking – protect consumers from overpaying.

- CM definition of stress event mirrors that in BSC– load shedding for energy balancing (no exemptions for gas emergencies)

Use of VoLLs in CM

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- Ofgem and DECC estimated VoLL at £17,000/MWh – which has since informed DECC's reliability standard (3 hours/year)

- Ofgem has proposed a £6,000/MWh price at times of lost load – recognising that prices need not go to full VoLL if the CM also provides missing money.

- DECC penalty regime will set a VoLL in between £6,000/MWh and "true" VoLL of £17,000 – to ensure there are still CM penalties even if cash out is at £6,000.

- Both Cash Out and the CM propose the same penalties for stress events whether blackouts or brownouts – to help parties to trade around imbalance /penalty risk