



Making a positive difference
for energy consumers

Gwneud gwahaniaeth gwirioneddol
i ddefnyddwyr ynni

All interested parties

Email: EMR_CMRules@ofgem.gov.uk

Date: 17 April 2014

Dear Colleague,

Consultation on draft guidance for the Capacity Market Rules change process

We are consulting on draft guidance (the CM Guidance) which explains how we expect to manage the Capacity Market Rules (the Rules) change process. The draft CM Guidance is attached at Annex 1 to this letter.

As part of Electricity Market Reform (EMR), we will become responsible for the Rules, which underpin the Capacity Market, following the first Capacity Markets auction. The Rules cover the:

- details on the contents of capacity agreements
- obligations of capacity agreement holders, including penalties
- technical operation of the Capacity Market.¹

We welcome your comments on the CM Guidance by **5pm on 22 May 2014 to EMR_CMRules@ofgem.gov.uk**.

We are holding a stakeholder event between **14:30 and 16:00 on 28 April 2014** at our London office to discuss the draft CM Guidance and the CM Rules change process. If you'd like to attend please email the above address. Please note that due to limited capacity, we request attendance is limited to one person per organisation.

Following this consultation, we intend to publish the final version of the CM Guidance in July.

Electricity Market Reform

The EMR programme is a government policy that seeks to incentivise investment in secure, low-carbon electricity, improve the security of Great Britain's electricity supply, and improve affordability for consumers.

¹ See Annex 2 for more detail on the content of the Rules.

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The Energy Act 2013 introduced a number of initiatives to achieve this, in particular:

- a **Capacity Market** to help ensure that security of electricity supply is secured at the least cost to the consumer
- **Contracts for Difference** which will provide long term revenue stabilisation for new low carbon initiatives.

The CM Guidance is concerned with the Capacity Market. The Capacity Market will provide incentives for investment in the overall level of reliable capacity needed (both supply and demand side response) to help ensure secure electricity supplies. The Capacity Market will be governed by a combination of The Electricity Capacity Regulations 2014 (the Regulations) and the Rules. The Regulations will provide the overarching policy and design of the Capacity Market, including the powers that the Secretary of State will retain. The Department for Energy & Climate Change (DECC) anticipate that the Regulations will come into force in August 2014 subject to the will of Parliament.

The Rules² will provide the detail for implementing much of the operating framework set out in the Regulations and will be made by the Secretary of State. We have set out a summary of the contents of the Rules in annex 2 to this letter.

Following the first capacity auction, Ofgem will be responsible for managing and making any changes to the Rules. We are consulting on the process we intend to adopt to amend the Rules.

The legal framework for the Rules change process

The Regulations permit us to amend, add to, revoke or substitute (change) any provision of the Rules. When exercising the power to change the Rules we must act consistently with our principal objective and duties while also having regard to the objectives for EMR as set out in the Regulations.

In accordance with the Regulations, Ofgem must consider any proposal to amend a provision of the Rules and must consult the Secretary of State, the Delivery Body, any person who is a holder of a licence to supply electricity, any person who is a capacity provider; and such other persons as we consider it appropriate to consult before publishing a revised version of the Rules.

Once the Rules are revised they will apply to existing participants and capacity agreements. The only exemption to this is those provisions in existing capacity agreements that DECC have committed to being grandfathered.³ As the grandfathering provisions are set by the Secretary of State in the Regulations, Ofgem does not have the power to amend them.

² A draft version of the Capacity Market Rules can be found on DECC's website: https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/249565/capacity_market_Rules_consultation_draft.pdf

³ A provision in which certain terms continue to apply in respect of existing agreements, while the equivalent new Rule will apply to all future participants.

Our proposed approach to the Rules change process

The Rules are critical to the successful operation of the Capacity Market. Our proposed approach to the Rules change process is designed to create a robust, transparent process that will work within the wider Capacity Market framework and is proportionate to the nature of the Rules.

We have considered whether to make changes to the Rules on a rolling basis throughout the year or as part of an annual process. A rolling process could allow changes to be made more quickly than a yearly approach. However, we think it could also create an overly complex and burdensome process for all parties concerned and increase the number of Rule changes brought forward, which would be potentially damaging to investor confidence.

We intend, therefore, to review proposals for changes to the Rules on an annual basis. This will enable us to undertake a holistic review of proposals rather than considering them on a piecemeal approach. We intend to consider proposals for amendments after an auction has closed and to publish any revised Rules, following consultation, ahead of prequalification for the next auction. We would engage with industry at regular stages during the change process. By taking an annual approach we will be able to give greater clarity as to when changes may be introduced and minimise the risk of changes during the prequalification or auction stages. This is important for investor confidence.

The key aspects of our proposed approach to the Rule change process are:

- We will invite proposals for changes to the Rules during an annual window for proposals. We anticipate that this would generally be open for two months and is designed to help ensure we take a holistic view across all the proposals when deciding how to amend the Rules.
- We will provide a form on our website to assist parties in developing their proposals (a draft can be found in Appendix 2 of the draft CM Guidance).
- We will consider the proposals received and undertake a review of the Rules. In addition to changes proposed by external parties, we may identify any changes to the Rules that we consider need to be made.
- We will consult on our proposed changes before making a decision on the revised Rules (assuming potential changes have been identified).
- We will publish the revised Rules before the prequalification period for the next auction.
- We will publish all proposals, including those not taken forward and provide feedback on our decisions.

In exceptional circumstances, where we agree that there is an urgent issue to be addressed, we may determine that the most proportionate approach is to take the change forward outside of the annual process. This would include a consultation stage.

Consultation on the CM Guidance

We are keen to ensure that we have appropriately balanced the expected short timeframe between one auction and the prequalification for the next, with the need to provide sufficient opportunity for industry and interested parties to bring forward proposals. Our aim is to ensure a robust, transparent and efficient process is in place. We would therefore welcome your views on the proposed Rules change process. In particular we would value your responses to the following questions:

- **Do you think that an annual process of managing changes to the CM Rules is appropriate? If not, please outline your reasons and your preferred alternative approach.**
- **Does the draft CM Guidance cover the necessary issues?**
- **Do you have any other comments on the draft CM Guidance?**

Next steps

We invite feedback on the draft CM Guidance by 5pm on 22 May 2014. We will then review the CM Guidance in light of responses received and expect to publish the final version in July 2014. Please note that unless marked confidential, responses will be published by placing them on our website. For further information on the Capacity Market Rules, please visit our website or email EMR_CMRules@ofgem.gov.uk.

Yours faithfully

Emma Kelso
Associate Partner
Wholesale Markets

Annexes

Annex 1: Draft CM Guidance for the Capacity Market Rules.

Annex 2: Summary of the Sections in the Capacity Market Rules.