

All interested parties

Email: EMR_CMRules@ofgem.gov.uk

Date: 1 August 2014

Dear Colleague

Electricity Market Reform Guidance for the Capacity Market Rules change process

Today we are publishing our guidance (the CM Guidance) which explains how we expect to manage the Capacity Market Rules (the Rules) change process. The CM Guidance is attached in Annex 1 to this letter. We consulted on a draft version earlier this year.

The Capacity Market (CM) has been established by government as part of its Electricity Market Reform policy. It is intended to provide incentives for investment in the capacity needed (both supply and demand side response) to help secure electricity supplies. The CM is governed by a combination of The Electricity Capacity Regulations 2014¹ (the Regulations) and the Rules. The Regulations provide the overarching policy and design, including the powers that the Secretary of State will retain. The Rules² underpin the CM and provide the detail for implementing much of the operating framework in the Regulations.

The Rules cover the:

- details on the contents of capacity agreements
- obligations of capacity agreement holders, including penalties
- technical operation of the Capacity Market.³

The Rules have been made by the Secretary of State. However, we will become responsible for managing and making any changes to them from after the results of the first capacity auction. The CM Guidance shows the process we will follow when making any such changes. In our design of the process, we have considered the need to avoid multiple sets of changes to the Rules in order to reduce investor uncertainty. We also considered the importance of providing clear opportunities for stakeholder engagement and the nature of the Rules as secondary legislation.

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

¹ The Electricity Capacity Regulations 2014 came into force on 1st August 2014
<http://www.legislation.gov.uk/ukdsi/2014/9780111116852/>

² The Capacity Market Rules are on DECC's website: <https://www.gov.uk/government/collections/electricity-market-reform-capacity-market>

³ See The Capacity Market Rules for further details

our principal objective and duties⁴ while also having regard to the specific objectives as set out in the Regulations⁵.

In accordance with the Regulations, we must consider any proposal to amend a provision of the Rules and must consult the Secretary of State (SoS), 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 through the Regulations to being grandfathered.⁶ As the grandfathering provisions are set by the SoS in the Regulations, we do not have the power to amend them.

Summary of response to the consultation

Our draft CM Guidance was published for consultation on 17 April 2014 and closed on 22 May 2014. We received 10 responses (available on our website). A summary of the responses is in Annex 2 to this letter. We have considered our draft CM Guidance in light of these responses and of comments we received at a stakeholder event on 28 April 2014. We have made a number of changes to our process as a consequence.

Among their responses, stakeholders emphasised their wish to be able to submit proposals all year round rather than during a designated window. They also highlighted the importance of ongoing stakeholder engagement.

We no longer intend to have a window for proposals. Instead, we have clarified in the CM Guidance that proposals may be submitted at any time. However, we will continue to have an annual process to minimise the number of times the Rules are revised in a given period. To do this, we will set an annual deadline for proposals. For any proposal received by this deadline, we will consider whether we are able to undertake the necessary analysis and development in time to take a decision within that year's revisions. If the proposal requires more complex analysis, we will roll it into the following year's review to allow greater time.

Proposals received after the annual deadline will not be part of that year's review of the Rules. Instead we will consider them and take forward any necessary policy development as part of the next review of the Rules. This does not prevent us from taking forward urgent changes sooner, if required.

We agree that active stakeholder engagement is important. We now intend to publish an open letter for comment setting out our views on the priorities for changes within that year's revision. The letter would be published between the prequalification stage and the auction. We will also run stakeholder events after the prequalification stage and the auction, ahead of the annual deadline to gather key concerns from stakeholders at the critical points of the auction process.

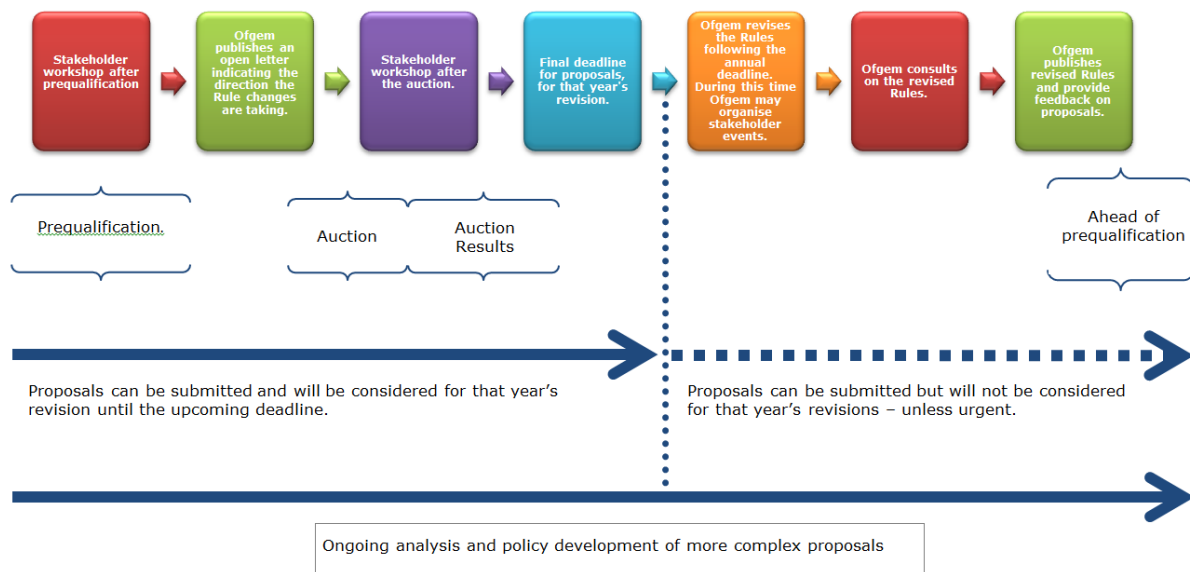
Some stakeholders requested more parallels between the CM change process and the industry-led code modification process. The Rules are a form of secondary legislation which Ofgem is responsible for managing changes to, rather than a new industry code. It is therefore necessary for there to be differences between the two processes. Our process reflects this while providing sufficient opportunity for industry engagement.

⁴ Ofgem's principle objective and general duties can be found on our website <https://www.ofgem.gov.uk/publications-and-updates/powers-and-duties-gema>

⁵ See Regulation 78

⁶ 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.

The CM Rules change process



The Capacity Market Rules change process for 2014/15

We will become responsible for the Rules from the day after the first auction results are published. **If any Rules changes are required before publication of the first auction's results, the Secretary of State will be responsible for consulting on and making them.** However, we expect to start running the change process from after prequalification for the 2014 auction so we have enough time to develop any revisions before prequalification opens for the second delivery year. We will accept proposals from **29 September 2014** to be considered for changes ahead of the 2015 T-4 prequalification stage.

In the first year, neither we nor industry will have had the benefit of learning from a full delivery year. Therefore we anticipate that we will only be able to address a limited number of urgent proposals in the first year. This should not prohibit industry from submitting more substantial proposals if they think it is necessary, but we anticipate that any such proposals are more likely to be considered in detail as part of the 2015/16 revisions when all parties will have had greater time to consider wider implications.

Demand Side Response (DSR) Transitional Auctions

DECC intend there to be two transitional Demand Side Response (DSR) auctions, one in 2015 and one in 2016. We think it is unlikely that we would make any changes to the Rules specific to the DSR transitional arrangements before the first prequalification for DSR, unless a critical issue has been identified. We think there is significant advantage in being able to gather lessons learned from the first transitional prequalification before making any amendments.

Next Steps

We will publish details on our website of the first stakeholder event after the prequalification stage for the 2014/15 change process. At this point we will also confirm the deadline by which proposals should be received in order to be considered for the first set of revisions. We remind you that this deadline is not intended to prevent stakeholders from submitting proposals after this point but any received after this point will be considered as part of potential changes for 2015/16.

We are committed to keeping our process and CM Guidance under review and to ensuring they remain fit for purpose as the CM arrangements evolve.

Yours faithfully

Adam Cooper
Associate Partner
Wholesale Markets

Annexes

Annex 1: CM Guidance for the Capacity Market Rules

Annex 2: Summary of the responses received to our consultation