Statutory consultation on changes to the Capacity Market Rules pursuant to Regulation 79 of the Capacity Market Regulations 2014

Consultation by Ofgem

Response by E.ON

Key Points

- It is crucial that a full, consolidated version of the Capacity Market Rules is published as soon as possible. Ofgem's approach to annotate the Rules with its proposed changes is welcome but understanding the impact of these alongside DECC's recent publication of 83 pages of amendments is extremely challenging.
- As soon as the consolidated Rules are published, and before Prequalification opens we encourage Ofgem and DECC to arrange a page turning session with industry. We are concerned that overlaps and inconsistencies may exist in the final Rules given the number of changes in different documents.
- Ofgem has decided not to implement a number of changes intended to clarify certain rules. Whilst we understand that Ofgem is trying to limit rule changes as far as possible, we believe simple rule changes to provide clarity or transparency should be implemented.
- In our response below we comment on Ofgem's questions then provide some specific comments on certain rule changes.

Consultation questions

Q1. CP06, CP25, CP34, CP41 and CP50: Qualifying Capital Expenditure for New Build CMU: We invite stakeholders to provide us with information, and factors, backed up with evidence as far as possible, that we should take into account in considering: When should the Rules be amended to introduce the period for qualifying expenditure of 77 months prior to the start of the relevant delivery year?

1. The original Rules linked Qualifying Capital Expenditure to 1 May 2012 to ensure that there would be no hiatus in investment ahead of the first capacity market auction.

2. Now that the first auction has taken place and the Capacity Market is implemented there is no risk of a hiatus in investment as a result of uncertainty of design or implementation. We agree with Ofgem that this date needs to move forward and should be linked to the start of the first relevant Delivery Year and believe this should be implemented ahead of the 2015 auction. If not, CMUs may qualify for longer agreements as a result of historic expenditure which could distort the auction outcome.

Q2. CP01, CP07, CP25, CP34, CP41 and CP50 Qualifying Capital Expenditure for Refurbishing CMU: We invite stakeholders to provide us with information, and factors, backed up with evidence as far as possible, that we should take into account in considering: (i) Should the starting point for qualifying refurbishing expenditure be prequalification results day or auction results day? (ii) Should this new starting point apply from 2016?

3. As described above, we agree with Ofgem that the date for Qualifying Capital Expenditure needs to move forward. However, we do not see any reason why Refurbishing CMUs should be treated differently to New CMUs.

4. All Prospective CMUs should declare Capital Expenditure using the same definition. The outcome of Q1 should determine the qualifying period for both New Build and Refurbishing CMUs.

Q3. CP69: Do you have any views on whether and how the Rules should be amended to prevent applicants being able to provide a calculation of connection capacity close to the value of entry capacity in the manner described in CP69?

5. We agree with the risk highlighted in CP69 that CMUs could nominate Connection Capacity above their entry capacity and above the level the CMU is capable of operating at. We suggested a rule change (CP26) to address this risk which Ofgem rejected (see paragraph 8 below).

6. Following lengthy debate in the policy design process, DECC decided to de-rate CMUs centrally rather than let them determine their own de-rating factors based on the risk of exposure to penalties. The de-rating must therefore apply to a Connection Capacity a CMU is capable of meeting; this is how the demand curve is constructed. Allowing CMUs to use Connection Capacity above the level they can physically meet means they are over-rewarded (they are essentially de-rated to a higher capacity than other CMUs of the same type) and the demand curve will purchase too little capacity as the CMUs in question are not as reliable as assumed by the central de-rating factors.

7. We would also highlight that, in order to meet the definition of 'commissioned' in the Regulations a CMU has to demonstrate that it is capable of operating at its connection capacity (as defined in the Rules). Therefore, by the letter of the Regulations, a CMU which nominates a Connection Capacity above the level it can physically generate has not actually been commissioned according to the Regulations and is therefore a Prospective CMU.

8. Our suggested change (CP26) attempts to prevent this behaviour via the Delivery Body's prequalification checks. As Ofgem correctly highlights when rejecting our proposal, requiring a CMU to generate at its CEC could, in some instances, contravene the requirements of the CUSC. This is precisely the circumstance our proposed change is intended to prevent. On the assumption a CMU cannot or will not breach the CUSC, the CMU can only demonstrate performance at a level it is physically able to generate; therefore this rule change means the

CMU cannot nominate a Connection Capacity any higher than this. We continue to believe that this proposed change (CP26) should be implemented.

9. We note that, should Ofgem decide no changes are necessary and maintain that CMUs can declare Connection Capacity at a level above that which they can physically meet, this may now result in other CMUs using this method in the upcoming prequalification process.

Q4. CP74: Do you agree that duration bid amendments should only be allowed to reduce during the auction?

10. We disagree with this proposal.

11. In the current Rules, in a non-Variable Price Duration Auction, a Duration Bid Amendment can only change an Agreement to one Delivery Year (Rule 5.6.6(a)). In a Variable Price Duration Auction, in most cases we would expect Duration Bid Amendments to reduce as the auction progresses. However, we see no reason why a CMU shouldn't be able to increase the agreement length in a Duration Bid Amendment if it so wishes.

Q5. CP46: Do you believe that DSR CMUs should be able to add, remove and reallocate CMUs? Please explain your answer. Do you think there are potential downside risks to this, as we describe above? If so, how would you suggest we mitigate these downside risks?

12. In principle we agree with this proposal. DSR CMUs or aggregators should be able to add, remove and reallocate in exactly the same way that Generating CMUs can through obligation trading. Not allowing this is likely to restrict DSR participation.

13. It is important that, at all times, the DSR CMU is capable of meeting its obligation. This can be delivered through a robust testing regime and some form of registration for new DSR Components. This is consistent with the treatment of other CMUs where new Secondary Trading Entrants have to register with the Delivery Body in advance.

Q6. CP24: Do you have any reasons or evidence for why we should not also include OC.6.7 as a form of load reduction in the definition of Involuntary Load Reduction (in addition to our proposal to make the amendment suggested by CP24)?

14. No comment.

Q7. CP49: Do you have any evidence to show that CHP is failing to prequalify or that there would be benefits to allowing embedded generation to bid as a DSR component?

15. Previous versions of the Rules did restrict participation of CHP and embedded generation as the Rules looked only at capacity connected to a transmission or distribution network. This meant that behind-the-meter CHP or embedded generation could only register its net exported capacity

or would have to prequalify as DSR and be subject to the baselining methodology which is designed for demand response rather than generation.

16. In DECC's recent amendments this barrier has been removed by expanding the definition of a Meter Point to include connections to a customer's site or unlicensed network. This means an embedded generating CMU can now declare its gross capacity.

17. Similarly, DECC's amendments appear to facilitate aggregation of smaller CHP or embedded generating assets which is necessary in order to meet the minimum capacity threshold of 2MW.

18. However, embedded generators can only prequalify as Distribution CMUs if they export electricity to a distribution network (see definition of *Distribution CMU* in the Rules and definition of *export* in the Regulations). This means an on-site, behind-the-meter generating unit can only prequalify as a DSR CMU and is therefore subject to the DSR baselining methodology and the issues identified in CP49.

19. Subject to DECC's amendments being implemented, we do not believe there are any specific barriers preventing the participation of CHP or embedded generating assets which are connected to Distribution or Transmission networks.

20. Amending the baselining methodology as proposed in CP49 would allow on-site, behind-the-meter generating CMUs to participate with their full generating capacity as DSR CMUs. In addition this offers the ability to prequalify as Unproven DSR which will help aggregators identify new sources of capacity.

Comments on specific rule changes

The comments below refer to changes included in Ofgem's amended Capacity Market Rules, published alongside the consultation.

Rule 2.3.1

21. This amendment changes the reference for calculation of de-rating factors from calendar year to Delivery Year. Our understanding in the current Rules is that a multi-year agreement would use a single de-rating factor for each Delivery Year as calculated in the calendar year of the auction.

22. This amendment implies that each Delivery Year of a multi-year agreement would now have a separate and different de-rating factor, it is not clear if these de-rating factors would all be published ahead of the auction (up to 15 years' worth, 4 years ahead). Similarly, it is not clear if de-rating factors in an existing multi-year agreement are updated each time the Delivery Body publishes new de-rating factors.

23. On the assumption that an Applicant cannot enter a CM Agreement without knowing the de-rating factor for each Delivery Year in that agreement, this amendment will still result in different CMUs having different de-rating factors in the same Delivery Year (because of the impact on multi-year agreements), which the amendment intended to avoid.

Rule 3.4.3

24. The amendment requires CMUs to specify an Ordnance Survey Grid Reference. These requirements should specify which format of grid reference to use: 4 or 6 digit.

25. The requirements should also specify what the grid reference is to refer to as larger sites may cover a number of grid references. We note that Environmental Site Permits already use an Ordnance Survey reference; it may be beneficial to use the same reference in the Capacity Market Rules.

Rule 3.4.5

26. This amendment requires a CMU to state multiple de-rating factors if it consists of generating units in different technology classes. However, Connection Capacity is required for the CMU in aggregate; therefore the technology specific de-rating factors cannot be applied. For this amendment to be effective the Connection Capacity would need to be declared for each generating unit.

Rule 3.5.6

27. This amendment states that Connection Entry Capacity (CEC) should be specified net of auxiliary load. We agree that clarity over the inclusion of auxiliary load is important but, when specified in a connection agreement, CEC may or may not include auxiliary load. Therefore, should a CMU use CEC in its prequalification as specified in its connection agreement it may include auxiliary load therefore this amendment is not appropriate.

28. Any reference to auxiliary load in the Rules needs to be accompanied by a definition of auxiliary load in rule 1.2.

Rule 3.7.1

29. This amendment ensures that an Applicant has the right to use the land on which a CMU is to be located. In its recent consultation response[1] DECC announced its intention to consider further

1 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/412934/Government_Response_to_Feb_2015_consultation_on_amendments_to_the_CM_Reg.pdf

the monitoring requirements and delivery incentives for Prospective CMUs. A strong delivery incentive would avoid the need for additional regulatory requirements such as this.

30. Should this amendment remain, it should refer to the land on which the CMU is to be located.

Rule 3.7.2 (c)

31. This DECC amendment references 1 May 2012 in its definition of Capital Expenditure. It needs to be updated to be consistent with Ofgem's revised definition of Qualifying Capital Expenditure (outcome of consultation questions 1 and 2).

Rule 8.3.1A

32. This rule specifies that Interconnector CMUs should supply the Relevant Planning Consent. The definition of Relevant Planning Consent applies only to UK planning regulations, any new build Interconnector CMU should also be required to demonstrate equivalent consent from the relevant interconnected country.

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