UK Demand Response Association

5th May 2015

Ofgem

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By email: EMR_CMRules@ofgem.gov.uk

Dear Ofgem

UKDRA welcomes the opportunity to respond to your consultation of 2 April on proposed changes to the Capacity Market (CM) Rules.

We have grouped our responses below by the Change Proposal (CP) they relate to, and have reproduced extracts from the consultation text for ease of reference.

We have also addressed questions 6 and 8 specifically.

We would be happy to discuss any aspect of this response with Ofgem if needed.

Yours sincerely

UK Demand Response Association

Proposal CP45 (Double forfeit for DSR)

The consultation said: "*NGET have clarified that a metering assessment and a metering test, if required, must have been successfully completed before a DSR test can take place. Therefore we do not believe that both penalties can be levied in practice so we reject this proposal.*"

UKDRA response

NGET's clarification only addresses one of two circumstances in which credit cover can be drawn down, namely, the situation in which a DSR CMU a DSR test takes place and the capacity demonstrated is insufficient. This is covered in Regulation 61 paragraph (1)(a)(ii).

This does not address Regulation 61 paragraph (1)(a)(i), which states that credit cover must be drawn down if the credit obligation period has not ended before the start of the relevant delivery year.

For the credit obligation period to end in respect of an Unproven DSR CMU which is the subject of a Capacity Agreement, it must provide a DSR test certificate demonstrating adequate capacity (Regulation 60 paragraph (1)(f)). A CMU which does not undergo the DSR test before the delivery year commences would suffer this drawdown.

Rule 6.10.3 states that termination fee TF1 (£5,000/MW) applies to a CMU in respect of which a capacity agreement is terminated under Rule 6.10.1 on the grounds specified in paragraph 6.10.1(h) – this would be the case if an Unproven DSR CMU failed to provide a Metering Test Certificate one month prior to the relevant delivery year.

We do not see any provision which ends the credit obligation period on termination of a Capacity Agreement or on payment of a termination fee.

Therefore an Unproven DSR CMU which is unable to progress at all would pay TF1 for failing to provide a Metering Test Certificate one month before the Delivery Year, and would suffer drawdown of credit cover at the start of the Delivery Year because it was unable to bring the credit obligation period to an end.

It appears to us, therefore, that the double forfeit is indeed present in the Rules as they stand. Our proposed modification – a general "safety net" provision against double forfeit – is one possible way of dealing with this situation. There may be alternatives which are more efficient or more targeted. We are less concerned with the particular remedy than with making sure that a remedy is found for the current unfair arrangement.

Proposal CP46 (DSR Allocation)

Question 6 asks: "*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?*"

UKDRA response

We welcome Ofgem's decision to consider this modification further and its aim to implement a version of it prior to the start of the Transitional Arrangements. The benefits brought by reallocation are proven: the vast majority of aggregated DSR present in GB at present is under such provisions, and the sector has enjoyed unprecedented growth since these provisions were introduced. In particular, the STOR market saw the introduction of such terms progressively, with the most important stage being the introduction of a new Aggregator Model in December 2010. Since then, competition in the STOR market has increased substantially, and several new DSR aggregators have entered the market.

It is clear that a single large power station is under the control of one person, who can take on obligations in respect of it. An aggregated DSR portfolio, by contrast, is at the level of its components under the control of a wide variety of people. It is only at the portfolio level that the aggregator can exert control equivalent to that of the power station owner. It does this by monitoring and predicting availability of existing components, sourcing new components when required, and allowing other components to leave.

Currently, aggregated DSR tends to consist mainly of medium-to-large-scale commercial and industrial sites. The Capacity Market, quite correctly, admits *all* scales, through aggregation. Clearly, inclusion of SMEs and domestic DSR will increase the volume participating in the CM and will lower costs for consumers. DSR companies are actively recruiting capacity in these categories.

When comparing multiple small entities in a portfolio against a power station, it is important to recognise that a Capacity Agreement is not a contract; it is a set of obligations in law to which individual *components* are subject. This is an onerous matter from the viewpoint of a small enterprise or a domestic consumer, and is thus a barrier to entry. Further, this means that all components are bound to their aggregators by law, regardless of commercial contract. It is not clear how competition amongst aggregators will be ensured given this circumstance, or how SME and domestic consumers will be protected.

The remedy – the ability to allocate, re-allocate and de-allocate DSR components to DSR CMUs – is a simple solution to these problems, because it allows consumers – domestic, commercial or industrial – the ability to withdraw from a contract with one aggregator and (if they choose to) engage in a contract with another. *De facto,* the force of the obligations fall on the aggregator, who is best placed to manage it.

Allocation must be managed and subject to a controlling framework which keeps "churn" to a reasonable level (noting that churn in obligation trading is virtually unlimited!). It would be advantageous to create a CMU Component Register to assist the DB and the SB in keeping track of changes (indeed, the existence of such a register could help in other areas of the CM, such as pre-qualification). In fact, the only possible downside we see is administrative: participating sites and associated arrangements must be tracked. However, most of the administrative tasks associated with this are already present in the current arrangements. The SB is already preparing, for example, a programme of random site visits to ensure compliance without excessive burden. The proposed framework is therefore a well-proven, practical enhancement which will deliver lower costs for the consumer.

Proposal CP47 (Line Loss Factors)

The consultation said: "*[UKDRA] proposed amendments should be made to clarify how Line Loss Factors are to be incorporated in the relevant areas of the Rules for Distribution CMUs…DECC published draft Rule amendments on 27 March and one of these amendments seeks to ensure that Line Loss Factors are applied consistently…Based on DECC's amendments we propose to add further provisions to ensure that Line Loss Factors apply consistently and are accounted for in the changes we are making to those parts of the Rules which will make use of the amended definitions*"

UKDRA response

We welcome Ofgem's recognition that changes are needed to the treatment of line loss factors. We understand that Ofgem recognises the fundamental point which is that each MW of DSR or distributed generation CMU is worth more, from a system security point of view, than a MW of traditional TSO-connected generation, because the former reduces transmission and distribution losses.

Ofgem will need to carefully consider how best to take this proposal forward. While any approach will need to work with the GB market, we urge Ofgem to look at how line losses are treated in other capacity markets in other jurisdictions, as part of the process of developing a GB approach. ISO New England (ISO-NE) in the United States, for example, applies what it calls a "gross up" to demand side resources. This is done based on determination of the average loss factor across the entire region that is used in the determination of the installed capacity requirement; it is neither locational nor temporal specific. We would support this sort of clear, simple approach, where the LLF was set to be a single number for all DSR/distributed generation CMUs, based on an average that is determined either directly or indirectly in the calculation of the UK capacity requirement.

We also emphasise that any approach needs to cover both transmission and distribution losses.

Proposal CP48 (Restrictions on participating in both Transitional Arrangements and T-4 auction)

The consultation said: "*This submission proposed to remove Rule 11.3.2(b) which prohibits Non-CMRS Distribution CMUs or DSR CMUs that have been awarded a Capacity Agreement in a Capacity Auction (other than a Transitional Capacity Auction) from participating in the transitional arrangements…. [Ofgem's view is that] The policy aim of the Transitional Arrangements is to help develop and grow the DSR sector so that it is able to participate in the first year-ahead auction in 2017, and subsequent auctions thereafter….Allowing existing DSR (or, equally, generation) with capacity agreements to take part in the transitional auctions would go directly against that policy intent – capacity that is demonstrably ready to take part in the full auctions would be able to participate in auctions specifically designed for those not ready to take part in the full auctions…capacity that is already developed so as to be able to successfully participate in the full auctions may crowd out the emerging resources the transitional auctions were designed to support. In the medium and long term we are of the view that this would be against the interests of consumers as it could lead to less DSR in total participating in CM auctions.*"

UKDRA response

We welcome Ofgem's repetition of the stated policy aim of the TAs. And it is true that allowing DSR to participate in the TAs will grow the capacity that is available to compete in the first delivery year of the CM (i.e., 2018/2019) to address security of supply, whether via a T-1 or via a T-4. If not for the TAs, there will be less DSR available to compete in the first CM delivery year.

However, DSR and aggregators would use the TAs to build more **new** DSR resources for the first delivery year of the CM if they were allowed flexibility of securing agreements via T-4. This would allow DSR future revenue certainty combined with TAs. Excluding **existing** DSR from participating in TA if it has already has secured a capacity agreement via T-4 would be a better implementation of the stated policy intent.

The effect of excluding DSR participating in the TAs from also participating in T-4 is that it needs to rely on the T-1 auction for the years immediately after the TAs finish. However, the T-1 auctions are not guaranteed to be run even if the T-4 auction for the corresponding delivery year was run. Thus there is the risk that GB customers pay for TAs and do not reap the benefits, plus an additional risk to DSR not faced by other resources. Excluding DSR from competing in TAs if it is already participating in the CM via T-4 only serves to reduce the options and increase the risk - in comparison to other types of CMU - by which that DSR can compete in the first delivery year.

Therefore, the effect of exclusivity is to **reduce** the level of DSR – the opposite of Ofgem's conclusion that removing exclusivity could "*…lead to less DSR in total participating in CM auctions*".

Additionally, the current rules lead to additional consumer costs, as shown by a report by NERA in 2014[3]. We urge Ofgem to consider this point carefully, in light of its principal objective.

Finally, to the extent that the government is investing in growing various technologies, it is fundamentally unfair to handcuff one technology (DSR) compared to others in terms of treatment in the market. The CM Regulations permit other technologies to secure subsides in the same interim years as the TAs cover, and still participate in CM via the T-4 so long as certifying that as of the start of the CM delivery year in 2018, they will cease to be getting subsidies.

Proposals CP 44 and 63: Introduce 'DSR alternative Delivery Period'

The consultation said: "*We propose to take forward this proposal in order to ensure that the Rules do not unduly prevent DSR CMUs from qualifying as Proven DSR CMUs if they are providing balancing services. This change will only apply to DSR CMUs and will affect the prequalification process for those CMUs with changes being made to Rule 13.2 (DSR Test) and Schedule 2 (Baseline Methodology).*"

UKDRA response

The proposed implementation by Ofgem meets our request and will indeed allow the DSR test of existing/proven DSR to happen as intended on past confirmed delivery of service to the system. This will be of benefit to DSR providers and the delivery body and align the rules with the intent of the regulations.

CP 49 (New baseline methodology)

The consultation said: "*We are rejecting this proposal based on the understanding that behind-the-meter generators such as the CHP technologies cited in this submission are able to participate in the Capacity Market by qualifying as an existing generating unit. However, we would welcome evidence that these technologies are failing to prequalify, or that there are benefits to allowing embedded generation to bid as a DSR component*".

The consultation asked a specific question on this change proposal: "*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?*"

UKDRA response

Our submission is based on the fact that there are significant benefits to allowing behind the meter generation including CHP to participate in the capacity market as components in a DSR CMU:

1. This would bring the CM in-line with current practice and DSR definition in the balancing markets allowing for a well understood market model for the valorisation of DSR (including CHP) across all accessible markets. The current implementation is confusing as the same asset is seen as generation in the CM but as DSR in the balancing services
2. In many cases the CHP flexibility is contracted together with load flexibility on the same site based on one process to find, valorise and contractualise the flexible potential of a consumer. Having to artificially split the flexibility between DSR and generation for the capacity market unnecessarily increases the complexity and more importantly increases risk for the consumer Indeed the split means that the over-performance of one cannot compensate the potential underperformance of the other component as would be the case if they could be part of the same DSR CMU.

We see no downside to allowing CHP to enter the CM as either generation or DSR CMU and believe this will allow a larger percentage of the CHP capacity to participate increasing market liquidity to the benefit of the end-consumer. It will allow the consumer that can offer flexibility in such a way to minimize their risks by choosing for the most adequate aggregation offer depending on their specific needs and profile.