Proposal for a Capacity Market Rules Change

Making a positive difference for energy consumers

Reference number*(to be completed by Ofgem)*: **CP132**

Name of Organisation(s) / individual(s): **Green Frog Power**	**Date Submitted:** **15 January 2016**
Type of Change: ☒ **Amendment** ☐ **Addition** ☐ **Revoke** ☐ **Substitution**	**If applicable, whether you are aware of an alternative proposal already submitted which this proposal relates to: No**

What the proposal relates to and if applicable, what current provision of Rules the proposal relates to *(please state provision number)***:**

9.2.5 (a) A transfer agreement under Rule 9.2.4 (a) can only be affected on the Capacity Market Register after the T-1 Auction for the relevant Delivery Year has concluded…

Description of the issue that the change proposal seeks to address:

This rule requires plant that does not have a capacity agreement for a delivery year to unnecessarily manage the risk that they might be unable to secure capacity income for the delivery year.

In the case of a plant that is unable to cover its fixed costs for the interim period, due perhaps to low market incomes combined with a cyclical maintenance programme, it may very well be the case that this plant will be unable to remain open for long-enough to permit the T-1 auction to determine its fate. This is particularly true if there are fixed costs for the Delivery Year that are sunk by the time of the T-1 auction (TEC, for example).

There is also the possibility that new build plant that *could* be built ahead of schedule *are not* if they are unable to secure an income stream at an early enough stage in the project schedule.

For any capacity committed plant that is unable to meet its obligation for any reason, enabling an earlier option for the risk of non-delivery of capacity could have a significant impact on the risk profile of the Capacity Market.

The Capacity market and consumers will be better off if capacity providers are able to manage these risks in an efficient and practical manner. Arbitrarily forcing plant to wait until almost the last minute to settle its risk position can only result in lower plant availability during the delivery year and higher overall costs, lower security of supply, or both.

If applicable, please state the proposed revised drafting *(please highlight the change)***:**

9.2.5 Transfers of a Capacity Agreement
(a) under Rule9.2.4 (a) can only be affected provided that, in the case of a Prospective Generating CMU and its second or third Delivery Year, it has achieved the Substantial Completion Milestone no later than 10 Working Days prior to the date of the T-1 Auction for that Delivery Year

Analysis and evidence on the impact on industry and/or consumers including any risks to note when making the revision - including, any potential implications for industry codes:

We do not believe there would be any implications for industry codes.

The impact on industry and consumers could only be positive. The intention of the Capacity Market is to reduce the risks, where possible, to Capacity Providers so that security of supply may be delivered at least cost. We believe that disallowing timely risk management techniques restores unnecessary risk to market participants. More risk will almost certainly result in a higher cost to the consumer.

In addition to lower costs of delivering security of supply, we believe that more plant will be available to deliver a higher level of security – again, with unambiguously positive impact on the consumer at little to no extra cost. If there is no shortage of capacity, then this proposal will make little to no difference to the outcome for consumers. If there is a capacity shortage than this proposal could have a dramatic impact

In theory this proposal could result in a lower quality of plant succeeding in the capacity market auctions, if they know there is an "easy out". We do not believe this is a material risk against the potential benefits. It seems that there would be little strategic benefit for intentionally acquiring an agreement to deliver capacity that the CMU is unable to deliver, even when knowing that the risk of non-delivery could be traded out.

Any plant that would engage in this strategy could very possibly find that it would have to pay a higher cost for substitute capacity than it achieved in the original auction. In the case that security of supply was tight because the counterparty would have the T-1 auction as an opportunity cost of the trade. In advance of the T-1 auction, where security of supply is tight, the counterparty could command a high payment for accepting the Capacity Agreement. But this circumstance on the final security of supply for the year, except that perhaps the counterparty would have been unable to wait to the T-1 auction before taking a closure decision.

It is only in the case where, as the Delivery Year gets closer, security of supply is not expected to be an issue that an intentionally unreliable plant might benefit from having obtained a T-4 capacity agreement, with a good expectation of being unable to deliver. In this case the Capacity Provider will be able to trade with a counterparty who would have an expectation of a low clearing price in the T-1 auction.

If this situation were to outturn, then only permitting a trade to occur after the T-1 auction would only increase the potential upside to the low-quality plant since a counterparty would likely pay more for a Capacity agreement if there were no other capacity income alternatives available for the delivery year. In other words, the counterparty will no long have the potential opportunity cost of the T-1 auction in its negotiating arsenal.

It appears clear to us that there could only be overall benefit to the industry and consumers of permitting earlier obligation trading, and that there are negligible downside risks to changing the rules accordingly.

Details of Proposer *(please include name, telephone number, email and organisation)***:**

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