



Open letter and consultation on changes to the Capacity Market Rules

Consultation by Ofgem

Response by E.ON SE Group

Key points

- We agree that Ofgem's focus should be on rule changes that simplify prequalification and clarification of the Rules. However, we are concerned that delaying rule changes for known issues creates complexity and could result in material, retrospective changes to existing agreements which have been entered into in good faith, at a capacity price based on the rules in place at the time of the relevant auction.
- More transparency is needed when Ofgem or the Delivery Body make decisions on interpretation of ambiguous rules, there should be a public register where decisions on interpretation are recorded and transparent to all participants.
- The process to determine connection capacity results in CMUs using multiple methodologies, some of which appear to conflict with the original policy intent and with other rules and regulations. Ofgem and DECC should clarify the policy intent as a matter of urgency and update the Rules to reflect this.
- Above all, the process to calculate connection capacity should ensure that all CMUs, both new and existing, prequalify on a consistent and comparable basis.
- DSR CMUs should be able to add, remove and reallocate in exactly the same way that generating CMUs can through secondary trading. There are opportunities to simplify the DSR metering tests which would ensure greater participation of DSR.

Consultation questions

Q1: Do you agree with our priorities? Are there other priorities which we should consider for this round of Rule changes?

1. We agree that Ofgem should continue to focus on changes which simplify prequalification and make the Rules clearer.
2. We also agree that Ofgem should only make changes where there is good evidence for doing so. However, we would caution that the risk of not correcting errors in the Rules quickly



enough often outweighs any risks in making changes in areas of the Rules which have not yet come into operation.

3. Bidders in the CM auction will base their prices around their understanding of the Rules, it is crucial therefore that the Rules reflect policy intent and are as accurate as they can be, even if they have not yet come into operation. For example, the rules concerning calculation of penalties for non-delivery will have a material impact on bidders' exit prices. Generally, any bidder will base its analysis and assumptions on the wording of the CM Rules even if this appears to conflict with policy intent. Delaying changes to rules because they have not yet been tested could therefore affect materially the clearing prices in auctions.
4. A CM provider with an existing agreement at a specified price would not expect a retrospective change to that agreement which had a material impact on its value. If, for example, Ofgem delayed until the first full delivery year (2018/19) a change to the rules relating to penalties in the delivery year, all agreements issued before that change would have prices based on the previous version of the rules, in force at the time of the auction. On the assumption that Ofgem does not make retrospective, material changes to agreements, these existing agreements would need to be grandfathered. As each auction issues agreements of different tenure, there would soon be a situation where in each delivery year, CM providers and the Delivery Body are working to multiple versions of the Rules which have been grandfathered at different times.
5. To some extent this situation is unavoidable and is made particularly complex by the multiple agreement tenures offered in each auction. Ofgem can minimise the complexity by ensuring material changes are made as early as possible, notwithstanding the need to ensure changes are fully considered and tested wherever possible.
6. Ofgem must also consider that the first delivery year begins in October 2016 for CMUs with agreements from the transitional arrangements auction. Therefore any changes which affect delivery of capacity which Ofgem may have otherwise delayed for the first full delivery year (beginning in October 2018) need to be implemented in this round of changes, ready for October 2016.
7. Where the application of the Rules by the Delivery Body has required a decision that in effect serves to clarify an otherwise ambiguous rule, this should be transparent. It would be helpful if Ofgem or the Delivery Body published such decisions and interpretations on a register. In addition, where an administrative party or capacity provider notifies the delivery body of a possible termination in accordance with rule 6.10.2 (a) this information, and any decision to progress with termination or a justification of why not, should be published immediately



(currently the Rules only require the CM register to be updated when the agreement is terminated, this could be up to 120 days after the initial notice was issued).

Q2: Do you think there are issues with the current methodology for calculating connection capacity, as described in Annex 1? Are there other issues we have not considered?

8. There are issues with the current methodology for calculating connection capacity. Most importantly, the process of determining connection capacity in the Rules allows multiple options, some of which appear to conflict with the original policy intent and with other rules and regulations. Above all, Ofgem (and DECC) should make it absolutely clear what is expected of a CMU when it determines its connection capacity. Only by doing this can Ofgem and DECC ensure that all CMUs prequalify on a consistent and comparable basis.
9. Our understanding of the policy intent is that connection capacity should be based on the maximum capacity a CMU can physically generate at a time of system stress; de-rating factors are then applied to this physical maximum which is used to determine the final capacity in the agreement.
10. As Ofgem highlights, the CM Rules currently allow a CMU to nominate connection capacity using CEC which could give a capacity greater than the maximum physical capacity of a CMU. However, when de-rated, a CMU could deliver this amount (and can therefore meet all testing requirements and delivery obligations).
11. On the assumption that capacity agreements already awarded are not retrospectively altered, we have no particular preference as to how this rule is corrected or which approach is deemed consistent with the policy intent. The priority must be to clarify the approach and ensure all CM participants, both new and existing, prequalify on a consistent basis.
12. We note that if CMUs are able to prequalify using connection capacity above the maximum level they can physically generate, the methodology behind National Grid's derating factors may be incorrect. However, we also note that a simple reduction in average derating factors to compensate for this would penalise CMUs who cannot use CEC or whose CEC is at a level they can physically generate. This would encourage all CMUs to increase CEC to a level which, when derated, meets their maximum physical generation (although arguably the Rules already provide this incentive).

Q3: Do you believe that any of the options presented in Annex 1 would improve the calculation of connection capacity? Are there other options we have not considered?



13. As highlighted above, we believe it is crucial that Ofgem and DECC clarify formally the policy intent in determining connection capacity, it is difficult to suggest or comment on rule changes whilst that intent is unclear.
14. We have previously suggested to Ofgem that, based on our understanding of the policy intent, the testing rules should apply to connection capacity rather than de-rated capacity (proposal CP26 in 2015 Ofgem rule changes). This would clarify that CMUs would have to nominate a connection capacity they could physically deliver at any time of year, although we do accept that CMUs in a stress event could deliver capacity in excess of TEC.
15. As has been illustrated by the multiple attempts to correct this rule, finding a single solution which suits all CMUs without unintended consequences seems unlikely. On balance we continue to believe that correcting the testing rule to ensure capacity agreements are adjusted to reflect the maximum capacity a CMU can deliver throughout the year is the most sensible approach, recognising that in some circumstances CMUs would have to adjust downwards their connection capacity to reflect their TEC to avoid breaching the CUSC during a testing event.

Q3a – Do you agree that the sum of unit CECs should always be used when apportioning TEC?

16. We agree with this proposal.

Q3b – Do you think that not being able to choose a lower connection capacity is a problem? What are your views on the options considered?

17. As the proposals set out by Ofgem in Annex 1 illustrate, defining a process which suits all capacity providers is extremely challenging. It is for this reason that throughout the design of the CM many capacity providers, including E.ON, suggested that allowing providers to nominate their own capacity would be more effective.
18. If supported by a well-designed auction which encourages capacity providers to maximise their capacity offers, and robust penalty and testing regimes to ensure capacity providers do not over-state their offers, we continue to believe that allowing applicants to choose their own connection capacity (option I in Ofgem's letter) offers the best solution.
19. Incentives to maximise capacity in the auction are already strong. We do not accept that existing providers would have an incentive or ability to withhold capacity; in any case, existing regulations already prevent this.
20. However, as we have highlighted consistently in our consultation responses to DECC and Ofgem, we believe the existing penalty and testing regime is weak. There is a case to review



and strengthen the penalties for non-delivery and testing arrangements, particularly if capacity providers are able to choose their own connection capacity.

Q3c – Do you think there is an issue with taking the lowest figure in a connection agreement? Do you believe that a choice of figures should be allowed?

21. As highlighted above, we believe applicants should have a choice in the nomination of connection capacity. The deterrent for an applicant considering over-stating its capacity should be a robust penalty and testing regime, not additional, prescriptive rules and regulations which risk unintended consequences (as demonstrated by the need to review connection capacity rules).

Q4: Do you believe that the benefits of allowing DSR CMUs to add, remove and reallocate outweigh the costs of increased testing and prequalification? Does volume reallocation already provide sufficient flexibility for DSR CMUs?

22. DSR CMUs should be able to add, remove and reallocate in exactly the same way that generating CMUs can through secondary trading. Not allowing this could restrict DSR participation and result in higher clearing prices.
23. We agree that volume reallocation provides some flexibility to DSR CMUs and has the potential to remove the need for more complex procedures requiring full DSR tests each time a DSR CMU swaps in or out a DSR component.
24. However, the metering test requirements for DSR CMUs are onerous, particularly where the component has already passed the relevant metering test in other schemes such as STOR. Aligning the CM metering test to STOR and accepting STOR metering test approvals in the CM would remove a key administrative barrier and result in more parties to participate in volume reallocation.

Q5: Do you agree that Emergency Manual Disconnection, as covered in section OC6.7 of the Grid Code, should be included in the definition of System Stress Event, Capacity Market Warning and Involuntary Load Reduction?

25. We agree with this proposal.

Q6: Do you agree with the proposals in Annex 2?

Defaulting CMUs

26. We agree that CMUs that are not successful in the auction can be defaulting CMUs, provided all other conditions are met.



27. We note that, for the same reasons Ofgem highlights, termination penalties only apply to CMUs with agreements. Therefore DECC's proposed new termination event for providing misleading information, which Ofgem cites as an example, will incur no financial penalty for CMUs which do not receive agreements in the auction.

E.ON SE Group

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