

David O'Neil  
The Office of Gas and Electricity Markets  
9 Millbank  
London  
SW1P 3GE

15 January 2015

Dear David,

**ELECTRICITY MARKET REFORM: OPEN LETTER AND CONSULTATION ON CHANGES TO THE CAPACITY MARKET RULES**

We welcome the opportunity to respond to the above Consultation.

We support Ofgem's commitment to ensuring that the detailed framework of Capacity Market (CM) Rules is fit for purpose going forward. In this context, we welcome the focus on simplifying arrangements for pre-qualification and making the Rules clearer. In addition, we consider that this is an opportunity for checking that the Rules provide a framework that effectively reflects DECC's policy aims, including its current focus on ensuring that there are no design flaws or inadvertent barriers to robust new build projects coming through the auction. A continuing focus on facilitating competition on a level playing field is clearly key to delivering upon this.

Our responses to the specific priority areas identified in the Open Letter are outlined below.

**Connection capacity**

We agree that that this is an area within the Rules that would benefit from change. We believe the simplest solution, in terms of minimising the risks of over and under procurement, is to determine connection capacity based on the minimum of historical output and Transmission Energy Capacity (TEC) (Option C). If this option were adopted, however, careful consideration would need to be given to the historical operation of a Capacity Market Unit (CMU), as a degree of flexibility may be required. For example, a CMU may have had a lengthy maintenance or repair outage, or it could have been mothballed, in which case the connection capacity could be based on TEC.

**Correction to the TEC formula**

We agree that using the station-level Connection Entry Capacity (CEC) could result in a connection capacity that is not equal to the total TEC. The option under Rule 3.5.5(a)(i) should, therefore, be removed to ensure that only the sum of individual CECs is used to apportion TEC.

## **How to treat CMUs which want a lower connection capacity**

We agree that that the inability to choose a lower capacity figure could lead to plant not pre-qualifying, rather than participating with a smaller agreement. We believe that participants wishing to choose a lower capacity figure should be able to apply for a derogation to the Rules during pre-qualification (with the appropriate director commitments). In spite of the need for an element of judgement by the CM Delivery Body, we consider this to be the appropriate approach, given the appeals process in place. We believe the risk of reducing competition in the CM auction due to this change would be limited.

## **Formal proposals for Rule changes**

We have also considered further potential Rule changes. In doing so, we have contributed to Energy UK's CM Rule Change engagement process with a view to assisting the overall Ofgem process and minimising time and effort where possible and appropriate. In parallel, we are here submitting three further Rule change proposals as outlined below.

- **Discrepancies between planning consents and TEC:** Planning consents are issued based on the ISO conditions, including an ambient temperature of 15 degrees C. In colder weather, a CCGT will have higher output, mainly because cold gas is denser and a greater mass therefore enters the turbine (and to a lesser extent also because of a higher Carnot efficiency). Accordingly, TEC for a Prospective New Build is likely to be set at that higher level. This difference can cause problems with the pre-qualification requirement that the planning consent level must be greater than or equal to the TEC. We consider that the Rules need amending to address this and we set out a possible way of doing this in our Change proposal.
- **Changes to prequalification to minimise tier 1 appeals:** For the 2015 T-4 Auction the 'tier 1 appeals' process was extensively used as, in effect, a pre-qualification 'technical verification process'. We consider that pre-qualification can be adapted and improved by providing for an explicit 'technical verification process'. This would offer a route to resolve minor pre-qualification issues without the need for engaging the formal appeals process. This in turn would enable such matters to be resolved more effectively with less resource and time being used. Moreover, it avoids unnecessary concerns being created amongst investors given that consideration of such minor and technical issues will generally be unlikely to lead to a failure to pre-qualify.
- **CM Register and technology type:** We believe that technology type should be added to the data published on the CM Register. This is submitted for de-rating purposes (and the Delivery Body use it in their publications) so it would be useful to see it published on the CM Register. Applicants would then be able to perform similar analysis to that of the Delivery Body. We also suggest the category of 'CCGT and reciprocating engines' is split such that the fuel types of gas and diesel can be distinguished. This proposed change is consistent with providing appropriate transparency to industry, other stakeholders and the public generally on what exactly was being procured. This is clearly important given the socialised funding of the CM through the supplier obligation. Further, it would enable matters such as the environmental impact of the different sub-categories of CMUs to be properly assessed.

Whilst these three proposals are aimed at simplifying the CM process and making it as clear and effective as possible, we consider that there needs to be further consideration given to the Regulatory and Rule framework to ensure that it properly delivers upon DECC's underlying policy aim of ensuring that all technologies compete on a level playing field so as to deliver a cost-effective Capacity Market.

In this context, we consider that in order to ensure a level playing field across the competition for CM agreements in the auction, it is necessary to prevent embedded generation from being double rewarded through both the CM and Triad management. This can be achieved by disregarding generation from CMUs in the calculation of demand in Triad periods. Otherwise, small embedded generators could be rewarded for Triad management (predicted to be around £45/kW in 2019/20) as well as by the CM (with a clearing price of £18/kW in 2019/20). This nearly triple reward is not available to larger new build power stations and is likely to lead to an inefficient allocation of resources. We consider that there will need to be changes to the overarching legislative, regulation and rules framework to ensure that this is addressed and we would therefore invite Ofgem to work with DECC on how this might be best implemented. We would, of course, be happy to discuss further this particular matter in more detail if that were helpful.

If you have any questions in relation to our response, please do not hesitate to contact me.

Yours sincerely,



**Rupert Steele**  
Director of Regulation