

Capacity Market participants,
prospective participants and
other interested parties

Email: EMR_CMRules@ofgem.gov.uk
Date: 17 November 2016

Dear colleague

Decision: Consultation on further amendments to the Capacity Market Rules (the "Rules") pursuant to Regulation 79 of the Capacity Market Regulations 2014 (the "Regulations")

Summary

- This letter sets out our decisions on three proposed changes to the Capacity Market Rules¹ (the "Rules") pursuant to Regulation 77 of the Electricity Capacity Regulations 2014 (the "Regulations")².
- We have decided to take forward two of the proposed changes to the Rules (affecting Rule 1.2 and Rule 13.4.1B). As these are not urgent, we will make these changes during our normal capacity market rule changes process ahead of prequalification in 2017, subject to the Parliamentary timetable.
- For the purpose of the first Transitional Arrangements Delivery Year, we have also identified a change to the Load-following Capacity Obligation (LFCO) formula that we consider would meet the specified objectives set out in Regulation 78 (affecting Rule 8.5.3). However, the Settlement Body has advised that this change cannot be implemented before settlement systems are updated by the Settlement Body and therefore we do not propose to make a change at this time.
- When reaching our decisions, we have taken into account the ten formal responses to our consultation on these three proposed changes to the Rules.

Introduction

On 21st July 2016 we published a consultation (the "July consultation") on further amendments to the Capacity Market Rules³.

¹ The latest version of the Rules can be found at https://www.ofgem.gov.uk/system/files/docs/2016/07/capacity_market_rules_2016_presented_to_parliament.pdf

² The Electricity Capacity Regulations 2014 came into force on 1 August 2014 http://www.legislation.gov.uk/ukdsi/2014/9780111116852/pdfs/ukdsi_9780111116852_en.pdf

³ Ofgem, *Consultation on further amendments to the Capacity Market Rules*, 21 July 2016, <https://www.ofgem.gov.uk/publications-and-updates/consultation-further-amendments-capacity-market-rules>

Two of the issues under consultation were identified as requiring further consideration in our earlier decision, published on 5th July 2016⁴. These were:

- the definition of Mandatory CMUs; and
- ensuring the Load Following Capacity Obligation (LFCO) formula scales obligations correctly during the first delivery year of the Transitional Arrangements (TA).

We also invited views on one further amendment which would correct the drafting relating to the demonstration of satisfactory performance for CMU Portfolios. This correction affects a change taken forward following our April consultation⁵.

The deadline for responding to this consultation was 19 August 2016. We received ten responses, which are summarised in more detail alongside our decision in Annex A of this letter.

Context

The Capacity Market is governed by the Regulations and the Rules. The Regulations permit us to amend, add to, revoke or substitute (change) any provision of the Rules. When changing the Rules, we must have regard to our principal objective and general duties⁶, and the specific objectives set out in the Regulations⁷:

- promoting investment in capacity to ensure security of electricity supply
- facilitating the efficient operation and administration of the Capacity Market
- ensuring the compatibility of the Capacity Market Rules with other subordinate legislation under Part 2 of the Energy Act 2013.

Section 41(9) of the Energy Act 2013 requires that the Authority, when amending the Rules, must, as soon as reasonably practicable after amendments are made, lay them before Parliament and publish them. We expect the amendments to be laid before Parliament alongside any changes made following our spring consultation in 2017. We expect therefore that the changes will be in force before the 2017 prequalification window opens.

Our decision on amendments to the Rules

Annex A sets out our decisions and reasoning for each of the proposals. We considered any new arguments or evidence received before making our final decisions. Where appropriate, we have amended our decision and/or drafting in light of stakeholders' feedback.

List of annexes

- Annex A – summarises the responses we received for each Rule change proposal we consulted on in the July consultation and our decisions
- Annex B – provides a table summary of our decisions

⁴ Ofgem, *Decision on the statutory consultation on amendments to the Capacity Market Rules*, 5 July 2016, <https://www.ofgem.gov.uk/publications-and-updates/decision-statutory-consultation-amendments-capacity-market-rules-0>

⁵ Ofgem, *Statutory consultation on amendments to the Capacity Market Rules*, 29 April 2016, www.ofgem.gov.uk/publications-and-updates/statutory-consultation-amendments-capacity-market-rules-0

⁶ Ofgem's principal objective and general duties can be found at www.ofgem.gov.uk

⁷ Regulation 78 sets out these objectives. Regulation 77(3)(a) states that the Authority must not make any provision in Capacity Market Rules which is inconsistent with the Regulations

Next steps

As explained above, where we have proposed Rules changes, these changes are expected to come into effect later next year. We are continuing to engage with ESC and EMR Settlement Ltd to discuss if, and when, systems changes related to the LFCO formula could be made.

Yours faithfully,

Philippa Pickford
Associate Partner
Wholesale Markets

Annex A

Of10

This proposal would amend the definition of Mandatory CMU under Rule 1.2 so that all types of capacity defined as 'excluded capacity' in the Regulations are excluded from the definition of Mandatory CMU.

Consultation responses and decision

We asked stakeholders two questions relating to this proposal; firstly asking if they agreed with the proposal (Q1a), and secondly if the drafting accurately captures the policy intent (Q1b).

We received nine responses to these questions in our consultation. Each respondent agreed that this proposal should be taken forward, and no issues were identified with regard to the proposed legal drafting. We will therefore take forward this proposal with the drafting set out in our July consultation. As stated above, we intend to introduce the required amendments in 2017 alongside any changes identified during the 2017 process for changing the Rules. For clarity, the final decision has been made in this letter, and therefore, whilst the amendments will be made as part of our 2017 process, there will be no further consultation on in this change during that process.

Of11

This proposal would add text to Rule 13.4.1B to ensure that CMU Portfolios are demonstrating satisfactory performance on three separate days during the winter of the relevant Delivery Year, as is required of individual CMUs under Rule 13.4.1.

Consultation responses and decision

We asked stakeholders if they thought our proposed drafting accurately reflects the policy intent we had outlined during consultation (Q2). We received nine responses on this question in our consultation. Each respondent agreed that the drafting accurately reflected policy intent, and there were no objections to taking the amendment forward. We have therefore decided to make the amendment and implement the proposed drafting. As stated above, we intend to introduce the required amendments in 2017 alongside any changes identified during our 2017 process.

CP128

This proposal sought a review of the LFCO formula to ensure it scaled obligations correctly during the first (current) delivery year of the Transitional Arrangements (TAs). We note that particular circumstances, notably seasonal variance in DSR capability, is required for this issue to arise and that the Delivery Body has advised us that these circumstances could be uncommon. However, in our April consultation we agreed that there was a functional issue with the formula and invited views on how it should be amended. In our July consultation we presented an overview of the formula, the issues identified, and a summary of each of the suggestions we had received for amending the formula. At that time we identified two proposals as our preferred solutions.

For a full overview of the issue please refer to our July consultation document and earlier decision on the statutory consultation. To summarise, the current formula is a two-part calculation, where the first part of the formula identifies the current obligation and the second part contains a multiplier (a minimum function) which should act to scale the obligation according to demand. The result is the Load Following Capacity Obligation.

The issue we identified in consultation relates to the multiplier function. The multiplier contains a proxy for demand based on the sum of capacity delivered by Capacity Committed CMUs during the occurrence of a Stress Event in a Settlement Period (E_{ij}). For the current TA delivery year, we noted that the amount of capacity, which is in the denominator, would be so small relative to nominator (E_{ij}) that the minimum function would always be set to equal 1, and obligations would not therefore be scaled appropriately.

Consultation responses and decision

In our July consultation we asked stakeholders if they agreed with our preferred option for amending the LFCO formula. This question followed our previous consultation, in response to which we received broad support for taking forward an amendment to fix the issue ahead of the first TA delivery year.

We received seven responses to our question during this consultation. Four respondents supported our lead option, to use historic average demand (proposed by Green Frog Power). However, EDF Energy pointed out that the Green Frog proposal, as it uses historic demand data, should be based on the same periods within years, in order to calculate an accurate average figure. We agree with this and note that the Green Frog proposal does not do this. However, we consider that the changes necessary to amend this omission would make this option more complicated than our other preferred option (the National Grid proposal).

The National Grid proposal would base the scaling factor on the proportion of system demand during stress to the peak system demand. We have therefore concluded that this is the best option for resolving this issue, as it is simpler than the amended Green Frog Power proposal. No one responded to our consultation stating there were opposed to this particular approach.

ESC, the Settlement Body, responded to our consultation raising concerns about the impact that changes to this formula could have for the systems they have already designed and are currently testing. ESC raised concerns that this would only be a temporary solution and also stated that they are currently completing testing for a number of changes to 'core functions' that must be delivered by the Delivery Year for the settlement processes to function in accordance with the current Rules, and that any change to the LFCO formula now would mean retests are required and the implementation of the settlement system would be delayed.

We have engaged with the ESC and EMR Settlement Ltd since receiving their response to consultation. Both parties have made clear that they are already delivering a heavy programme of capacity market settlement change from BEIS and as a result it is not possible for the systems that would introduce an amendment to the LFCO formula to be delivered at this time. Therefore, we do not propose to make a change to the rules that cannot be implemented by ESC and EMR Settlement Ltd.

We are continuing to engage with ESC and EMR Settlement Ltd to determine if and when system changes are possible and if they can be prioritised. As noted in our April consultation, we believe that the current formula would be more likely to

have detrimental effect in the summer, when TA participants are likely to be required to deliver less than their full obligation. Therefore, if a change can be made before next summer it is likely to still be beneficial.

A number of stakeholders raised concerns for how the current LFCO formula may impact obligations in the enduring arrangements. As we have not received a specific rule change proposal relating to this, we are not currently considering this further.

Annex B

Ref. No.	Summary of proposals	Decision
Of10	This proposal would amend the definition of Mandatory CMU under Rule 1.2 so that all types of capacity defined as 'excluded capacity' in the Regulations are excluded from the definition of Mandatory CMU.	Take forward
Of11	This proposal would add drafting within Rule 13.4.1B to ensure that CMU Portfolios are demonstrating satisfactory performance on three separate days during Winter of the relevant Delivery Year, as is required of individual CMUs under Rule 13.4.1.	Take forward
CP128	This proposal would amend the LFCO formula to ensure that obligations are scaled correctly in the event of Stress Event during the Delivery Years of the Transitional Arrangements.	Take forward if and when systems can be implemented.