

# Proposal for a Capacity Market Rules Change



Making a positive difference  
for energy consumers

Reference number (to be completed by  
Ofgem): CP293

Name of Organisation(s) / individual(s):  
EP UK Investments

Date Submitted:  
13 October 2017

**Type of Change:**

- Amendment
- Addition
- Revoke
- Substitution

**If applicable, whether you are aware of an alternative proposal already submitted which this proposal relates to:**

[Click here to enter text.](#)

**Proposal summary** (short summary, suitable for published description on our website)

This proposal would amend the Capacity Market Rules so that Existing CMUs which opted out of the T-4 auction for a Delivery Year on the basis that they would be closed down by the start of the Delivery Year are no longer excluded from participating in the T-1 auction for that Delivery Year. This will ensure liquidity in the T-1 auctions and remove perverse incentives when CMUs are making opt out decisions at the T-4 stage.

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

Rules 3.3.3(b) and (c) and the definition of Excluded CMU prevent an Existing Generating CMU which opted out of a T-4 auction for a Delivery Year on the basis of the reason stated in 3.11(f)(i) from participating in the T-1 auction for that Delivery Year and the two following Delivery Years.

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

Likelihood of changed circumstances

If a Mandatory CMU wishes to opt out of a T-4 auction, it is required to select a reason for opting out from the list of three prescribed reasons in Rule 3.11.2(f). Although Directors of these CMUs will select the statement that best reflects the balance of their views on the basis of the information available at the time, it may not be possible for Directors to determine with certainty whether their CMU will be open or closed in four years time and there is no 'Do Not Know' option in the Rules.

In reality, there is a strong likelihood that the operational circumstances of a CMU could change between the T-4 auction and the Delivery Year as a result of altered market and regulatory conditions. This can be seen in the case of Longannet, which opted out of the T-4 auction for the 2018/19 Delivery Year on the basis that it would remain open into the Delivery Year but closed in March 2016.

These changed circumstances are likely to be particularly pronounced for CMUs which opted out of the first few T-4 capacity auctions in the expectation that they would be closed by the Delivery Year because of unexpected policy and regulatory interventions since then. For example, CMUs which were anticipated to close may since have secured Supplemental Balancing Reserve contracts or been successful in the Early Auction for the 2017/18 Delivery Year, neither of which

could have been foreseen when choosing a reason for opting out of the initial T-4 auctions.

It therefore possible that CMUs which opted out of the initial T-4 capacity market auctions on the basis that they would remain open into a Delivery Year have subsequently closed whereas those which opted out on the basis that they would be closed are still operational.

#### Ensuring liquidity in the T-1 auction

The T-1 auctions play an important role in securing enough capacity to meet the Reliability Standard. The capacity requirement at the T-1 stage could be large, especially where unforeseen circumstances have occurred since the T-4 auction (eg. where a Capacity Agreement awarded at the T-4 stage has been terminated). To ensure that there is sufficient capacity to participate in the T-1 auction and guarantee that it is competitive (thereby preventing the unnecessary escalation of costs to consumers), it is crucial to ensure that all available capacity is able to participate.

As described above, it may be the case that some capacity which opted out of the T-4 auction on the basis that it would be closed by the start of the Delivery Year is still operational at the T-1 stage whereas plant which opted out on the basis that it would remain operational or participated in the auction but did not secure an agreement has shut. If these CMUs which are still operational are not allowed to obtain support in the T-1 auction for that Delivery Year, they may also close, leading to less capacity being available in that Delivery Year than originally anticipated and less competition and a higher clearing price in the T-1 auction.

#### The consequences of different opt out decisions do not reflect their impact on consumers

If a CMU opts out of a T-4 auction on the basis that it will be closed by the Delivery Year, it is excluded from participating at the T-1 stage if it is still operational. However, if a CMU opts out of a T-4 auction on the basis that it will remain operational, it is allowed to participate in the T-1 auction and does not face any penalty if it is not operational in the Delivery Year. This is likely to incentivise CMUs that are not sure of their future operational status at the T-4 stage to state that they will remain operational and therefore keep their options open, potentially giving a false impression of the capacity that will be available in the Delivery Year.

However, the impact on consumers of an opted out CMU stating it will remain operational but subsequently closing is likely to be worse than an opting out CMU stating it will close but remaining operational. If the first case insufficient capacity will have been procured at the T-4 stage, leading to a higher capacity requirement and probably a higher clearing price in the T-1 auction, whereas in the second case replacement capacity will have been procured in the T-4 auctions, which have been shown to be competitive, therefore limiting the cost impact on consumers.

The current rules therefore create an incentive which could have negative consequences for consumers. This incentive would be removed if CMUs which opt out of a T-4 auction on the basis they will be closed are able to participate in the T-1 auction.

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

Delete Rule 3.3.3(b); and

Amend the definition of Excluded CMU to read as follows:

Excluded CMU means for a T-4 Auction for Delivery Year "t", an Existing CMU (or any Generating Unit forming part of an Existing Generating CMU) that is, for any T-4 Auction in respect of Delivery Years t-1 or t-2, Retired.

#### **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:**

As replacement capacity is procured in a T-4 auction when a CMU states it will be closed by the start of the Delivery Year, this reduces the likelihood of that CMU securing an agreement in the T-

1 auction and therefore the possibility for any strategic bidding behaviour by participants in relation to the T-4 and T-1 auctions. We therefore consider that this rule change is unlikely to have a negative impact on consumers and could benefit them by ensuring increased liquidity in T-1 auctions.

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

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