

Michael Wagner - Deputy Director, Wholesale Markets
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Dear Michael,

Five Year Review of the Capacity Market Rules and NGET's incentives

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, storage, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

Priorities for Ofgem's Five Year Review

We welcome the opportunity to comment on Ofgem's priority areas for its Five Year Review. We are particularly keen to see that Ofgem's proposal on connection capacity is implemented and would welcome further engagement on how this will be achieved.

We agree that intermittent renewables should be permitted to participate in the Capacity Market. It is important that all of the implications are properly considered which include:

- Ensuring that the de-rating factors for renewable technologies are based on incremental Equivalent Firm Capacity;
- Satisfactory Performance Day (SPD) testing should be based on full (not de-rated) capacity;
- Testing to take place at or near "peak demand" periods of the day;
- Consider a requirement for at least one test annually to demonstrate Satisfactory Performance over an extended period.

We believe that there is a case for reform of the penalty regime. This should lead to higher levels of penalties related to the Value of Lost Load and independent of the clearing capacity market price. However, reform of the penalty regime will not be enough on its own as significant changes to SPD testing is also required.

As system stress events are perceived by many stakeholders to be unlikely, the risk of high penalties in a system stress event may not be an effective deterrent against poor performing capacity. A fairer and more effective testing regime should be introduced, including requirements to prove that capacity can be delivered at peak times of day and can be delivered for extended durations. Improvements are also required in the interaction between the Capacity Market Rules on secondary trading and SPD testing and in the data transfer processes for demonstrating SPDs.

We believe that increased liquidity of secondary trading would support the more efficient delivery of capacity, which would benefit both market participants and consumers. We set out our detailed views and recommendations on the penalty regime, SPDs and secondary trading in the attachment to this letter.

Objectives of the Capacity Market Rules

EDF Energy believes that the current objectives for the Capacity Market Rules remain appropriate. However, we believe that it is important that the Capacity Market Rules should be kept as simple as possible. While all players within the Capacity Market agree on the importance of simplicity, there is an almost inevitable drift towards greater levels of complexity whenever changes are made to the framework. Wherever possible, we should look for simpler ways to deliver the objectives.

Some valuable improvements to the Capacity Market framework have been delayed due to lack of Parliamentary time to amend the Regulations. Ofgem should work with Government to review the Capacity Regulations and Capacity Market Rules to determine whether these could be rationalised and, in particular, whether any elements of the Regulations could be more effectively managed within the Capacity Market Rules by Ofgem.

2018/19 Capacity Market Rule change proposal process

We have submitted one Capacity Market Rule change proposal for Ofgem to consider for 2019 implementation. Ofgem's open letter sets out its intention to focus on implementing changes which have already been consulted and decided on. We welcome Ofgem's commitment to ensure that amendments are to be made to ALFCO as well as implementation of Of12.

In Ofgem's 2018 decision letter, it committed to deliver CP270 and CP271 but to delay implementation, so these are aligned with implementation of Of12. In addition, Ofgem pledged to engage with stakeholders on 'changes to configuration' of Generating Units as part of the Five Year Review to enable flexibility for Capacity Providers, while retaining delivery assurance. We still need clarity on what "change the configuration" means and ideally confirmation that changing the text and/or the number of BMU IDs is not considered to be a change to the configuration.

Furthermore, in its 2017 decision for CP233 Ofgem committed to consult on the Capacity Market Rules clarifying how auxiliary load should be calculated where it is not separately metered for each unit. It also committed to consult on detailed drafting for aspects of Of15 including capacity tests and penalty parameters to be applied for partial termination. We believe that it is important that Ofgem's Five Year Review does tackle all these issues.

Capacity Market Rule change process

We believe that Ofgem is the right body to manage changes to the Capacity Market Rules, to be responsible for the resolution of disputes and overseeing the Delivery Body's compliance with their Capacity Market duties. However, there are opportunities to improve the change process which should be explored.

Recently the Delivery Body and EMR Settlements Body released letters highlighting difficulties they have responding to the pace of changes in the Capacity Market. We understand that the Delivery Partners work with Ofgem to establish a prioritised list of changes which can be implemented into its systems to support the Capacity Market framework.

We recommend that Ofgem work with the Delivery Partners to ensure that a schedule of planned Capacity Market Rule reviews and system developments by the Delivery Partners is published regularly detailing at least an 18-month outlook. By taking account legislative and technical constraints, this would provide all stakeholders with a clearer picture of future developments and allow them to better understand how Capacity Market Rule change proposals could be implemented. This in turn would help ensure that stakeholders are able to put forward more considered change proposals.

Ofgem should also explore what can be done to expedite more timely delivery of improvements to the Capacity Market by minimising the delays arising from Delivery Partner systems development.

We believe that it is important that accessing the Capacity Market Rules is simplified. We have encountered issues with access, such as:

- Not being able to obtain official consolidated Capacity Market Rules;
- Publication of Capacity Market Rule changes being located on different websites and different versions of the Capacity Market Rules are not easily accessible.

We believe that there is a role for Ofgem to better display the Capacity Market Rules so that Capacity Providers are able to refer to and track their obligations for CMUs from the point in time the Capacity Agreements apply. We are concerned that over time, with more Capacity Market Rule changes expected it will be increasingly difficult to maintain an up to date knowledge of the current version of the Capacity Market Rules. An example of this issue is where the 2018 consolidated Capacity Market Rules sets out the SPD obligations for Capacity agreements entered into after December 2017; where some Capacity Providers have up to 15 year agreements that will have different SPDs obligations that applied prior to the December 2017 changes.

We welcome the co-operation and level of engagement between Ofgem and BEIS to date and are keen to ensure that this continues as the industry works together to improve the Capacity Market Rules and the Regulatory framework.

We note that Ofgem intends to review National Grid's incentives on dispute resolution, DSR prequalification, demand forecasting, and customer and stakeholder satisfaction for 2019/20. We would welcome further engagement on this to ensure that the incentives on the Delivery Body to exercise its functions in delivering the Capacity Market are appropriate.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Natasha Ranatunga on 07875 112981, or me. I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely

A handwritten signature in black ink, appearing to read "Angela Hepworth".

Angela Hepworth
Corporate Policy and Regulation Director

Attachment

Reform of Penalty Regime

There is a case for strengthening the penalty regime to provide stronger incentives to deliver during system stress events. We believe that:

- Penalties should be related to (an estimate of) Value of Lost Load (VOLL) so they are broadly equivalent to the damage suffered by customers if capacity providers do not deliver.
- There should still be a cap to limit the extreme risk to Capacity Providers if there is a year with multiple stress events.
- Penalties and penalty caps related to VOLL (not to actual capacity revenues) will provide more consistent incentives and will encourage liquidity in secondary trading.
- Ofgem should consider whether the removal of over-delivery payments would provide better incentives for capacity providers in stress events

However, higher penalties on their own are not an adequate solution. When there is a high risk of an imminent system stress event, scarcity prices in the energy market can be expected to provide incentives for action by market participants – the role of the Capacity Market is to ensure that capacity will be available to respond in these circumstances.

Moreover, the likelihood of system stress events is perceived by many stakeholders to be very low. A very low probability of penalties may not provide sufficient incentive for all Capacity Providers to take action in advance to ensure that adequate capacity will be available when required, even though there is a potentially very high impact if the penalties were ever incurred. In other words, the overall risk posed by the penalties may be judged to be low enough not to warrant taking advance action.

Nonetheless, the risk of penalties may incentivise some Capacity Providers to transfer obligations in advance of long periods of planned outages. However, as Obligation Transfers must be notified to the Delivery Body five working days in advance, it should be noted that secondary trading does not necessarily provide a route for intermittent generators to manage penalty risk (e.g. from low wind conditions).

Reform Satisfactory Performance Days testing

We believe that further measures, including reform of the SPD testing regime, are necessary to ensure that capacity will be available when required. A fairer and more effective testing regime should be introduced, including requirements to prove that capacity can be delivered at peak times of day and can be delivered for extended durations. Improvements are also required in the

interaction between the rules on secondary trading and SPD testing and in the data transfer processes for demonstrating SPDs.

Testing should be based on the full connection capacity (not the de-rated capacity); this would be consistent with Ofgem's Of15 proposals on connection capacity. As stated above this becomes particularly important when intermittent renewable capacity is included in the Capacity Market.

Testing should be carried out at (or near) the peak time of day, measured in terms of the net requirement from Capacity Market capacity. With an increasing proportion of capacity provided by sources other than firm generation capacity, there is an increasing possibility that the capacity contribution from some assets will not be the same at all times of day and may be lower when it is most needed.

Ofgem should consider whether it would be beneficial to require more frequent testing. Under current arrangements, it is possible for a Capacity Provider to meet SPD requirements in the first four months of the Delivery Year and then to continue to receive capacity revenue for the remainder of the Delivery Year, whether they are available or not. A balance must be struck between the level of assurance obtained and the cost to Capacity Providers; however, a regime which required testing on, say, a quarterly basis, might provide stronger assurance that capacity will be provided when required. Although system stress events are more likely in the mid-winter months, it would not be impossible for them to occur at any time of year.

Improve the interaction between the SPD and secondary trading arrangements so that when a capacity obligation is transferred for a significant period, say three months, the SPD requirement is transferred with it. At present, the SPD requirement is only transferred when the entire capacity obligation is transferred for the entire Delivery Year. This limits the scope for the systematic use of secondary trading to cover major outages to ensure that adequate capacity is available when required throughout the year.

Ofgem should encourage Government to introduce partial termination as a remedy for partial failure to meet SPD requirements, consistent with the approach to pre-T-1 testing in Ofgem's Of15 proposals on connection capacity.

Ofgem should consider whether to require all CMUs to perform one extended duration SPD test annually to show that they can deliver capacity for 4 hours. This recognises that concerns over duration could potentially apply to technologies other than storage.

There should be a review to the settlement processes operated by EMRS that are used to transfer data to demonstrate achievement of SPDs. We believe that the current processes are inadequate and introduce additional unnecessary risk for participants.

Enhance Secondary Trading Arrangements

We believe that there is a strong case for allowing Obligation Transfers to be registered before the T-1 auction to facilitate the most effective provision of capacity into the market. This would provide a straightforward mechanism for a Capacity Provider to transfer a capacity obligation to another provider at the earliest opportunity. It would also ensure that such transfers are visible to the market before the T-1 auction takes place.

We also believe that Capacity Providers should be allowed to offer their obligations in the T-1 auctions at pre-determined prices i.e. the lower of Capacity Agreement price or T-1 clearing price. This could help facilitate the development of a secondary market and provide a better signal as to the value of capacity.

We believe that it would be helpful to have a central platform for identifying trading parties, or some other more efficient mechanism than just the provision of secondary trading contacts on the Capacity Market Register.

The Delivery Body process to 'action' secondary trade is not instantaneous, Capacity Market Rule 7.5.1 (p) allows the Delivery Body to complete this process within five Working Days of receiving a 'valid request' from both the transferor and the Transferee. Determining/ agreeing what a valid request is could delay this process further. We do not believe that this process is sustainable if the volume of secondary trading increases.

Ofgem should consider whether over-delivery payments for volume reallocation should be removed in order to incentivise trading following a system stress event. This could create a much stronger incentive for participants to use Obligation Transfers or Volume Reallocation to extract some value from their assets.

Obligation Transfers only allow a CMU to transfer SPD testing requirements when the whole capacity obligation is transferred for the whole of the year; this does not facilitate the systematic use of secondary trading to cover major outages to ensure that adequate capacity is available when required throughout the year. Capacity Providers should be allowed to transfer SPD testing requirements (for 1 or more SPDs) to be transferred through Obligation transfers covering periods of [three] months or more.