

# FIVE YEAR REVIEW OF THE CAPACITY MARKET RULES AND NGET'S INCENTIVES

Open Letter

National Grid Interconnector Holdings (NGIH)

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## About National Grid Ventures

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*National Grid Ventures (NGV), part of National Grid plc, is a distinct commercial unit that owns and operates energy businesses in competitive markets in the UK and US. NGV's UK portfolio includes National Grid Interconnector Holdings, Grain LNG, and National Grid Metering.*

### Executive summary

NGIH<sup>1</sup> welcomes Ofgem's Open Letter, signalling the start of its Five-Year Review of the GB Capacity Market. The Capacity Market is a critical tool in delivering security of supply at the lowest cost for consumers. Ofgem's review running concurrently with that of the Department for Business, Energy and Industrial Strategy (BEIS) will help to ensure the Capacity Market remains fit-for-purpose, continuing to drive security and affordability, while supporting the efficient transition to a smarter, low carbon energy system.

The Capacity Market is broadly working well; making meaningful steps towards its primary aim of ensuring security of supply at the lowest cost for consumers. In its first year of full operation we have witnessed no Capacity Market Notices indicating security of supply has been maintained despite a colder than average winter in 2017/18<sup>2</sup>. The auctions have delivered good value for GB consumers. The Capacity Market has also played a key role in encouraging investment in new build capacity again promoting security of supply into the future.

We have separately provided a response to BEIS' recent Call for Evidence. In that response, we have provided evidence on some of the major policy related aspects of the design of the Capacity Market. We do not repeat those points in this response; instead we are focussing our response to Ofgem on some of the more practical aspects related Capacity Market Rules where we believe that significant efficiencies could be delivered through Ofgem's five-year review. We would be happy to provide Ofgem with a copy of our response to BEIS if that would prove useful.

Our main comment is on the Capacity Market Prequalification process. This has evolved into a needlessly time-consuming exercise that sucks in huge amounts of industry resource. We feel that it can be significantly simplified and by doing so reduce the administrative complexity and costs associated with it. It should also break down barriers to entry and inject further liquidity into the capacity market.

<sup>1</sup> NGIH holds ownership shares in IFA, BritNed and Nemo Link and this response is on behalf of those entities

<sup>2</sup> Source: Met Office <https://www.metoffice.gov.uk/climate/uk/summaries/2018/winter>

We have also provided commentary on other areas of the Capacity Market Rules. Our key insights are that:

1. **The calculation of an interconnector's real time capacity obligation during a stress event** (its "Adjusted Load Following Capacity Obligation" or "ALFCO") needs to be considerably improved. At present, it does not deliver an unambiguous baseline against which delivery can be assessed for an interconnector.
2. **The ability to query data provided by the System Operator used in the settlement process.** A key learning from this year's mock stress event is that it is unclear how such data, if inaccurate can be queried and remedied prior to settlement of penalties occurring.
3. **The Capacity Market Change Process.** As we pointed out in our response to BEIS' call for evidence, coordination between BEIS and Ofgem is crucial. Both in this five-year review process and in the general annual change process we would encourage even greater coordination between government and regulator to ensure that the appropriate changes to the Capacity Market Rules and Regulations can be delivered in a timely manner.
4. **Delivery Body Incentives.** We believe that the existing set of incentives that broadly target the customer service offered by the Delivery Body to be correct. Through reform of the prequalification process we believe that this will free up Delivery Body resources to focus on additional value-adding activities rather than devote most of its time to simply getting applicants through the process.

## 1. Simplifying the Prequalification Process

The existing prequalification process is in urgent need of reform. It is a vital element of the capacity market process, but in its current form it represents a significant drain on industry resources and a needless barrier to entry to participation in the capacity market.

Maximising the number of market participants enhances efficiency; the current design of the Capacity Market is putting this at risk. Pre-qualification is an increasingly complex, data intensive, and labour intensive process. The increasing complexity is due to the increased number of applicants compared to the first years of the Capacity Market, and the increased requirements at the prequalification stage.

The process is labour intensive as applicants have only one chance to prequalify - if they fail they are barred from the auction. Regulation 69 prevents new information from being provided as part of the dispute process. Therefore, applicants seek reassurance that they have not made an avoidable error; this requires the Delivery Body to put significant resources into queries and guidance material. Despite the Delivery Body's efforts, we have seen a significant rise in the number of disputes, as shown in Figure 1; reinforcing that the process is becoming ever more complex.

The process is not easier for parties that have undertaken prequalification in previous years. Each year changes to the rules and regulations inevitably mean that new or different information is required as part of the prequalification process. Together with errors by new entrants, this has seen the numbers of disputes rise significantly year on year.

One way to address this can be found in our recent Capacity Market rule change proposal [CP328]<sup>3</sup>. This suggested that parties who had made an error in prequalification be conditionally prequalified, lodging credit cover until such time the error is rectified. Ofgem rejected this approach as a change in the regulations would be required.<sup>4</sup> As the five-year review offers an opportunity for coordinated Rules and Regulations changes we would ask that this be examined again. We have advised BEIS of the issues as well in our response to the call for evidence.

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<sup>3</sup> [https://www.ofgem.gov.uk/system/files/docs/2017/10/cp328\\_ngih.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/10/cp328_ngih.pdf)

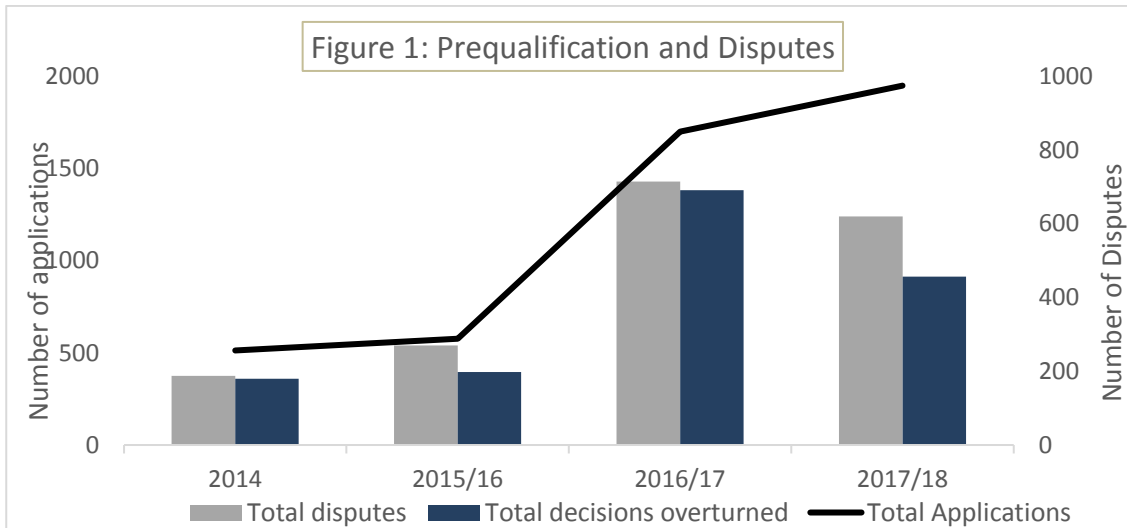
<sup>4</sup>

[https://www.ofgem.gov.uk/sites/default/files/docs/2015/06/annual\\_report\\_on\\_the\\_operation\\_of\\_the\\_cm\\_final\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/06/annual_report_on_the_operation_of_the_cm_final_0.pdf),

[https://www.ofgem.gov.uk/system/files/docs/2016/06/annual\\_report\\_on\\_the\\_operation\\_of\\_the\\_capacity\\_market\\_6\\_june\\_2016\\_final.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/06/annual_report_on_the_operation_of_the_capacity_market_6_june_2016_final.pdf),

[https://www.ofgem.gov.uk/system/files/docs/2017/06/annual\\_report\\_on\\_the\\_operation\\_of\\_the\\_capacity\\_market\\_in\\_2016-17.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/06/annual_report_on_the_operation_of_the_capacity_market_in_2016-17.pdf),

[https://www.ofgem.gov.uk/system/files/docs/2018/08/20180802\\_annual\\_report\\_on\\_the\\_operation\\_of\\_cm\\_2017-18\\_final.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/08/20180802_annual_report_on_the_operation_of_cm_2017-18_final.pdf)



Should our proposal for a “Conditional Prequalification” pending the rectification of errors in a prequalification application not be taken forward we have been considering alternative proposals. We set out our thinking in this area below.

We present three ways in which the process can be simplified:

<b>Delete</b>	<b>Remove data from the prequalification process where it serves no purpose at prequalification or later in the lifetime of an agreement</b>
<b>Delay</b>	<b>Data that is required but not to judge eligibility for the auction should be provided at the appropriate point after success at an auction</b>
<b>Advance</b>	<b>Take data that will rarely change into a “registration” process, carried out before 1<sup>st</sup> prequalification eliminating a need to recheck every year</b>

## 1.1. Deleting

There are a small number of data items that we have identified that, if removed, would streamline the prequalification process. These are not “game-changing” amendments to the process, but represent a set of marginal simplifications that, if adopted, will reduce the amount of administrative time spent by applicants gathering and entering the data. They will also correspondingly reduce the amount of time that the Delivery Body spends in checking the data.

Our analysis reveals that the following data requirements could be removed from the prequalification process:

Requirement	Associated Rule	Explanation
Interconnector Licence	3.4.1 (ea)	Unnecessary requirement which has already been eliminated for Generators
Connection Agreements	3.6A.2 or 3.7.3	Unnecessary requirement for transmission connected generators. CMU can be verified via TEC/Interconnector register
Technical Specifications	3.6B.1 (a)	Information provided by Interconnector CMUs only. Not used for any purpose and is unnecessary
Non-GB Part Location	3.6B.1 (b)	Information provided by Interconnector CMUs only. Not necessary and already defined by connecting country and derated capacity
Forecasted Technical Reliability	3.6B.1 (c)	Information provided by Interconnector CMUs only. Not necessary and already defined by derated capacity
Description of Interconnector / CMU	3.4.3 (a) (i)	Not necessary. Information provided is meaningless.
Relevant interconnector identifiers	3.4.3. (a) (iv)	Unnecessary requirement as duplicates information given under requirement to provide BMU ID data
Conduct Declarations	3.12.4	Not necessary, already accounted for by the Certificate of Conduct

## 1.2. Delaying

We believe that there are a certain number of data items that could be removed from the Prequalification process entirely and then provided later following successful prequalification or after success at an auction. These data items directly relate to processes after prequalification and so do not need to be provided and checked at prequalification.

Such processes include construction monitoring of New Builds. The details provided as part of a construction plan can be provided and monitored as part of the process following a successful award of a capacity agreement following the auction. All that need be provided at prequalification is a simple declaration that the New Build project is intended to be constructed by the start of the relevant Delivery Year.

Others relate to processes even further ahead of prequalification. For example, the provision of contact details for secondary trading. It seems an overly draconian process to require this at the prequalification stage, especially as it is likely years before any party will be optimising their delivery year positions and so likely to be able to either buy or sell through secondary trading. It would be far better to require these details at a point following prequalification.

It is likely that far more data items could be stripped out of prequalification via this route and more significant efficiency gains could be achieved. This should also remain relatively simple to implement from a systems perspective as the data items can simply be left out of the prequalification process and then added into a subsidiary process already being run following prequalification.

The following information requirements could be delayed for New Build CMUs

Requirement	Associated Rule	Explanation
Construction Plan – Summary, Extended Years, Milestones & Total Project Spend	3.7.2	Information could be removed from Prequalification and initially provided in the first construction report (under Rule 12.2) following the auction
Secondary trading details	3.4.1 (a) (ii)	A New Build CMU is unable to trade until it has passed its Substantial Completion Milestone. Trading contact details can be provided as part of this process.
BMU/Component ID	3.4.3 (a) (iii)	Should be provided as part of the Substantial Completion Milestone for New Build CMUs
MPAN/MSID Meter ID	3.4.3 (a) (ii)	
Metering Assessment and Associated Load	3.4.5, 3.5A.1 & 3.5B.1	
Single Line Diagram	3.6A.3	
Other Metering Information	No associated rule	

### 1.3. Advance

To realise maximum efficiency in the prequalification process would require a system of registration of Capacity Market Units. This would establish outside of the formal prequalification window a record of the CMU and Applicant Company data that currently is re-entered and re-assessed every single prequalification period.

Instead the bulk of information about applicant companies and the Capacity Market Units would be gathered ahead of the prequalification process through a process of registration with the Delivery Body. This could take place well in advance of the formal “prequalification period”. Once the information has



been provided and validated once by the Delivery Body that data can then be “locked” within the prequalification system.

Then when applying for prequalification all that need be selected is a Capacity Market Unit ID and the Applicant Company. The data that then would need to be provided could be very limited at prequalification. This would significantly improve the prequalification process and turn it from a hugely intensive 12-week period, to perhaps one that could be completed inside of a month.

Our analysis is that the following data items could be removed from the Prequalification process to a one-off “registration” process that could be run to validate data at any time of the year.

	Existing	New Build
<b>Company Information</b>		
<b>Company Name, Address and Registration Number</b>	X	X
<b>Certificate of Incorporation</b>	X	X
<b>VAT Number</b>	X	X
<b>Type of Enterprise</b>	X	X
<b>Secondary Trading details*</b>	X	
<b>Parent Company &amp; Name</b>	X	X
<b>Low Carbon Exclusions and Low Carbon Grants Declarations</b>	X	X
<b>STOR Declarations</b>	X	X
<b>CMU information</b>		
<b>CMU Name</b>	X	X
<b>Classification of CMU (e.g. CMRS)</b>	X	X
<b>BMU/Component ID*</b>	X	
<b>Method used to calculate the Connection Capacity (e.g. CEC)</b>	X	X
<b>GB Location of Interconnector CMU</b>	X	X
<b>Ordinance Survey Grid Reference of the CMU Component</b>	X	X
<b>MPAN/MSID Meter Identifier*</b>	X	
<b>BMU ID(s)*</b>	X	
<b>Metering Assessment*</b>	X	
<b>Interconnector Associated Load*</b>	X	
<b>Single Line Diagram*</b>	X	
<b>Other Metering Information*</b>	X	
<b>Connection Agreements (for distribution or private wire connected generators)</b>	X	X
<b>Planning Consents</b>		X
<b>Financial Commitment Milestone</b>		X

\*: For New Build CMUs, Delay until after Prequalification. Also included in this category are the Substantial Completion Milestone and Declaration on Credit Cover pre-FCM.

By combining all three proposals we believe that the Application sent in at prequalification could then be limited to the following information:

	Existing	New Build
<b>CMU ID</b> (selected from a drop down list of registered CMUs)	x	x
<b>Applicant Company</b> (selected from a drop down list of registered Companies)	x	x
<b>Application Status (Legal Owner / Joint Owner etc.)</b>	x	x
<b>Despatch Controller / Aggregator / Joint Owner Exhibit</b> (If applicable)	x	x
<b>Agent Nomination Form</b> (if applicable)	x	x
<b>Previous Settlement Period Performance</b>	x	
<b>Evidence of previous Settlement Period Performance (e.g. Supplier Letter)</b> (If applicable)	x	
<b>Information on whether Credit Cover previously supplied still stands</b>		x
<b>Prequalification Certificate</b>	x	x
<b>Certificate of Conduct</b>	x	x

This represents a very significant reduction in the volume of data that would need to be checked and validated during the prequalification window. We believe that if adopted, while similar information would be gathered about the CMU as now, the summer prequalification process would be vastly simplified and be far more efficient as a consequence.

#### 1.4. Directors Signatures

A final point on the Prequalification process is the requirement for a number of documents to be signed by Directors of a company. This we feel is unnecessary for the documentation provided under the Capacity Market rules.

Many commercial contracts require only parties that are authorised to sign “for and on behalf of” a company. Companies have delegations of authority established such that every document need not be signed by the board of directors. Requiring a signature on exhibits “for and on behalf of” an Applicant company would significantly ease the process.

## 2. Other Issues

### 2.1. Interconnector ALFCO

Following the decision by BEIS to introduce an ALFCO formula for interconnectors, through the inclusion of interconnector CMUs in rule 8.5.2 (a), we have become concerned over its ability to accurately measure interconnector performance. It is right that interconnectors are subject to an ALFCO formula as it ensures that stress event performance is based solely on the delivery for which the CMU is responsible rather than for the levels of delivery outside of their control, such as SO actions. However, we doubt that the ALFCO formula can undertake this task for interconnector CMUs in its current form. As there has been no adjustments to the formula, which was originally designed for generating units, to reflect the differing nature of interconnector operations it seems very unlikely that the formula will work for interconnector CMUs, especially given their unique BMU ID set up.

We have previously been in conversation with Ofgem to resolve this issue, and have been made aware of a piece of work by EMRS into ALFCO more generally, but are yet to see any results of these inquiries. This five-year review presents an opportunity for Ofgem to conduct further investigations into this issue and present an ALFCO solution which will precisely measure real interconnector performance in a stress event.

Moreover, this formula must be designed with future developments in mind. CCM, TERRE and MARI all grant additional powers to the GB SO and the connecting SO to control flows on the interconnector. These must be accounted for by ALFCO formula along with more traditional SO actions. We look forward to supporting a review in this area.

### 2.2. Electricity System Operator (ESO) Data

During this year's mock stress event we witnessed two issues with the recording of Interconnector performance data. Whilst we investigated the causes of these errors for IFA we also understand that the performance data for other interconnectors was inaccurately recorded.

Following further investigation by EMRS this inaccuracy for IFA was traced back to data provided by the ESO.

Following the mock stress event simulation, we have independently verified with the ESO that the live system which will be used in an actual stress event should not produce the same error. Nevertheless, this outlined a clear flaw in the current data dispute process. Had this error occurred in a real stress event inaccurate performance data would have prevented NGIH interconnectors from the opportunity to volume reallocate. Furthermore, slow resolution of this error may lead to the wrongful issue of penalties, creating real financial impacts for an affected interconnector CMU.

This is an issue that could affect any CMU that is reliant on ESO data for settlement. For example, this includes providers of Balancing Services as well as interconnectors.

Ofgem should take this opportunity to introduce a timely dispute mechanism for data provided by the SO in a stress event. Currently, there is no mechanism for such a dispute to take place; the arrangements for EMRS data state that a dispute must not relate to that provided by a third party i.e. the SO. Therefore, there is currently a gap in accountability for a key portion of data which makes up

stress event settlement. This must be resolved to ensure that stress event performance is accurately recorded and paid/penalised.

### 2.3. Capacity Market Change Process

The legal and regulatory framework for the Capacity Market establish dual roles for BEIS and Ofgem. BEIS have responsibility for Capacity Market Regulations while Ofgem have responsibility for Capacity Market Rules.

It is clear from the first five years of operation that the two interact heavily. While BEIS has generally set out proposals for changes to the Regulations each year these tend to be restricted to the matters that BEIS has raised. Changes in areas beyond what are initially consulted upon are rarely taken forward.

Ofgem runs a wider change process in relation to the Rules, inviting submissions from the industry on any area of change the Rules. Ofgem does on many occasions find itself having to reject a change on procedural grounds as it would need a corresponding change in regulations which only BEIS can progress.

We would prefer to see a process be established whereby changes that are identified by industry can be progressed in a coordinated manner, such that if approved the required Regulation and Rules changes can be progressed in parallel.

### 2.4. Delivery Body Incentives

The Delivery Body provides a crucial role in the Capacity Market especially during prequalification and the auction. The circumstances in which they deliver this role are undeniably challenging, given the complexity of the processes and the numbers of applicants now taking part in the capacity market. As government considers opening the capacity market to further participants (e.g. renewables) the role will become increasingly important but also increasingly challenging.

The existing incentives on the Delivery Body, targeting measures of customer service in the form of numbers of disputes and the results of surveys of overall customer satisfaction are broadly appropriate. We think it important the Delivery Body continue to be incentivised to delivering first class customer service as they assist applicants through the process. The overall aim for the Delivery Body during prequalification should be to facilitate as straightforward a process as possible, that allows maximum participation (within the limitations of the rules and regulations).

As indicated in the first part of the response there is a clear challenge to simplify the prequalification process. By reducing the complexity this would also assist the Delivery Body by easing the peak workload during the three months where prequalification occurs. We believe that the five-year review offers a key opportunity for Ofgem, the Delivery Body and Capacity market participants to work together to simplify the prequalification process.