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Open letter on the Five-Year Review of the Capacity Market Rules Dated 11th September 2018

Dear Michael,

SmartestEnergy welcomes the opportunity to respond to Ofgem's Open letter on the Five-Year Review of the Capacity Market Rules and NGET's Incentives.

SmartestEnergy is an aggregator of embedded generation in the wholesale market, an aggregator of demand and frequency services and a supplier in the electricity retail market, serving large corporate and group organisations.

Please note that our response is not confidential.

SmartestEnergy's response

Overall, we consider that the existing Capacity Market (CM) Rules are failing to meet their objectives. On a general level, the existing set-up and governance of the rules are preventing effective change from taking place. We propose that obligations and requirements of participation in the scheme should be placed within a CM code, in order to provide a cogent hub of current arrangements and change information. This would make the CM more accessible to participants who currently have to be aware of Rules, Regulations and Working Practices. It would also provide a standard change process under an administrator with sufficient resource to implement changes without the restriction of a time-limited window.

We understand the complexity involved with running a full rule change process alongside both this and the 5-Year Review being conducted by The Department for Business, Energy and Industrial Strategy (BEIS). However, we consider it inappropriate that Ofgem can choose to cherry-pick which areas of the rules should be reviewed before an assessment procedure under open governance. Numerous change proposals, such as the one allowing generation without a distribution connection to bid into CM auctions, are worthy of consideration just as much as the issues outlined in the open letter. We are also concerned about the inability to raise new change proposals in light of our own experience of the last CM year. We would like to raise a change to allow submission of Satisfactory Performance Day (SPD) data through any available method, in response to challenges we have encountered this year. We understand this has been a problem for a number of CM participants. The fact that new proposals will have to wait until the 2019/20 Rule Change process further shows the arbitrary nature of CM governance.

We address the suitability of the CM Rules when measured against their objectives below:

Objectives:

Promoting investment in capacity to ensure security of electricity supply:

Thus far, the Capacity Market has not promoted investment in new capacity to ensure security of supply. The rules have been such that auctions have turned out at low prices. Whilst this is good for consumers, it does mean that new capacity has been unable to deploy using CM contracts, as was originally envisaged when designing the scheme (gas plant particularly). However, security of supply has been achieved since the CM began operating. This has largely been due to sufficient electricity margins negating the need to call many CM events.

Moving forwards, we believe that there are two ways in which changes to the CM Rules can promote investment to ensure security of supply. Firstly, renewables should be allowed to compete in CM auctions. When considered against the current policy environment of subsidy removal, it is important that renewables are able access CM revenues in order to incentivise continued investment and deployment. Secondly, coal plant should be excluded from CM auctions. By removing coal (which will have to come offline by 2025 anyway), the auction turn-out price will rebound to a more realistic level (as coal, being established and financially written down, has a relatively low short term marginal cost, artificially suppressing the out-turn value) providing a better opportunity for investment in new projects.

Facilitating the efficient operation and administration of the Capacity Market:

We are strongly of the opinion that the operation and administration of the CM has been extremely inefficient. The existing rule change process leads to a piecemeal approach with annual rule changes. Approval or rejection of changes are solely down to the opinion of the regulator, with the weight of industry opinion not having the bearing it does in other change processes across industry codes. Decisions have also been influenced by Ofgem's operational constraints. For example, Ofgem have previously rejected sensible changes to the rules on the basis that they would require too much work e.g. CP254 – allowing incremental capacity from sites with T-4 agreements to bid into T-1 auctions for the same delivery year. Whilst we recognise the difficulty Ofgem faces in managing the rules, this is a clear demonstration that another body with dedicated resource would be better served as administrator of the CM Rules.

The Rules have also been subject to sudden political intervention. Changes to the de-rating of batteries, metering tests and restrictions on diesel generation are just some examples. This makes for an uncertain policy environment and adds complexity to the operation and administration of the CM.

The pre-qualification rules are a specific area which are in desperate need of improvement. The existing rules are too restrictive, as pre-qualification applications can be rejected on the basis of a spelling mistake or other minor issue. We would welcome a fast-track appeals process for such decisions which has more common-sense discretion in order to make administration and operation of the CM more efficient.

Ensuring the compatibility of the Capacity Market Rules with other subordinate legislation under Part 2 of the Energy Act 2013

The existing process prevents effective change due to the distinction between which issues can be addressed in the Rules governed by Ofgem and the regulations governed by BEIS. Both this and the Parliamentary time allocated to Brexit changes has led to an unsatisfactory change process for 2017/18. We would advocate the creation of a CM code containing all Rules and obligations on participants in order to optimise the change process and ensure compatibility between Rules and regulations. Ofgem is currently attempting to conduct a similar role to a code administrator without having the required resources (and potentially expertise) needed to govern the Rules surrounding the CM. By giving this obligation to a suitable party, Ofgem can return to its appropriate role as arbiter of material change, much like it does for the BSC, DCUSA, CUSC etc.

Should you require further clarification on this matter, please do not hesitate to contact me.

Yours sincerely,

Colin Prestwich
Head of Regulatory Affairs