

Report

Report on our Five Year Review of the Capacity Market Rules and Forward Work Plan

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In April 2019 we consulted on our Five Year Review of the Capacity Market Rules (“Rules”). This consultation invited stakeholders to provide feedback on proposed amendments to the Rules, as well as respond to wider policy questions on the Capacity Market framework. This was aligned with the priorities identified in our September 2018 open letter.

This document is intended to meet the requirements of Regulation 82 of the Electricity Capacity Regulations 2014 (“Regulations”) and Rule 15.2 of the Capacity Market Rules 2014, which require the Authority to carry out a review of the Rules within five years of their entry into force. This document also outlines our Forward Work Plan for changing the Rules and regulatory framework over the next two years.

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Executive Summary

Capacity Market Rules: Five Year Review

Scope

Regulation 82 of the Electricity Capacity Regulations 2014 (“Regulations”) and Rule 15.2 of the Capacity Market Rules 2014 (“Rules”) requires the Authority¹ to carry out a review of the Rules by 1 August 2019. This review is intended to assess whether the Rules continue to meet their objectives, whether the objectives remain appropriate, and whether those objectives could be met with less burden. Our review is in parallel with and complementary to the Department for Business, Energy and Industrial Strategy’s (“BEIS”) Five Year Review of the Capacity Market.

This report is intended to meet the requirements of Regulation 82 and Rule 15.2. We have assessed the Rules against the objectives set out under Regulation 78, in addition to the wider objective² of the CM within the Electricity Market Reform (“EMR”) programme of delivering security of supply at the lowest possible cost to consumers. Our view is that work is required in order to better facilitate these objectives. This report contains a Forward Work Plan which sets out our strategy for changing the Rules and regulatory framework to reduce both complexity and regulatory burden.

Background

We initiated our review by publishing an open letter on 11 September 2018³. On 15 November 2018 the General Court of the Court of Justice of the European Union found in favour of Tempus Energy in Tempus Energy Ltd and Tempus Energy Technology Ltd v European Commission. The result of the judgment was to introduce a standstill period while the Government seeks to reinstate State aid approval. Mindful of the standstill, in April 2019 we consulted on our Five Year Review of the Rules⁴. This First Policy Consultation invited stakeholders to provide feedback on discrete proposed amendments to the Rules, as well as respond to wider policy questions on the CM framework that aligned with the priorities identified in our open letter. This consultation was the first phase in developing a longer-term programme of changes to the Rules and to the way Ofgem’s Rules change process operates.

Our decision letter published on 18 July 2019⁵ set out our decisions and reasoning for the specific Rule change proposals put forward in the First Policy Consultation. It should be noted that not all of the feedback provided as a result of the consultation was directly addressed in this decision document. We would like to inform stakeholders that we are still reflecting on this valuable feedback; it will be addressed, and will help shape our policy position in the relevant future work stream as outlined in the Forward Work Plan.

BEIS published their Capacity Market: 5-year Review report on 22 July 2019⁶. It outlined their view on the performance of the Capacity Market (“CM”) scheme overall and also the

¹ References to the “Authority”, “Ofgem”, “us”, “we”, “our” are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

² https://www.legislation.gov.uk/ukdsi/2014/9780111116791/pdfs/ukdsiem_9780111116791_en.pdf

³ <https://www.ofgem.gov.uk/publications-and-updates/open-letter-five-year-review-capacity-market-rules-and-nget-s-incentives>

⁴ <https://www.ofgem.gov.uk/publications-and-updates/five-year-review-capacity-market->

⁵ <https://www.ofgem.gov.uk/publications-and-updates/decision-statutory-consultation-amendments-capacity-market-rules-2>

⁶ <https://www.gov.uk/government/publications/capacity-market-5-year-review-2014-to-2019>

performance of the scheme against its objectives. In addition, the report set out a plan for a future consultations and potential subsequent legislative changes to address issues highlighted in their call for evidence.⁷

Objectives

This section sets out the objectives intended to be achieved by the Rules, assesses the extent to which those objectives are being achieved, whether the objectives remain appropriate, and whether those objectives could be met with less burden.

We continue to believe that the objectives of the Rules remain appropriate and that the wider objective of the EMR programme of delivering security of supply at the lowest possible cost to consumers still remains appropriate. Therefore, we do not intend to make any amendments to the objectives of the Rules at this time. This was also the conclusion of BEIS' review of the CM's objectives⁸.

We believe that the Rules are meeting their first objective to deliver security of electricity supply; there has been a marked improvement of capacity margins since the introduction of the CM.

We believe that the second objective to facilitate the efficient operation of the CM is being met to an extent, but could be achieved more effectively and efficiently. This would require a reduction in the complexity and regulatory burden currently present in the Rules, systems and processes of the CM. The changes we decided to implement in the 18 July 2019 decision letter acts as a first phase in aiming to reduce these barriers. The Forward Work Plan outlined in this report details our programme of work to further reduce the regulatory burden imposed by the Rules, systems and processes.

We are committed to improving the Rules and framework, with the aim of reducing complexity and burden for participants. However, it is our view that this can only be achieved fully if these changes are aligned with the implementation of a much improved EMR Delivery Body Portal ("Portal"). On this basis we welcome the announcement at the Capacity Market Launch Event on the 17th July that National Grid Electricity System Operator EMR Delivery Body ("NGESO DB") is planning to review and improve the Portal by the Prequalification round in 2021. We will be working with BEIS and NGESO DB to ensure appropriate Rule changes and system improvements are aligned to achieve the step change stakeholders believe is required.

Forward Work Plan

This section covers our Forward Work Plan for changing the Rules and regulatory framework in the near future. It signposts planned future work streams, encompassing the policy areas that will be addressed from the first Policy Consultation, including the key activities associated with them and what the work stream aims to deliver.

The Forward Work Plan covers the following areas:

- **Rules change process:**

We propose to form a 'CM Advisory Group' comprised of industry stakeholders to assist in developing, scrutinising, and scoping potential proposals before they are submitted to Ofgem.

⁷ <https://www.gov.uk/government/consultations/capacity-market-and-emissions-performance-standard-review-call-for-evidence>

⁸ <https://www.gov.uk/government/publications/capacity-market-5-year-review-2014-to-2019>

- **Secondary Trading:**
In order to better facilitate an effective, liquid Secondary Trading market we plan to amend the Secondary Trading Rules and the associated framework. We aim to develop proposals with industry to reduce Rule complexity, remove barriers to entry and ensure the transfer of risk is appropriate.
- **A second consultation (including future Prequalification Rule changes and remaining changes discussed in the First Policy Consultation):**
We aim to issue a further consultation(s) on proposed Rule drafting amendments, which will take into consideration the feedback received in response to the First Policy Consultation.
- **NGESO DB incentives:**
We will decide upon an improved suite of incentives for NGESO DB. In order to do so we will aim to make a decision on any changes that might be required to the Special Conditions of NGESO's Electricity Transmission Licence.
- **NGESO DB revenues:**
We will decide upon a package of revenues for the RIIO-T1 period appropriate for the role undertaken and enabling implementation of a new Portal.

1. Introduction

Context and related publications

- 1.1. Regulation 82 and Rule 15.2 require us to carry out a review of the Rules by 1 August 2019. Rule 15.2 also outlines that the review must set out the objectives intended to be achieved by the Rules and assess the extent to which those objectives are being achieved. It should also assess whether those objectives remain appropriate and, the extent to which they could be achieved in a less burdensome way. Our review is in parallel with and complementary to the BEIS Five-year Review of the Capacity Market.
- 1.2. We initiated our review by publishing an open letter on 11 September 2018⁹. We asked for views on whether the Rules are meeting their objectives, whether those objectives could be met with less burden, and whether those objectives remain fit for purpose. We also introduced our four priority areas for policy development:
 - 1.2.1. Whether the objectives of the Rules could be achieved with less burden on participants;
 - 1.2.2. Our annual Rules change process as set out in our guidance;
 - 1.2.3. The appropriateness of the secondary trading arrangements; and
 - 1.2.4. The appropriateness of NGENO DB's incentives for exercising its functions in delivering the CM to ensure that they remain fit for purpose.
- 1.3. On 15 November 2018 the General Court of the Court of Justice of the European Union found in favour of Tempus Energy in Tempus Energy Ltd and Tempus Energy Technology Ltd v European Commission¹⁰. This judgment had the effect of annulling the European Commission's State aid approval for the GB CM scheme and introducing a standstill period, during which aid cannot be granted under the CM. The General Court's judgment was decided on procedural grounds; it was not a challenge to the nature of the CM mechanism itself. On 25 January 2019, the Commission lodged an appeal against this decision. The pace of our Five Year Review programme has been reduced as a result of the standstill of the CM.
- 1.4. Following the judgment, the Secretary of State postponed the T-4 and T-1 Capacity Market Auctions ("Auctions") for Delivery Years 2022/23 and 2019/20 and suspended all payments. The Government is seeking reinstatement of State aid approval from the European Commission.
- 1.5. Secondary legislation was laid on 28 February 2019 that allowed the postponed T-1 auction which was due to be held in early 2019 to be rearranged, and for 'conditional capacity agreements' to be granted pending the Commission decision. The rearranged T-1 Capacity Auction for delivery in 2019/20 concluded on 12th June 2019.

⁹ <https://www.ofgem.gov.uk/publications-and-updates/open-letter-five-year-review-capacity-market-rules-and-nget-s-incentives>

¹⁰ (Case T-793/14)

- 1.6. On 5 March 2019, Tempus Energy also issued a claim for judicial review against BEIS in the UK courts for continuing to operate other aspects of the CM during the standstill period.
- 1.7. We continued our review of the Rules to meet our statutory deadline to issue a decision by August 2019. In April 2019 we consulted on our Five Year Review of the Rules¹¹. This First Policy Consultation invited stakeholders to provide feedback on discrete proposed amendments to the Rules, as well as respond to wider policy questions on the CM framework that aligned with the priorities identified in our open letter. This consultation was the first phase in developing a longer-term programme of changes to the Rules and to the way Ofgem’s Rules change process operates.
- 1.8. Our decision letter published on 18 July 2019¹² set out our decisions and reasoning for specific Rule change proposals put forward the First Policy Consultation. In making these decisions, we considered how the proposed amendments align with our statutory duties, the purpose of the CM, and the objectives of the Rules. It should be noted that not all of the feedback provided as a result of the consultation was directly addressed in this decision document. We would like to assure stakeholders that we are still reflecting on this valuable feedback; it will be addressed, and will help shape our policy position in the relevant future work stream as outlined in the Forward Work Plan.
- 1.9. BEIS published their Capacity Market: 5-year Review report on 22 July 2019. It outlined their view on the performance of the CM overall and also the performance against its objectives. In addition, the report set out a plan for a future consultations and potential subsequent legislative changes to address issues highlighted in their call for evidence.

Scope

- 1.10. This report is intended to meet the requirements of the Regulation 82 and Rule 15.2. This document also outlines our Forward Work Plan for changing the Rules and regulatory framework over the next two years.
- 1.11. We received an extensive amount of feedback through 29 responses to the First Policy Consultation; a range of workshops held with industry associations and a number of bilateral meetings held with market participants. Where appropriate, we have amended our drafting in light of stakeholders’ feedback. We would like to thank all those who provided feedback and comments on the proposed Rule and framework changes, along with the wider policy questions posed.
- 1.12. This document consists of two further sections, each of which are detailed below

Objectives of the CM

- 1.13. Section 2 sets out the objectives intended to be achieved by the Rules, as per Rule 15.2.2; assesses the extent to which those objectives are being achieved, whether the

¹¹ <https://www.ofgem.gov.uk/publications-and-updates/five-year-review-capacity-market->

¹² <https://www.ofgem.gov.uk/publications-and-updates/decision-statutory-consultation-amendments-capacity-market-rules-2>

objectives remain appropriate, and whether those objectives could be met with less burden.

Forward Work Plan

1.14. Section 3 covers our Forward Work Plan for changing the Rules and regulatory framework in the near future. For each of the areas within scope of this longer-term review, we outline our planned deliverables; the key activities underpinning our expected policy development and regulatory change process; and where possible indicative timings.

Next steps

1.15. We are continuing to reflect on the full range of issues raised in the First Policy Consultation. As highlighted above we have set out in the Forward Work Plan section, the areas in which we intend to carry out further work and associated timescales

Your feedback

General feedback

1.16. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments?

Please send any general feedback comments to stakeholders@ofgem.gov.uk

2. Objectives of the CM

Section summary

Regulation 82 and Rule 15.2 requires the Authority to carry out a review of the Rules within five years of their entry into force. This section, as per Rule 15.2.2, sets out the objectives intended to be achieved by the Rules, assesses the extent to which those objectives are being achieved, whether the objectives remain appropriate, and whether those objectives could be met with less burden.

We believe that the Rules are meeting their first objective to deliver security of electricity supply. We believe that the second objective to facilitate the efficient operation of the CM is being met to an extent but could be achieved more effectively following a reduction in the complexity and regulatory burden imposed by the current Rules, systems and processes of the CM. The changes we decided to implement in the 18 July 2019 decision letter acts as a first phase in aiming to reduce these barriers.

The Forward Work Plan outlined in Section 3 of this report details our longer term programme of work to reduce the regulatory burden imposed by the Rules, systems and processes where appropriate.

Background

- 2.1. Regulation 82 and Rule 15.2 requires the Authority to carry out a review of the Rules within five years of their entry into force. Under Rule 15.2.2, the review must set out the objectives intended to be achieved by the Rules, assess the extent to which those objectives are being achieved, whether the objectives remain appropriate, and whether those objectives could be met with less burden.
- 2.2. The objectives of changes to the Rules are set out in Regulation 78 as:
 - 2.2.1. Promoting investment in capacity to ensure security of supply;
 - 2.2.2. Facilitating the efficient operation and administration of the CM; and
 - 2.2.3. Ensuring the compatibility of the Rules with other subordinate legislation under Part 2 of the Energy Act 2013.
- 2.3. Along with the objectives set out under Regulation 78, we believe that the wider objective¹³ of the CM within the EMR programme of delivering security of supply at the lowest possible cost to consumers still remains appropriate. To achieve this, we also

¹³ https://www.legislation.gov.uk/ukdsi/2014/9780111116791/pdfs/ukdsiem_9780111116791_en.pdf

believe the Rules should not unduly form a barrier to entry or provide excessive regulatory burden that is not justified.

- 2.4. In our First Policy Consultation in April 2019 we sought stakeholder feedback on whether the objectives as outlined in paragraph 2.2. and 2.3 were still relevant and whether they could be met with less burden.
- 2.5. This section will set out Ofgem’s view of the Rules objectives as well as stakeholder responses to our First Policy Consultation on this topic.

Promoting investment in capacity to ensure security of electricity supply

- 2.6. Our minded to view was that the Rules fulfil their objective of ensuring security of supply at lowest cost to consumers by bringing forward investment in new capacity. However, we acknowledge that the Rules would benefit from simplification and that the complexity of the Rules, systems and processes of the CM may be a barrier to participation.
- 2.7. The Government reliability standard for security of electricity supply is expressed as a Loss of Load Expectation (“LOLE”) of 3 hours per year.¹⁴ Figure 1 below sets out forecasts of LOLE for the last five delivery years. NGESO’s Winter Outlook for 2018-19 forecast a Loss of Load Expectation of 0.001 hours per year, a fraction of our reliability standard of 3 hours per year. These figures further support our view that there is a strong need to maintain the CM.

	2014/15	2015/16	2016/17	2017/18	2018/19
LOLE (hours per year)	1.6	1.1	0.5	0.01	0.001

Figure 1: Loss of load expectation in Great Britain over the last five years¹⁵

- 2.8. In addition to the formal LOLE metric, capacity margins¹⁶ can also be used to help assess the importance of the CM. In the CM’s first full year of operation (2017/18) there were higher daily winter capacity margins than in winter 2016/17. This suggests that the CM has been effective so far in improving capacity margins. It has done so through a combination of reducing the rate at which existing capacity closes, and stimulating investment in new capacity.
- 2.9. NGESO’s figures show that capacity margins rose from 7.6% in Winter 2015/16 to 10.4% in Winter 2017/18, the first full delivery year of the CM. NGESO projections in its Future Energy Scenarios (“FES”) base case show an expectation that margins will

¹⁴ LOLE represents the number of hours per year in which supply is expected on average to be lower than demand under normal operation of the system.

¹⁵ <https://www.nationalgrideso.com/insights/winter-outlook>

¹⁶ The capacity margin is the forecast or actual level of excess electricity supply capacity over expected or outturn peak demand

be sustained at >10% for the next five years.¹⁷ This is in marked contrast to the years preceding CM delivery, which saw margins falling to 6.1% in Winter 2014/15.

2.10. It should be noted that the margin figures for prior to the implementation of CM scheme from 2017 onwards include Contingency Balancing Reserve (“CBR”)¹⁸. Without these measures the capacity margins would have been much lower. For example, in 2016/17 NGESO procured around 3.5 GW of CBR¹⁹ and so without utilisation of this additional procurement tool the margin would have actually been just above zero. This shows that the CM under the current Rules, has had a positive impact on investment to ensure security of supply.

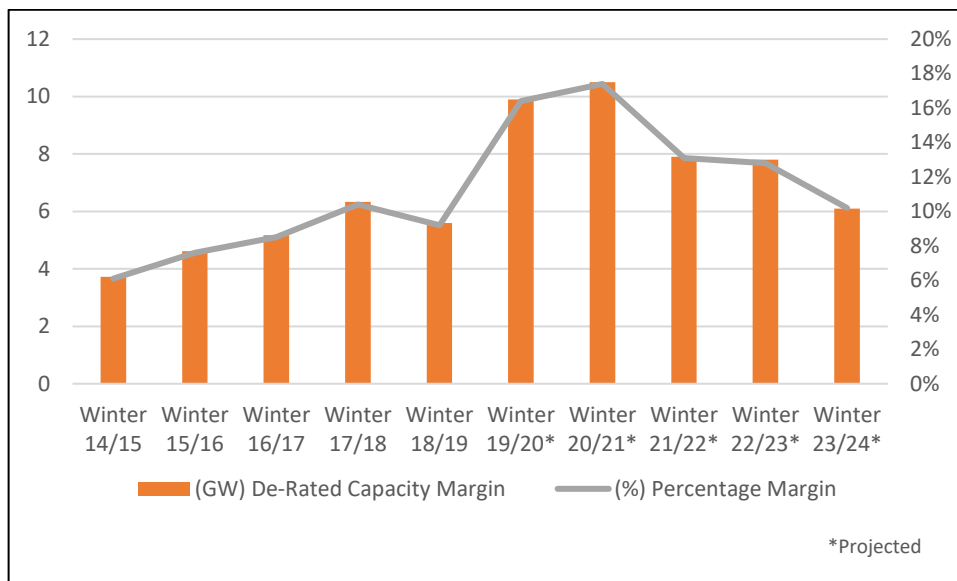


Figure 2: Electricity supply margin outturns¹⁷ (Winter 14/15 - Winter 18/19 achieved and Winter 19/20 - Winter 23/24 projected).²⁰

Stakeholder responses

2.11. Many stakeholders agreed that the Rules fulfil the objective of promoting investment to ensure security of supply. Respondents noted that the CM is the most appropriate method of ensuring security of supply at the lowest cost for the consumer.

¹⁷ The FES demand and supply assumptions are published on its website <http://fes.nationalgrid.com/>. De-rating factors are published in the Electricity Capacity Report. National Grid ESO will carry out full, detailed analysis for Winter 2019/20 this summer ahead of publishing Winter Outlook later this year, and as such, the numbers are subject to change.

¹⁸ CBR consists of the Supplemental Balancing Reserve (SBR), where existing power stations were contracted by NGESO outside the market to stand by ready to generate additional electricity and the Demand Side Balancing Reserve (“DSBR”) where companies were contracted by NGESO to reduce their electricity usage times of peak demand.

¹⁹

<https://www.nationalgrid.com/sites/default/files/documents/201717%20Winter%20Review%20and%20Consultation.pdf>

²⁰ The historic margins are estimates based on re-running the detailed margin analysis with actual demand out-turn and known generator outages. The 2018/19 margin presented above is lower than published in NGESO’s Winter Outlook mainly due to nuclear outages.

- 2.12. Most respondents also noted that the Rules would better facilitate bringing forward investment in new capacity if they were simplified and the regulatory burden on market participants was reduced. Market participants noted that the regulatory burden imposed by the Rules hinders market participation and may impact overall investment in new capacity.
- 2.13. A stakeholder disagreed with the view that the CM is effective in promoting investment in capacity, stating that potential investment is “priced out” by existing operators who have an advantage.

Final view

- 2.14. We have reflected on the stakeholder responses and the evidence presented above and we conclude that overall the Rules are effective in incentivising investment in secure electricity generation, while improving affordability for consumers. However, we acknowledge that the Rules would benefit from some simplification. This will be an objective of our Forward Work Plan detailed below. BEIS have expressed support for this work area and are keen to assist Ofgem and NGESO DB in the development of proposed Rule simplifications.

Facilitating the efficient operation and administration of the CM

- 2.15. The Rules, along with the systems and processes to administer the CM, were designed under the assumption that there would be around 300 applications for Prequalification per year from around 45 applicants. The reality was different, NGESO DB received 1,700 Prequalification applications in 2016/17, and around 1,950 applications in 2017/18. These figures are much greater than was first envisaged when the CM scheme was designed.
- 2.16. The expansion of Demand Side Response (“DSR”), storage, distributed generation and subsidy-free renewables have changed the market landscape within which the Rules are designed to be used; significantly increasing the number of participants.
- 2.17. The original design of the CM did not foresee these market wide changes occurring so quickly. The structure of the Rules reflects this, for example, in the complexity of the Prequalification process, which was designed to provide delivery assurance for large generation projects. Instead, a large proportion of applications have come from small projects for which some of these delivery assurance requirements are less appropriate.
- 2.18. Our minded to position, as set out in the First Policy Consultation, was that we believed to an extent the complexity of some provisions of the Rules hinder their own ability to meet the second objective to ensure the efficient operation of the CM. Our view was this objective is not currently being fully met and that the Rules could better facilitate the efficient operation and administration of the CM by decreasing their regulatory complexity. In addition, the current systems and processes that deliver the CM require improvement to streamline the operation of the CM and decrease the burden on market participants.
- 2.19. We would like to note there are areas which change has been facilitated and in some cases been driven by our Rule changes to account for changing market conditions. For

example, we have implemented changes to allow for more flexibility with regard to DSR components within delivery year, known as component reallocation (OF12).

Stakeholder responses

- 2.20. Respondents highlighted the importance of a holistic view of the Rules and that individual Rule change proposals should not be considered in isolation from the big picture. In particular, stakeholders called for Ofgem to provide greater clarity on the rule changes implemented and to provide market participants with a consolidated version of the Rules after each round of rule changes. Respondents noted that this would significantly ease the regulatory burden on market participants and better facilitate this objective. One respondent noted that the provision of consolidated Rules would better facilitate a level playing field between larger and smaller market participants.
- 2.21. Respondents broadly welcomed Ofgem's intention to move to a more measured timeframe for Rule changes, with an expectation of Rule changes taking eighteen months. There was also broad support for involving industry more in the prioritisation and assessment of Rule change proposals, through a Rules Advisory Group. It is clear that stakeholders share our view that the impact of Rule changes can be better understood utilising industry expertise.
- 2.22. Prequalification was highlighted by many respondents as an area of particular concern. Respondents noted that the regulatory burden imposed by the current prequalification processes impedes the efficient operation and administration of the CM. It is clear from the feedback that stakeholders would like to see a step change improvement in the administrative process of prequalification for the auctions. Stakeholders believe that there could be significant improvements made to the Portal to make the process easier to follow and result in an increased success rate for viable projects. Stakeholders also believe that a simplification of the Rules relating to Prequalification could also increase participation. Reducing the burden relating to assurance provided by applicants would also be welcomed by respondents.
- 2.23. The principal of technology neutrality was highlighted as a key to the efficient operation of the CM by stakeholders, with one respondent raising concerns that recent Rule changes have moved the CM away from this core principle, something that could jeopardise the efficiency of the CM. Two respondents expressed concern that the regulatory burden incurred by the Rules in the processes associated with prequalification and agreement management creates a bias towards larger market participants as they have the resources to deal with such burden.
- 2.24. There is also a widely held view that the Rules, systems and processes could allow for more flexibility of transferring Capacity Obligations or Capacity Market Units. Stakeholders are calling for more flexibility ahead of and within delivery year.

Final view

- 2.25. We do believe that the efficiency of the CM could be improved by updating the Rules. However, it is important to recognise that the Auctions to date have been liquid, with falling clearing prices over time and large numbers of participants. This indicates that the regulatory burden imposed by the Rules has not unduly deterred or prevented participants from successfully completing prequalification and accessing the CM.

- 2.26. Given the changes that have taken place in the market, Ofgem believes that the complexity of prequalification and the management of agreements in particular leaves room for improvement. Redesign of the Rules, systems and processes could improve participation and better facilitate the efficient operation of the CM. The Rules may have been appropriate for a market with a much smaller number of participants but the efficient administration of the CM would now benefit from the Rules being updated to reflect the changed market conditions.
- 2.27. We are committed to make these improvements to the framework, with the aim of reducing complexity and burden for participants. However, it is our view that this can only be achieved fully if these changes are aligned with the implementation of a much improved Portal by NGENO DB. On this basis we welcome the announcement at the Capacity Market Launch Event on the 17th July that NGENO DB is planning to review and improve the Portal by the Prequalification round in 2021. We will be working with BEIS and NGENO DB to ensure appropriate Rule changes and system improvements are aligned to achieve the step change stakeholders believe is required. We will also be consulting on the funding arrangements for NGENO DB to achieve these improvements. More details on this are included in the Forward Work Plan below.
- 2.28. We also intend to introduce other reforms as set out in our Forward Work Plan in Section 3. This will address stakeholder concerns and better meet this objective by reducing the regulatory burden on applicants and simplifying the Rules. In the next phase of work, we will reform the Rules change process by further involving industry in the process. We are minded to create a CM Advisory Group with participants drawn from across industry to create a fair and balanced forum. Industry parties have the expertise to reduce the complexity and burden on Applicants. We want to tap into that expertise. Our minded to position is that this group will scrutinise change proposals and assist in prioritisation. Ofgem would always retain the decision on Rule changes as per Regulation 77. We will also continue to facilitate the publication of consolidated, up to date Rules for market participants²¹.

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

- 2.29. Ofgem's view is that the Rules are compatible with subordinate legislation under Part 2 of the Energy Act 2013. We did not receive any direct feedback in relation to this objective and we will continue to work with BEIS to ensure alignment and compliance of the Rules with legislation.

²¹ We recognise that this has not yet been provided for Prequalification 2019. This is due to the rules accommodating standstill being finalised close to the opening of the Prequalification Window. We are working with BEIS to consolidate the latest set of rules and will publish them as soon as possible.

3. Forward Work Plan

Section summary

This section covers our Forward Work Plan for changing the Rules and regulatory framework in the near future. For each of the areas within scope of this review, we outline; our planned deliverables; the key activities of policy development and regulatory change process; and indicative timings. We will use stakeholder feedback in response to our First Policy Consultation and through ongoing engagement in developing further change proposals across each of the areas identified in the Forward Work Plan.

Introduction

- 3.1. The First Policy Consultation issued in April 2019 proposed a set of specific amendments to the Rules and wider policy questions. These areas were highlighted as priorities in our September 2018 open letter. The open letter and First Policy Consultation initiated a programme of work to improve the Rules and regulatory framework. The work will seek to reduce the regulatory and administrative burden of the Rules where appropriate, revise the governance arrangements and ensure NGESO DB's incentives framework and revenue allowances remain fit for purpose.
- 3.2. The decision letter published on 18 July 2019 set out our decisions and reasoning for some of the specific proposals put forward in the First Policy Consultation. It should be noted that not all of the feedback provided as a result of the First Policy Consultation was directly addressed in this decision letter. We are continuing to reflect on the full range of issues raised in the First Policy Consultation. We will be addressing the remainder of this valuable feedback throughout the course of the Five Year Review programme.
- 3.3. This section acts as a signpost for planned future work streams, encompassing the policy areas that have been left unaddressed from the First Policy Consultation. It includes key activities associated with them and what the work stream aims to deliver.
- 3.4. The Forward Work Plan covers the following areas:
 - 3.4.1. Improving the Rules change process;
 - 3.4.2. Redesigning the Secondary Trading Rules;
 - 3.4.3. A second consultation (including future Prequalification Rule changes and remaining changes discussed in the First Policy Consultation);
 - 3.4.4. NGESO DB incentives; and

3.4.5. NGESO DB revenues.²²

- 3.5. A visual which outlines timelines for each of the discrete work stream can be found on the next page. This visual aid should be read in conjunction with the key below.
- 3.6. Following the diagram, there are separate sub sections for each work stream, outlining the deliverables and associated key activities.

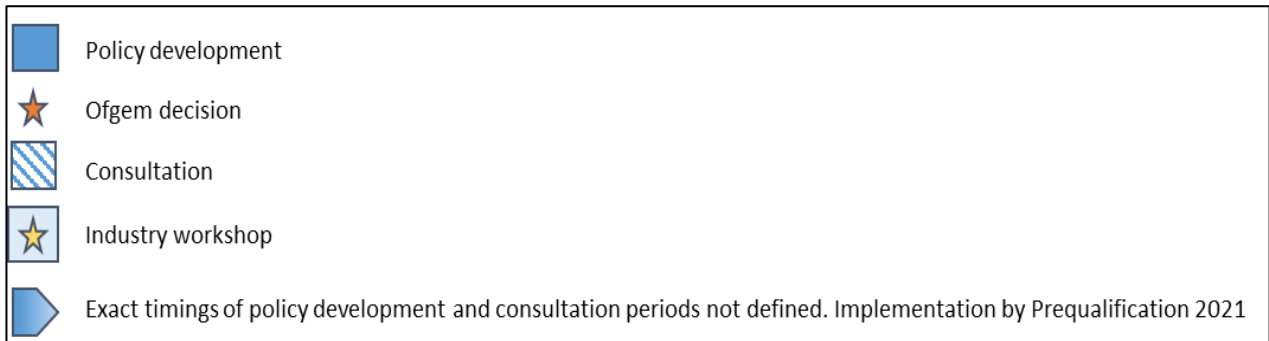
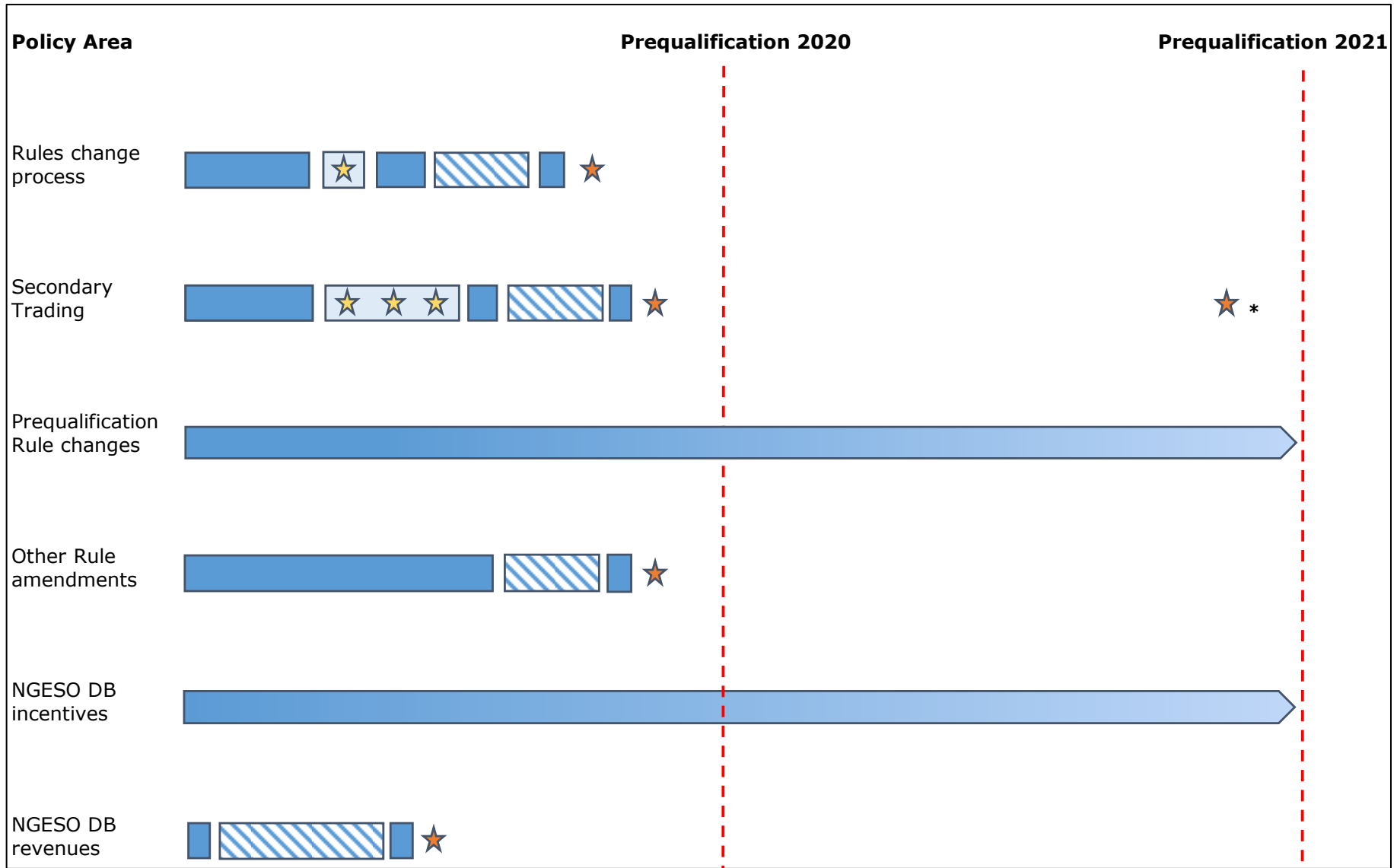


Figure 2: Forward Work Plan timeline visual key.

²² We note that the sub-section covering the NGESO DB revenues was not highlighted in the First Policy Consultation. We have decided to include it in the Forward Work Plan as a work stream as it is key to enabling other aspects of the programme.

Overview of timelines for the Forward Work Plan



* The Forward Work Plan visual aid shows two Ofgem decision points in this work stream; one ahead of Prequalification 2020 and the other ahead of Prequalification 2021. The two decision points are to show that where possible some amendments will be implemented ahead of the 2020 Prequalification Window if they are not contingent on IT system development. Otherwise they will be developed for delivery ahead the 2021 Prequalification Window.

Rules change process

- 3.7. The annual Rules change process has continued to increase in duration, complexity and difficulty of implementation as a result of enduring industry interest in making changes to the Rules. In the First Policy Consultation we set out that the change process would benefit from several improvements such as formalising roles and responsibilities in the process, providing greater clarity over timelines, increasing transparency, and seeking further industry involvement when evaluating change proposals.
- 3.8. We proposed to form a 'CM Advisory Group' comprised of industry stakeholders to assist in developing, scrutinising, and scoping potential proposals before they are submitted to Ofgem. The creation of the group will enable us to effectively utilise industry expertise.
- 3.9. This is a priority area for us and it will be the first work stream we progress. We are minded to create the new group as soon as possible, noting that this is dependent on first devising a robust framework, terms of reference and establishing appropriate membership.

Deliverable

- 3.10. Our key deliverables in this area are to:
 - 3.10.1. Establish a CM Advisory Group comprised of industry experts, within the governance arrangements for the Rules change process;
 - 3.10.2. Decouple the Rules change process from the CM operational timeline; and
 - 3.10.3. To further clarify the difference between urgent and non-urgent Rule changes.

Key activities

- 3.11. We will use our next CM stakeholder workshop, which we are planning to hold in Autumn 2019 to further develop our views on the objectives, remit and functions of the CM Advisory Group. This will build on the responses we received to our First Policy Consultation questions on this issue.
- 3.12. Ahead of and following the workshop we will develop our detailed thinking on the objectives, remit and functions of the CM Advisory Group.
- 3.13. Following the policy development, we aim to consult on changes to the Rules change process guidance document. This will enable us to make a decision on those changes, enabling establishment of the group prior to the 2020 Prequalification Window.

Secondary trading

3.14. We agree with stakeholders who have highlighted that the Rules governing Secondary Trading are burdensome, unclear and do not facilitate an effective, liquid secondary trading market. Following our First Policy Consultation, we plan to further consider Rule change proposals to:

3.14.1. Eligibility:

3.14.1.1. Simplify and reduce the requirements for becoming eligible to receive a trade and to clarify which Rules apply to which type of application. This includes potential changes to enable a CMU that has Prequalified in a previous Delivery Year to automatically become eligible for receiving a trade, provided that it submits any additional information required to bring its application in line with the Delivery Year questions; and

3.14.1.2. Support the creation and maintenance of a publically available register of eligible secondary trading participants.

3.14.2. Barriers to trading:

3.14.2.1. Lower the minimum threshold volume for obligations to be traded; and

3.14.2.2. Reduce the time which NGESO DB has to assess whether an applicant is eligible to engage in secondary trading and to accept or refuse a trade.

3.14.3. Framework:

3.14.3.1. Extend the defined trading window permanently, beyond the results day of the T-4 Auction for the relevant Delivery Year; and

3.14.3.2. Lower the requirements for Transferors and Transferees to have fulfilled prior to trading an agreement.

3.14.4. Transfer of risk and Satisfactory Performance Days ("SPD"):

3.14.4.1. Ensure that termination risk and obligation to demonstrate SPD are transferred appropriately between the Transferor and Transferee following a trade.

Deliverable

3.15. We plan to amend the Secondary Trading section of the Rules, which we highlighted as priority in our open letter and First Policy Consultation.

Key activities

- 3.16. Our target timing is to implement changes to the Rules as soon as is feasible. The feasibility will need to take into account the progress made by planned industry workshops, and the implementation of system changes in a cost efficient way.
- 3.17. The activities associated with this work stream are as follows:
- 3.17.1. BEIS and Ofgem will develop and provide policy intent behind the Secondary Trading Rules;
 - 3.17.2. We aim to run a number of workshops beginning in October 2019, to develop proposals for changes to the Rules on Secondary Trading arrangements;
 - 3.17.3. We will work with the Delivery Partners to assess system impacts of subsequent workshop proposals and where appropriate align the delivery programme of any changes; and
 - 3.17.4. Finally, we will consult on amendments through a Rule change consultation. The Forward Work Plan visual aid shows two Ofgem decision points in this work stream; one ahead of Prequalification 2020 and the other ahead of Prequalification 20201. The two decision points are to show that where possible some amendments will be implemented ahead of the 2020 Prequalification Window if they are not contingent on IT system development. Otherwise they will be developed for delivery ahead the 2021 Prequalification Window.

Second policy consultation (including future Prequalification Rule changes)

- 3.18. Several policy questions posed in our First Policy Consultation remain unaddressed. We will issue a follow-up consultation(s) on proposed Rule drafting amendments, which will address these areas. This follow up consultation will take into consideration and address the stakeholder feedback received in response to the First Policy Consultation, along with any other Rules change proposals suggested.
- 3.19. This work stream will be separated into two sub work streams, which can be seen from the Forward Work Plan timeline visual above. The two separate work streams will be created to address:
- 3.19.1. Amendments to the Rules which govern the Prequalification process; and
 - 3.19.2. Other Rules amendments which facilitate the agreement management process. This includes but not limited to, potential amendments to:
 - 3.19.2.1. Rule 4.4.4 (configuration of Generating Units);
 - 3.19.2.2. Progress reports and Independent Technical Expert (“ITE”) assessments;
 - 3.19.2.3. Capacity Market Register (“CMR”) data items; and
 - 3.19.2.4. Planning consents.

Deliverables

- 3.20. To develop and deliver policy changes to reduce the burden and complexity of Prequalification.
- 3.21. To develop Rule change proposals to assist in reducing the regulatory and administrative burden of the agreement management processes, including the areas listed in paragraph 3.18.2 above.

Key activities

- 3.22. We will reflect further on feedback gained from the First Policy Consultation and develop policy positions. We will also consider using the stakeholder workshop in Autumn 2019, or other engagement with industry parties, to feed into this work stream.
- 3.23. Work with BEIS and NGENSO DB on a joint delivery programme of Regulations, Rules, systems and processes.
- 3.24. We will consult on amendments to the Rules and where appropriate we will work to align changes with the Portal implementation.
- 3.25. However, as noted in the Forward Work Plan timeline visual we will consult on and implement the “other amendments” detailed in paragraph 3.18.2 on an expedited timeframe where possible, ahead of Prequalification 2020.

NGESO DB incentives

- 3.26. NGENSO DB’s incentives for the CM currently cover demand forecasting accuracy, dispute resolution, DSR Prequalification, and customer and stakeholder satisfaction. We want to ensure that the NGENSO DB is appropriately funded, incentivised, and that it is delivering excellent performance. We believe that it may be effective to align NGENSO DB’s financial incentives for the CM more closely with the wider NGENSO incentives.

Deliverable

- 3.27. We will deliver a fit for purpose suite of incentives for the NGENSO DB. In order to do so we will aim to make a decision on any changes that might be required to the Special Conditions of NGENSO’s Electricity Transmission Licence.

Key activities

- 3.28. We will continue to assess the relevant feedback received from our First Policy Consultation, develop a future framework for EMR incentives and will publish a statutory consultation on licence modifications.

NGESO DB Revenues

- 3.29. Revenues provided to NGESO DB currently cover the roles of delivering the CM and Contracts for Difference (“CfD”) regimes. For the CM this includes processing applications, appeals and agreements as well as running the Auctions. For CfDs, this includes processing applications and appeals then running the allocation rounds. In order to achieve this role, a number of IS systems are either managed in house or licences paid for. We want to ensure that NGESO DB is appropriately funded to deliver their role with a high level of service in an evolving environment.
- 3.30. NGESO DB currently receives funding for this role on the basis of a determination made in September 2015 for the period April 2016 to April 2021. It was recognised that the EMR regime may evolve during this period, hence an Uncertainty Mechanism was introduced into NGESOs Licence in Special Condition 7D which allows them to submit an application for additional funding for specific activities required to manage this change. We accept that the CM in particular has evolved since April 2016 and some additional funding may be required for this period.
- 3.31. An application was received in May 2019 and we are currently producing a consultation to be published in August based on our proposals with a determination required by 30th September 2019. Depending on the outcome of the consultation, another Uncertainty Mechanism window in 2021 may need to be introduced to manage any remaining uncertainty up to April 2021.
- 3.32. We are conscious that Applicants consider that the Portal is a blocker to efficient participation in the CM and we aim to find an efficient resolution to this issue through this funding settlement.

Deliverable

- 3.33. We will deliver a package of revenues for the RIIO-T1 period appropriate for the role undertaken and enabling implementation of a new Portal.

Key activities

- 3.34. We will develop a consultation on proposals for any additional funding for NGESO DB for the period April 2016 to April 2021, consider feedback and develop a minded to position in line with the required timescales.
- 3.35. Once we have developed a considered position on funding beyond April 2021, we will publish a statutory consultation on the level of funding.