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Statutory Consultation for adjusting the Electricity Market Reform Delivery Body Incentives and mechanisms to recover uncertain costs – Response by the EMR Delivery Body

We welcome the opportunity to reply to this consultation in our role as EMR Delivery Body within the National Grid Electricity System Operator (NGESO). We play a key role in facilitating the delivery of the Capacity Market and Contracts for Difference regime, contributing to security of supply and low carbon generation to the lowest possible cost to consumers.

Key points of our response

- We support the licence changes to NGESO Special Conditions 7D and 4L as proposed in the consultation document. These changes will enable the Delivery Body to be funded appropriately in a context of continuing uncertainty and will address some of the shortfalls of our current incentives framework.
- Change in EMR is continuing, including the restart of the Capacity Market, the implementation of Foreign Participation in capacity markets and the impact of the Coronavirus pandemic. We are supporting BEIS and Ofgem in dealing with these new requirements and challenges.
- Whilst we are seeking to minimise changes in the current EMR portal, it is clear from the above that there are unavoidable policy changes that we are required to implement. We therefore welcome Ofgem's confirmation that the additional funding reopener will allow us to recover efficient cost associated with the system refresh and unavoidable policy changes.
- We agree with Ofgem's proposal to remove the Demand Side Response (DSR) incentive as the Delivery Body is penalised or rewarded for prequalification outcomes that are outside of our control. We will, of course, continue to support DSR providers and other participants to promote wide participation in the Capacity Market.
- We support Ofgem's intention to consider integrating the EMR incentives into the wider NGESO regime for RIIO-2. We would welcome further dialogue about how the potential EMR incentives pot can be factored into the consideration of the overall NGESO incentives pot size.

In the remainder of this letter, we provide our detailed response to the proposals in the consultation document.

Funding

We welcome Ofgem's proposal to allow a further funding reopener for the Delivery Body in March 2021. In our funding request submission in May 2019 we outlined areas of uncertainty which may impact the outputs set in our business plan and that may require additional funding. As Ofgem are aware, we are working on the refresh of the EMR Portal and will continue to provide updates to Ofgem and stakeholders on this. There have been several developments since Ofgem's funding decision in September 2019 which lead to continuing change and uncertainty.

Continuing change and uncertainty

We understand Ofgem's objective, as stated in their decision last September, to avoid changes in the current EMR Portal, other than those resulting from unavoidable policy changes. We agreed to proceed on that basis and to keep Ofgem informed of any changes that may impact agreed outputs and/or our funding requirements.

As Ofgem are aware, alongside the system refresh work, we have also worked closely with BEIS to support the restart of the Capacity Market following confirmation of State Aid approval last October. BEIS have made several commitments regarding the Capacity Market which we will need to deliver prior to this year's prequalification process. We have been working with BEIS, Ofgem and other Delivery Partners to fully scope out what is required to deliver these commitments within these timescales. Many of these commitments require changes to the current EMR Portal prior to the 2020 prequalification process.

In addition to this, we have been supporting Ofgem and BEIS in their work on the ongoing Five Year Reviews of the Capacity Market. Whilst much of this work has now been put on hold due to the Coronavirus pandemic (see below), we have supported this work by analysing and discussing change proposals and undertaking impact assessments in terms of our processes and systems.

The requirements regarding Foreign Participation in capacity markets have also become clearer as EU-wide methodologies are being developed by ENTSO-e. Some of the requirements and delivery timescales are now more defined, e.g. the need to put in place common registers by July 2021, and we are currently assessing the impact of this on our EMR Portal refresh project. Further clarity on the requirements for Foreign Participation is expected once the methodologies have been finalised by ENTSO-e and approved by ACER later this year.

The Coronavirus pandemic has added a new level of uncertainty and potential change. We are working with BEIS and actively support their work on potential easements to mitigate the impact of the pandemic on the Capacity Market. This work is ongoing but it is likely to require changes to processes as well as system change in the current portal where manual workarounds are not possible or where the compliance risks of these workarounds are too high.

Whilst we are seeking to minimise changes in the current portal, it is clear from the above that there are unavoidable policy changes that we are required to implement. There is also continuing uncertainty, not least around the impacts of the Coronavirus pandemic. We will keep Ofgem informed of these changes but we will need to have appropriate funding for any of this work which is over and above our agreed business plan.

The 2021 funding reopener

We therefore welcome Ofgem's confirmation that the additional funding reopener in March 2021 will allow us to recover efficient costs associated with the system refresh and unavoidable policy changes. We support the proposed changes to NGESO's Special licence Condition 7D as shown in Appendix 2 of the consultation document.

We also welcome Ofgem's confirmation that, as this decision on additional funding will take place during NGESO's RIIO-2 price control, the settlement will be undertaken as part of the RIIO-1 close out process in 2021.

Outputs and Incentives

There has been a lot of change since the EMR incentives were introduced in 2015, including a large increase in the number of CM participants, new types of technologies taking part in the markets and significant regulatory change by BEIS and Ofgem. We and Ofgem have also gained a better understanding of how the EMR incentives operate in this changing context and about the influence the Delivery Body has on the outturn of some of the incentives.

DSR incentive

There has been significant growth in DSR participation over time, as shown in the consultation document. As the Delivery Body, we have done a significant amount of work to support DSR and other new providers. We have described the measures that we have taken to support DSR in our annual letters to Ofgem under this incentive.

The incentive target uses the DSR volume that prequalified in previous years as the baseline, but this does not consider that a major factor in DSR participation is the target volume for the relevant T-1 auction. That auction target volume was very low in 2019/20 (only 300MW) compared to an incentive (prequalification) target of 1.9GW. There was very little, if anything at all, that the Delivery Body could have done to meet the 1.9GW target.

We agree with Ofgem that the way this incentive is designed means that the Delivery Body is penalised or rewarded for prequalification outcomes that are outside of our control which is not appropriate. We agree with Ofgem's proposal to remove this incentive for 2020/21. We will, of course, continue to support DSR providers and other participants to promote wide participation in the Capacity Market.

Other incentives

The disputes incentive is another example where the market has moved on. The incentive uses the absolute number of prequalification decisions taken by the Delivery Body which get overturned by Ofgem during the disputes stage. A reward is only granted if no decision is overturned by Ofgem and the Delivery Body starts to incur a loss for two or more overturned decisions. This seemed appropriate at the start of EMR when the overall number of applications was relatively low. But using the absolute number of overturns now seems inappropriate as we now receive 2,000 or more applications. In other words, we start to incur a loss if less than 0.1% of our prequalification decisions are overturned.

We continue to believe that disputes are an important measure of the Delivery Body's performance, because efficient and correct decisions will promote successful prequalification. The larger the number of applicants that prequalify and enter an auction, the higher its effectiveness and the lower the costs to consumers. While many factors influencing the cost of auctions are outside our control, we can control elements of their effectiveness. By making sure applications meet the standards set by government and Ofgem, we ensure fairness and minimise delivery risks.

In our RIIO-2 business plan we have therefore proposed to continue to use disputes as a key metric for our Capacity Market work. To overcome the shortfalls of using the absolute number of overturns, we propose to measure the percentage of our prequalification decisions overturned by Ofgem in the tier 2 disputes process. The lower the proportion that get overturned, the more efficient the prequalification process is, particularly for applicants.

We understand that Ofgem do not intend to change the disputes incentive for 2020/21 but that they will consider how the design of this metric can be improved for RIIO-2. In the meantime, we support Ofgem's pragmatic approach to base the number of overturned decisions on the categories rather than individual decisions.

Future EMR incentives

We support Ofgem's intention to consider integrating the EMR incentives into the wider NGESO regime. During the RIIO-1 period, the EMR Delivery Body has its own business plan, allowances and incentives. For RIIO-2, the EMR function is included in the NGESO business plan and allowances under Theme 2: Transforming participation in smart and sustainable markets.

Given that the EMR Delivery Body function will be part of the NGESO business plan and allowances in RIIO-2, it would appear sensible for EMR to be covered by the NGESO incentives framework, rather than continue to have its own incentives. We would welcome further dialogue about how the potential EMR incentives pot can be factored into the consideration of the overall NGESO incentives pot size. We will continue to engage with Ofgem on the design of an appropriate incentives framework for RIIO-2.

Conclusions

We welcome and support the proposed licence changes to Special Conditions 7D and 4L. They will provide a mechanism to ensure the Delivery Body is funded appropriately for the efficient delivery of any changes or additional outputs which are required. The removal of the DSR incentive addresses a shortfall in the current EMR incentives framework.

We look forward to working with Ofgem to implement these changes and in developing appropriate incentive arrangements for the RIIO-2 period. We would of course be happy to discuss any of the matters raised in this letter, should you find this useful. Please contact Stefan Preuss (stefan.preuss@nationalgrideso.com) in the first instance.

Yours sincerely,



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