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## Consultation response | Capacity Market Rules 27 May 2016

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The Association for Decentralised Energy (ADE) welcomes the opportunity to respond to the Ofgem consultation on changes to the Capacity Market Rules.

The ADE is the UK's leading decentralised energy advocate, focused on creating a more cost effective, efficient and user-orientated energy system. The ADE has more than 100 members active across a range of technologies, and they include both the providers and the users of energy. Our members have particular expertise in combined heat and power, district heating networks and demand side energy services, including demand response and storage.

### Consultation questions

**Q1. CP136 (interconnector capacity): Do you agree that de-rating from CEC rather than TEC is a more appropriate way to measure the De-rated Capacity of Interconnector CMUs? Do you agree with the suggestion to cap Interconnector derated capacity at TEC, or should the requirement for interconnectors to hold sufficient TEC be removed altogether?**

On the face of it, this would appear to be a change that favours interconnectors over transmission connected generators who also have a requirement to hold TEC. We believe that, wherever possible, there should be a single set of rules for all participants, with variations only allowed when clear evidence is presented that a derivation is required.

Given the proposed changes to connection capacity for transmission connected generators, we would suggest that the same proposals be applied to interconnectors. This would mean that should interconnectors choose to use their connection capacity instead of their TEC, they must be able to demonstrate full import delivery to that connection capacity under normal market operation, i.e. import based on market fundamentals and not System Operator to System Operator trades. While interconnectors can deliver over their TEC, so can thermal generators, yet the proposed changes would only apply to interconnectors. Such an approach appears to create an unlevel playing field.

As a result, we believe that Ofgem should further consider this proposal and reject it, particularly the requirement to hold sufficient TEC. However, should the proposal go ahead, then we would agree that de-rated capacity should be capped at TEC.

**Q2. CP129 (adding DSR components): Do you agree there are overall benefits to creating a bespoke process for adding new DSR CMU components? (Please provide evidence to support your answer)**

The ADE supports taking forward proposal CP129.

Allowing DSR CMUs to add, remove and reallocate components would align the provisions for CMU components DSR CMUs with those found in demand management balancing services like STOR and frequency control, and in other countries' capacity markets.

Simplifying testing and pre-qualification will further improve the business case of this important change. Like in other markets the contractual obligation to deliver and the penalties for under delivery should be the key guarantees, instead of the administratively burdensome pre-qualification and tests.

While there will be some costs incurred in developing and operating a process for DSR component reallocation, these costs can be kept manageable during the development of the approach. These increased costs are likely to be less than the alternative of requiring the registration of additional CMUs for new components, combined with obligation trading.

**Q3. CP95 (reallocating DSR components): Do you agree that the combination of CP124, CP129 and CP130 would be a better solution to the issues that CP95 seeks to address?**

The ADE supports the reallocation of DSR components.

While we prefer CP95 to achieve the outcome of allowing DSR component allocation, as it would provide greater flexibility and simplicity, we recognise that combining CP124, CP129 and CP130 could provide a satisfactory outcome, allowing an aggregator to manage its portfolio effectively.

As discussed in the Ofgem Stakeholder Workshop on 24 May, there is one additional use case which was mentioned in CP95, but may not be supported by the combination of CP124, CP129 and CP130 as currently drafted: Transferring a DSR component between CMUs controlled by different aggregators. If an aggregator is unable to transfer a DSR component between CMUs, customers would be locked into a relationship with whichever aggregator they signed up with first, and unable to take up a better offer from a competing aggregator (without missing out on a year's revenues). Such an approach would impair competition.

For compatibility with CP130, it would be reasonable to restrict such transfers so that they only occurred at the boundary between Delivery Years. However, this approach would still necessitate support for the new aggregator being able to submit the component for a metering assessment (and maybe also a DSR Test) as part of the new CMU for the following Delivery Year while it remains a member of the old CMU.

We look forward to working with Ofgem as they further develop their approach.

**Q4. CP108 (CM warnings): Do you think there is a need to align Capacity Market Warnings with other existing system warnings? If so, how would you suggest this is done? Are there any associated risks?**

We would encourage as much alignment as possible between system warnings without any material changes to the timeframes associated with the various warnings, i.e. the four hour warning for a system stress event. However, it is important to consider whether all the involved parties will already be using that system and whether they are able to access the data.

Therefore, we would suggest that the Capacity Market Warning is displayed as part of the BMRS system as well as on a separate dedicated website for those participants that do not use the current systems.

A further consideration to account for is how the alerts would be provided. For example, a panel operator on a shift pattern may have difficulty accessing text message/email alerts sent to other colleagues, therefore the solution must be robust enough for changes in personnel.

**Q5. CP128 (LFCO formula): Do you agree that the LFCO formula will not scale delivery obligations appropriately during the first TA Delivery Year? Is this issue significant enough to require changes before first TA Delivery Year (starting in October 2016)? If so, how should the formula be amended?**

Yes, we agree that the LFCO formula will not scale obligations appropriately during the TA Delivery Year. We consider this to be significant enough to require changes, as leaving the problem unfixed would lead to great uncertainty for TA capacity providers as to the quantities they are expected to deliver. It would cause particular difficulties for DSR CMUs if a system stress event occurs during a relatively low demand period, as the amount of capacity that a DSR CMU can provide tends to be highly correlated to system demand – if a customer is not consuming, they cannot curtail.

Members have advised us that the formula can be amended by replacing the reference to  $[2 \times \sum_i E_{ij}]$  with a measure of system demand during Settlement Period 'j', and replacing the reference to  $\sum_i [AACO_{ij} - SCO_{ij}]$  with a measure of total system capacity.

**Q6. CP115 (volume reallocation): Do you agree there is an issue with Rule 10.4.1 (c)(ii)? If so, would our suggested addition to this Rule fix the problem? If not, how should it be amended?**

No comment.

**Q7. CP124 (portfolio testing): Do you agree with our assessment of the benefits and risks with CP124?**

Yes. The ADE believes that the benefits of this proposal to consumers outweigh any of the potential risks. We agree with Ofgem's response to stakeholders, and note that CP129 and CP130 would not satisfactorily address the portfolio management problem without CP124.

**Q8. CP98 and CP148 (FFR): Do you agree with the solution put forward in these proposals to ensure the participation of dynamic FFR in the CM? If not, what changes to the DSR test and volume calculation are necessary to achieve this?**

The ADE supports the solution put forward in these two proposals. However we understand that Ofgem have outstanding concerns about this proposal. We are working with members, Ofgem and National Grid on a specific methodology to enable the participation of dynamic FFR demand response while alleviating any outstanding concerns.

**Q9. Do you agree with our analysis and conclusions in relation to connection capacity?**

Yes, the ADE supports the conclusion to allow the CM participant to choose their own de-rated capacity, as they are best placed to understand their own plant operations and its ability to deliver.

The flexibility to choose a lower or higher connection capacity is particularly important for CHP participants. CHP CMUs have a variable power output depending on the heat load, and many CHP sites provide a heat demand to industrial process. Delivering the Connection Capacity within the definitions in Rule 3.5 is therefore not always possible without interrupting a heat supply and the cost of reducing heat supply during a stress event may be significant. The historical maximum may therefore not reflect the cost impacts of delivery, and discourage potential capacity from participating. Providing greater flexibility for participants would increase participation and competitiveness in the Capacity Market, driving down costs.

We are pleased that Ofgem appear to have recognised the complexity of the issue and are taking their time in finding a suitable resolution. We agree that no changes should be implemented for Winter 17 T-1 and Winter 2020/21 T-4 auctions.

**Q10. Would the satisfactory performance requirements remain appropriate if we test up to connection capacity? In particular, would it be appropriate to demonstrate satisfactory performance on three separate days, and for CMUs to lose all capacity payments if this is not met?**

In theory, the satisfactory performance days should remain appropriate provided that CMUs must only demonstrate delivery of their de-rated capacity obligation. However, in practice, should testing up to the full connection capacity be required we believe that some leeway is required.

Plant performance degrades over time and performance also depends on the ambient conditions at the time. Should the same ambient conditions not be met in the delivery year as in the two years ahead of prequalification, then the plant may not be able to demonstrate satisfactory performance to the full connection capacity, despite prequalifying in good faith and while still able to deliver the required de-rated capacity. The difference may be as little as a few megawatts.

In addition, for a CHP generator, local steam and power requirements may change over time, impacting the ability of plant to deliver. It would seem highly unfair and potentially expensive to exclude a large plant on the basis of a few megawatts when all rules had been followed. Furthermore, this could result in additional costs to consumers as plant become ever more conservative with their connection capacities, meaning that excess volume that is not really required is procured – the opposite of the issue that the proposed solution is trying to resolve.

Therefore, we believe that a pro-rata approach under such circumstances would be appropriate.

**Q11. Would market rules around exceeding TEC result in genuine capacity being excluded under this approach? Does the ability to purchase short term TEC help address this? If not, is this a significant enough issue for concern?**

Yes, we have concerns that the proposed approach could result in genuine capacity being excluded as a result of not having sufficient TEC. One option is have short term TEC, which would allow generators to increase their TEC. Such an approach would recognise that some areas of the Transmission system are more constrained than others.

There is also no guarantee that purchasing the short term TEC would be a worthwhile investment if the forecast clearing price of the Capacity Market is less than the cost of the additional TEC. Furthermore, there is no guarantee that this short term TEC would be available in the delivery year and this may cause issues with delivery of satisfactory performance days.

**Q12. Do you consider that there is a significant risk of capacity withholding if generators are given a free choice of connection capacity? Would any additional measures be needed to help mitigate this risk (e.g. minimum capacity thresholds or supporting justifications for going below certain thresholds)?**

No, we do not envisage there is any significant risk of participants withholding capacity. With connection information provided at the prequalification stage, we find it highly unlikely that anyone would even try, let alone be able, to second guess the outcome of prequalification and hence the overall outcome of the auction. Therefore we do not see the need for additional measures or justifications.

## **ADE comment on rejected CM Rule Change proposals**

### **Proposal CP96: Delete Rule 5.3.2(b)**

Ofgem rejected the proposal to delete Rule 5.3.2(b), which excludes bidders unless they have complied with “the terms of any continuing Capacity Agreement in relation to any CMU”, or replace it with a paragraph which states the specific Rules and Regulations where it would be appropriate to exclude Bidders from a Capacity Auction for non-compliance.

The ADE strongly urges Ofgem to reconsider the rejection of this proposal and further to the original proposal, we would like to make the following four points.

- The phrase “the terms of any continuing Capacity Agreement in relation to any CMU” is extremely broadly worded. The example that was given in the proposal submission was where a CMU manages two Satisfactory Performance Days in a season but experiences a breakdown late in the winter and fails to deliver the third. Members have stated they lack clarity on this issue and raised several questions:
  - Is that a failure to comply with the terms of a capacity agreement?
  - What about marginal failure to deliver in a system stress event – is that a failure to comply with the terms of a continuing Capacity Agreement?
- Remedies for failures are explicitly set out in the Rules and Regulations already. In some cases, agreements are terminated and termination fees are applied. In other cases, penalties are applied but the agreement remains in place. There is no need for a further, blanket provision. We would point to Ofgem’s response to the proposal that supports this:
  - “Ofgem’s enforcement guidelines describe how we will use our enforcement powers if businesses breach their obligations, how we will provide redress and remedies for consumers, and how breaches or infringements will be punished or deterred.”
- This extremely wide provision would cause a Capacity Provider to suffer the loss of its entire Capacity Market income stream – one failure in one CMU renders the entire portfolio unable to bid in an auction. In many cases, especially for DSR participant, the CM will be a major source of revenue and could be a bankruptcy threat.

- Capacity Providers can render this rule impotent by the simple expedient of proliferating corporate entities – one per CMU. Ofgem should not be encouraging this behaviour, as it clearly leads back to the problem faced last year in dealing with failures by companies with zero turnover. The more a company is willing to ‘play games’, the less threat it will feel from Rule 5.3.2(b).

**Proposal CP03: Agent for more than one applicant**

Ofgem rejected this proposal due to having ‘not seen any evidence’ that this has prevented participation in the Capacity Market. The ADE has previously provided evidence to Ofgem that the current rules have had a tangible impact on the opportunity for industrial energy users to participate in the Capacity Market. For example, we are aware of an industrial site with a CHP plant who had an opportunity to participate, with their Energy Service Company (ESCo) acting as agent. However, as their ESCo was already agent to another applicant, they were not allowed to support their application. The inability to use the energy service company as an agent meant the industrial site did not take their application forward.

We are also aware of ESCos that could proactively attract potential Capacity Market participants, but were unable to do so out of concern they would be accused on breaching any customer confidentiality if those potential participants became actual participants.

The current restrictions therefore do not allow these companies to encourage potential participants that were either not fully aware of the Capacity Market, unable to understand the complexity, or could not prioritise the administrative costs above other business interests. For industrial energy users, these issues are very real, so a change to this rule could help facilitate their market participation, increasing bidding capacity and reducing consumer costs.

**Proposal CP23: Remove legal opinion requirement for legal status**

Ofgem rejected the proposed removal of the requirement for a legal opinion of an applicant’s legal status, citing that there is no justification for removal. If Ofgem’s view is that some form of legal certification is necessary, then the regulation should be clarified to remove the significant uncertainty, as the current version creates significant costs due to its unnecessary lack of clarity.

**Proposal CP54: Legal owner requirement**

Ofgem rejected a proposal to remove the requirement that the applicant for a new build generating CMU is also the legal owner. We recommend Ofgem reconsider this proposal, as there are a number of sites where the legal owner may not be the company operating the CHP, such as commonly occurs under an ESCo arrangement. Such a change could be an alternative approach to the issues raised in CP03.

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