

Energy UK response to the Ofgem statutory consultation on changes to the Capacity Market Rules

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About Energy UK

Energy UK is the trade association for the GB energy industry with a membership of over 80 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership encompasses the truly diverse nature of the UK's energy industry, from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 26 million homes and every business in Britain. Over 619,000 people in every corner of the country rely on the sector for their jobs with many of our members providing lifelong employment as well as quality apprenticeships and training for those starting their careers. The energy industry adds £83bn to the British economy, equivalent to 5% of GDP, and pays over £6bn in tax annually to HMT.

Introduction

Energy UK welcomes the opportunity to respond to the Ofgem statutory consultation on changes to the Capacity Market Rules. However, the structure of the consultation does not appear open and, where Ofgem has given its "minded to" opinion it is clear that any decision otherwise is not likely to proceed. In the future, it would be useful to spend additional time with industry to discuss whether change proposals being brought forward by industry are likely to proceed. This would save significant amounts of time for industry and Ofgem, allowing for the process to become more streamlined in the future.

Response to individual 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 de-rated capacity at TEC, or should the requirement for interconnectors to hold sufficient TEC be removed altogether?

We consider that whether interconnector capacity is de-rated using Connection Entry Capacity (CEC) or Transmission Entry Capacity (TEC) should be determined in line with the European Network Code on Capacity Allocation and Congestion Management.

We support the proposal that de-rated capacity of Interconnectors CMUs should be capped at TEC as this ensures that Interconnector CMUs meet prequalification requirements related to connection arrangements which are in place for all capacity providers. Also, as interconnectors are not considered purely as transmission assets in the Capacity Market we do not consider that the requirement for interconnectors to hold sufficient TEC should be removed.

We consider that the change favours interconnectors over transmission connected generators who also have a requirement to hold TEC. There is only one interconnector that does not hold a TEC equivalent to its CEC which would suggest that this proposal is to the advantage of that sole interconnector, the proposer of the change, whereas all other interconnectors seemingly comply with the existing rules. We therefore believe that this is not a change that benefits competition and is not required.

As a result, we believe that Ofgem should not proceed with this proposal, particularly the requirement to hold sufficient TEC. However, should it 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)

We consider that there are overall benefits from making this process available. As explained in Ofgem's consultation document, aggregators have to be able to do this to cope with customers who cease to be able to participate. If this process were not in place the reliability of DSR CMUs would be undermined.

Without the process proposed in CP129 (or the one in CP95), aggregators would instead have to create entire new CMUs every time they wanted to add a customer. The administrative costs associated with all these additional CMUs for National Grid, Elexon, etc. as well as for the aggregators seem likely to exceed the costs of this new, simpler process.

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?

From an aggregator's viewpoint, the combination of CP95 (portfolio management) and CP124 (aggregation) would be preferable to the combination of CP129 (adding components), CP130 (removing components), and CP124 (aggregation). However, we accept Ofgem's reservations about CP95, and agree that CP129, CP130, and CP124 together should provide adequate flexibility.

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?

The Capacity Market Rules contain a clear definition of the circumstances under which Capacity Market Warnings (CMW) will be called and CMWs are an integral part of the design of the Capacity Market, playing an important role in determining the potential exposure to penalties and hence affecting capacity providers' decisions regarding their exit bids in capacity auctions. Therefore any change in definition of a CMW would have commercial consequences: making them more likely to occur could increase risk to capacity providers, leading to increased costs of the Capacity Market in the longer run; making them less likely to occur could adversely affect security of supply.

One reason for a CMW to be called is that an Inadequate System Margin is expected to occur in at least four hours' time (CM Rule 8.4.6 (a) (ii)); the requirement for four hours' notice is important in determining the commercial risk for capacity providers. NISMs are a tool to manage operational risk and have no such time constraint; so, for example, a problem that occurs, and is resolved, within four hours may trigger a NISM but no CMW. We would appreciate additional clarity on how these different warnings may interplay and why changes may be required to align warnings.

We consider that more work can be done ensure that CMWs are reliably received across the industry. This issue is particularly important for smaller companies who may not have the capability to monitor multiple information outlets. We consider the Capacity Market Warnings should also be posted on the Balancing Mechanism Reporting System (BMRS) website to improve transparency.

It may also be prudent to allow the Capacity Market to operate for at least one year before reviewing how other existing system warnings interact with Capacity Market Warnings.

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?

The existing LFCO formula will not work for the 2016/17 Delivery Year, and this is a significant issue that needs to be fixed before October 2016. CP128 outlined the solution of using a better proxy for system demand and for total capacity, but neglected to provide a concrete suggestion. The following is therefore proposed as a solution: replacing the LFCO formula with the one

given below. This change could be achieved either by adding the second formula to Rule 8.5.3, or by including an additional rule (say 8.5.3A) which overrides Rule 8.5.3 for the 2016/17 Delivery Year.

For the 2016/17 Delivery Year only, the LFCO formula should be:

$$LFCO_{ij} = \frac{AAO_{ij} + PTCO_{ij} - SCO_{ij}}{2} \times \min\left(\frac{D + 2 \times ILR_j + RfR}{C}, 1\right)$$

where:

- D is National Demand (a defined term in the Grid Code).
- C is Total Peak Capacity for the relevant Delivery Year, as published in the most recent Electricity Capacity Report, taking the average across the scenarios.
- Other terms are as currently defined in Rule 8.5.3.

The changes from the existing formula are highlighted. This formula will provide a load-following effect in the 2016/17 Delivery Year comparable to that in other years.

From section 8.2.2 of the 2015 Electricity Capacity Report, C would be 83,425 MW, but presumably a 2016 report will be published before the start of the 2016/17 Delivery Year. Since this new formula will only be used for one year, an even simpler approach could be taken: specifying a fixed number (e.g. 83,425 MW) in the text of the rule, rather than including a reference to the report.

In the future Ofgem may want to consider whether profiling demand from past years can be used to scale delivery obligations.

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? Q6. CP124 (portfolio testing): Do you agree with our assessment of the benefits and risks with CP124?

We agree that it is not the intention to limit volume allocation trades to a perfect fit but to provide an option for managing penalty risk. Restricting volume allocation trades to perfect fits will limit the market and liquidity, and could even perhaps result in gaming behaviour (as it possibly lowers the incentive to over deliver if the aggregator is less confident the entire volume can be traded) or other uncompetitive.

We agree with Ofgem's proposed wording would be a sufficient solution, whereby "a Remaining Under-Delivery Volume for that CMVR Transferor" is added to Rule 10.4.1(c)(ii).

Q7. Question 7 - CP124: Do you agree with our assessment of the benefits and risks with CP124?

We agree with Ofgem's assessment of the benefits and risks with CP124. This will reduce costs both of headroom and of administrative overheads without compromising reliability or auction granularity.

We also consider that it would be appropriate to stress test the level of the cap, before proceeding with the proposed solution.

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? Questions on connection capacity

No comment.

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

We agree that using TEC as the basis of the analysis is likely to overstate the size of the issue due to the ability for plant to generate over and above its TEC. Whilst Maximum Export Limit (MEL) is a better proxy, we still believe that this could overstate the size of the issue due to the fact that a MEL does not directly reflect the operating parameters of a power station. Where multiple units exist under one Balancing Mechanism Unit (BMU) (such as multiple gas turbines, steam turbines and auxiliary boilers), the MEL may not always reflect the maximum capability of the plant and so, again, the size of the issue may be overstated somewhat.

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 until a robust solution is found ensuring sufficient time to put in place.

Whilst we accept the status quo, if changes are going to be made, we support the proposals that Ofgem are making – in that plant operators should have the ability to choose connection capacity themselves, whilst implementing a suitable and sensible testing regime around this.

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?

For new build plant the capacity should be relevant to the Connection Entry Capacity or for existing plant this should reflect its Transmission Entry Capacity. However, there should be a process in place to determine when a new plant would transition to being an existing station.

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 degrades over time and also performance 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 whilst still able to deliver the required de-rated capacity. This may be as little as a few MW.

That this happens should not be considered a security of supply threat – it will most often happen in the summer, when obligations are lower. It is however possible that it could happen during a very warm winter. In this case significant levels of plant may not be able to generate to their full connection capacity. In this case, so long as it is able to demonstrate delivery to the level of its de-rated capacity, it should receive de-rated payments, until able to demonstrate full capacity again.

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?

There are concerns that the proposed approach could result in genuine capacity being excluded as a result of not having sufficient TEC. The ability to purchase short term TEC to allow generators to increase their TEC may not solve the problem, as the short term TEC may not be available in the first place, recognising 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 mechanism 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.

If a generator wants to be tested to CEC than using short term TEC to do so is an option, however, this will be at the CMU's own risk if they are subsequently not available during a System Stress Event and subsequently will need to either trade out the obligation or face the penalty.

We also note that there are products under National Grid's ancillary services which have the ability to exceed TEC when called upon such as Maximum Generation.

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)?

We do not consider that any additional measures are needed to help mitigate the risk of capacity being withheld from the market. Wholesale Energy Market Integrity and Transparency REMIT provides the framework which provides a consistent EU-wide regulatory framework specific to wholesale energy markets that:

- Defines market abuse. This includes market manipulation, attempted market manipulation or insider trading
- Explicitly prohibits market abuse
- Requires effective and timely public disclosure of inside information by market participants
- Obliges firms professionally arranging transactions to report suspicious transactions.

We do not consider that additional measures are needed to help mitigate the perceived risk.

We still consider that the best approach is to allow for plant to provide their own estimates of connection capacity. We do not believe that plant will have an incentive to understate capacity for the purpose of gaming.

There are too many market participants with a wide variety of technologies and business models for any single player to benefit from withholding capacity. Any capacity provider that “withholds” capacity is likely to be doing so for legitimate reasons, such as concerns about reliability.

Q13. Other issues

OF1 – Ofgem

We note that Ofgem has decided to implement OF1 which would extend the definition of Defaulting CMU to include a Capacity Market Unit (CMU) that has engaged in or is suspected of engaging in Prohibited Activities under the Rules, and participated in the auction, but was not awarded a capacity agreement.

Implementation of this rule must be objective and evidence based to ensure all CMU’s are treated fairly.

CP131

This proposal relates to the treatment of Interconnector CMUs with respect to the obligation and output of the CMU. Currently, the Interconnector Scheduled Transfer (IST) is used for determining the output. ESC proposes amending the Rules so that the metered volume is used to calculate an Interconnector CMU’s output, consistent with the approach used for other CMUs.

We note that this has not been implemented, and Ofgem has instead agreed to take forward a new rule to ensure the SO must provide the settlement body with an IST in certain specific circumstance. However, we consider that interconnection is treated as generation in the Capacity Market and should therefore be subject to the same metering arrangements as generation.

CP99

We noted Ofgem’s minded to implement CP99. We believe this creates an additional level of flexibility not afforded to CMRS CMUs and also steps away from 3rd party verification/regulation when certifying a CMUs capacity. Additionally it circumvents Elexon and regulated Meter operators’ data from being used in prequalification for this class of CMU. This could introduce risks to the end consumer and security of supply and potential self-certification and in our view requires further consideration from Ofgem.

Should you require further information or clarity on the issues outlined in this paper then please contact Kyle Martin on 020 7747 1834 or kyle.martin@energy-uk.org.uk.

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