EMR_CMRules@ofgem.gov.uk

27 May 2016

Dear Ms. Pickford,

Statutory consultation on changes to the Capacity Market Rules (the "Rules") pursuant to Regulation 79 of the Capacity Market Regulations 2014 (the "Regulations")

Green Frog Power are very grateful, as always, for the opportunity to engage in discussions and consultations regarding our very complex electricity market.

We are broadly in agreement with the decisions that Ofgem has made concerning the acceptance or rejection of rule change suggestions. WE provide more detail below.

We agree that the measurement and assessment of connection capacity is particularly relevant, though it is of course also very complicated and any design or design change is prone to unintended consequences. It is important that any changes made that affect market fairness and competitiveness also take into account the practicalities and limitations of testing regimes.

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For this reason, we propose that there is very close contact with industry to ensure that all of the potential benefits and risks have been considered well in advance of implementation.

Yours faithfully,

Graz Macdonald
Head of Regulatory and Policy Analysis
Green Frog Power Limited

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?

No opinion.

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)

This seems sensible.

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?

No opinion.

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?

Green Frog Power agrees that it is important that there is an alignment of system warnings. The implications of each system warning needs to be made clear to all parties at all times. If there is any ambiguity or chance for confusion or uncertainty, there is every risk that parties may take inappropriate, or otherwise inefficient actions.

However, we think it would be most appropriate to address this issue outside of the CM Rules, except, obviously, to the extent that there could be modifications to the definition of System Stress Events or Capacity Market Warnings.

It would be sensible for National Grid to work with industry to develop a straightforward industry standard ranking and defining system warnings and their precise definitions.

If it were the case that this work provides a result in which it is sensible to align the definition of System Stress with cash-out, for example, we would be supportive of changing the capacity market rules to reflect that. However, we think this required significant thought and discussion amongst industry parties before this step can or should be taken.

Regardless of the alignment issue, another very important point is that communication of all market warnings should always be made available in a widely accessible, clear and equally timely way to all market participants.

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?

Green Frog Power agrees that the current LFCO formula will not work appropriately because of the pool of capacity providers in the transitional auction delivery year will be so much smaller than in the usual capacity market delivery years.

The result of this is that a capacity provider will be required to deliver their entire derated capacity throughout the delivery year (i.e., the obligation will not be scaled to meet the system level of demand).

The level of risk is raised for these participants as there will be very little capacity that can trade under the volume reallocation provisions – this will raise the risk penalty above what was envisioned in the policy design, and what capacity providers had anticipated.

The intention of the LFCO formula is to ensure that:

- there is some demand shaping applied to capacity providers' obligations so that they can manage the risks associated outage schedules and
- capacity providers are not unduly or unnecessarily exposed to the actions of generators who were not part of the capacity market who perhaps have different constraints or incentives, and
- capacity providers are not penalised for demand shortfall as a result of balancing actions taken by the System Operator (constraints etc.).

We worry now that these reasons are not valid for the transitional delivery year under the current LFCO calculation.

We propose instead that a straightforward demand shaping is applied to the transitional delivery year to ensure that participants are able to participate in a way that mirrors the intent of the main capacity market but avoids the unnecessary complications and extra risks that will not exist for main capacity market providers. We suggest the shape from the previous year or the average of the previous few years would be (imperfect we accept, but) sufficient and fit for purpose.

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?

Green Frog Power agree with the issue that E.ON has raised concerning Rule 10.4.1(c)(ii). It is not the intention to limit volume allocation trades to perfect fits, 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 behavior, as it possibly lowers the incentive for over deliver if one is less confident the entire volume can be traded over and above prearranged trades, or other uncompetitive practices (where for example unwarranted bidding wars could occur for the extra output from large parties).

It is also possibly unfair to smaller capacity providers, as their extra output will only be tradable with other small parties. On the other hand, large generators will be able to trade with other large generators (though the pool is smaller) and small parties.

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

No opinion.

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 opinion

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

Ofgem have identified a potential of 1.5GW of capacity that is "over-stated" in terms of transmission entry capacity as compared to their derated capacity agreements. We agree that this is a possibly a serious issue with both competitive and security of supply implications.

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?

If the approach is adopted such that parties choose their own connection capacity (against which they are derated, as now), then we agree that it makes sense to test to connection capacity. Otherwise we do not agree with testing to connection capacity.

If this approach is taken, and testing to connection capacity is a requirement, then it should most certainly only be for one settlement period per year.

In our opinion, there has never been a valid reason to run plant on three occasions to prove they can operate. This disadvantages peak generators who are only intended to run a few (and sometimes no) occasions per year – it is inefficient and uneconomic, not to mention environmentally unsound, to expect GWs of plant to run out of merit, three times per year, when one time is all that is necessary to prove the plant is "real" and able to generate to the required level.

In line with the above, we think it is absurd for a plant to lose its payments in the event it was only able to generate once or twice per year – this is even more true if plant is to be tested to connection capacity. These plant may find that it is impossible to deliver to full capacity in the case where ambient temperature lowers its capacity.

That this ambient effect 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, though it is also true that there is unlikely to be a system stress event in such a winter. So long as the CMU is able to demonstrate delivery to the level of its derated capacity, it should receive payments proportionately scaled downwards, until able to demonstrate full capacity again.

In this case we would also suggest that back payments are made to repay the earlier payment reduction, if tested to full connection capacity within, say, six months. This would take into account potentially realistic scenarios beyond an operator's control without applying penalties where there is no intention to "cheat" or "game" and where there is no threat to security of supply.

It is important to also consider the requirement to provide evidence historical performance. of three settlement periods over the previous twenty-four months where the CMU had delivered to at least its derated capacity. We presume that this would be changed to connection capacity too, and that only one event would be necessary. In fact, when delivery years start rolling over – the testing success from the previous delivery year could be used as prequalification evidence in the next prequalification. This would reduce unnecessary administrative burden and unnecessary plant dispatch, which is intended merely to prove the plant is "real", and "not cardboard".

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?

Green Frog Power do not agree that it is sufficient to permit parties to claim a connection capacity that is above their TEC – this appears to go completely against the idea of using "connection capacity" or its proxy.

It is possible to generate above TEC under a Maximum Generation order from National Grid, but such an order will not necessarily be issued in a system stress event. Particularly given the widening definition of a system stress event and the risk it may further widen in the future now that we have started on that slippery slope.

Nonetheless, it is clear that overstatement of capacity provides a Rules based (rather than fundamental) competitive benefit to certain plant that could very easily result in lower security of supply that targeted and planned for.

This raises risks to customers who face potential supply interruptions (that they have paid to avoid) and to other market participants who face higher penalty risks than they would if security of supply were properly calculated based on a notional capacity more closely aligned to actual capacity.

Those who do not have sufficient TEC in a system stress event which does not coincide with a Max Gen will potentially either commit a breach of Grid Code or increase the penalty exposure for the rest of the market. It really does not seem a sensible approach for policy.

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)?

As we have said in previous consultation responses, we think 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 their 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 etc. Allowing individuals to effectively derate their own capacity is a good thing for the market, for competitiveness, and ultimately, for security of supply, as it decreases the risks associated with asymmetric information.

For added comfort in regard to gaming, and to underpin the strength of enforcement principles, we would support the requirement for a justification to be provided for claiming connection capacity below a certain proportion.

We think that the best way would be something like the approach for the price maker memorandum and certificate, where the reasoning is separately held by Ofgem, and not used or "judged" for prequalification purposes unless there is an enforcement related reason to do so.

It is very important that the Delivery Body are not given the task in prequalification, or at any other time, of rating or judging the reasons provided by parties submitting reduced connection capacities. This would add significant risk and complications to the prequalification process, and takes National Grid's role well across the line towards that of regulator. It is very important that this distinction is always clearly maintained in any regulatory design.

Additional comments

Green Frog Power agrees with the principle of checking and aligning connection capacities and planning permissions (CP157). We would like it to be made clear that an explanation of any discrepancy should only be required if the nominated

capacity is higher than the planning permission capacity (it already cannot exceed connection capacity).

If planning permission capacity is lower than connection capacity, it is entirely possible that this is due to project evolution, timing, or even rounding errors. It should be explicitly stated in the Rules that the lower of the two is the default and does not require explanations or uncertainty around prequalification success.

There should also be a clear and transparent decision process for determining whether the explanation is robust and credible, to minimise the obvious potential for gaming when this option is chosen.

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