Rupert Steele OBE
Director of Regulation

Philippa Pickford
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Dear Philippa,

STATUTORY CONSULTATION: CHANGES TO THE CAPACITY MARKET RULES

Thank you for the opportunity to respond to the above Consultation as part of Ofgem's annual review of possible Capacity Market (CM) Rule changes under Regulation 79 of the Electricity Capacity Regulations 2014.

In this context, we recognise that a lot is happening in and around the CM this year, including DECC's important wider reform work and its bringing forward some technical changes to the Regulations. We fully understand therefore Ofgem's heightened concern around the need for any changes to the CM Rules to be well justified. It will also be important that any implications for the EMR delivery partners (the EMR delivery body, the CM Settlement Body and the Electricity Settlements Company) are thoroughly understood. With this in mind, we would highlight the following points.

Ofgem's Of1 Rule change proposal

We agree that it is appropriate to extend the definition of a Defaulting CMU to include a Capacity Market Unit (CMU) that has engaged in Prohibited Activities under the Rules (and participated in an auction) but was not awarded a Capacity agreement. However, we do not believe that the definition should be extended to those *suspected* of having engaged in Prohibited Activities, as we believe that mere suspicion is not a sufficient trigger for such a strong remedy. Indeed, we note that there seems to be some uncertainty in Ofgem's own wording around whether this is really intended or not. We do not, therefore, fully support Ofgem's Of1 proposal as it is currently put forward and strongly suggest that the precise terms of this proposed change are more carefully considered.

ScottishPower's Rule change proposals

We welcome the fact that most of our proposals have been addressed by Ofgem.

However, we are disappointed to see that Ofgem does not propose to take forward our proposed Rule Change and the linked one from National Grid Electricity Transmission (NGET) (CP 146 & CP 158) which proposed a new formal 'verification' stage in the

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prequalification process. In this context, we consider that DECC's proposal to change the timing of the publication of the Capacity Market Register until after the Tier 1 appeals process has concluded only partially addresses our concerns. Whilst this approach protects the identity of those who make small errors that can be easily rectified (CP146 & CP158), we believe that, without a verification process, there is a serious risk of the operation of Regulation 69(5) (which has been disapplied to date) hindering an effective process.

Regulation 69(5) prevents further information or evidence being provided to support an appeal application and this looks like it would prevent the resubmission of an updated document or appropriate supporting materials (that may provide clarification on minor issues or address technical points). This raises concerns that the Delivery Body may not be able to use the appeals process to remedy technical errors in prequalification applications, with the risk that the auction outcome could be materially distorted (at considerable cost to consumers) on a technicality. We note that there are 'slip rule' practices in the civil courts to address similar issues.

In amending the Rules to implement other changes to the Prequalification processes, we would, therefore, request that further consideration is given to allowing for the resubmission of updated materials to support a Tier 1 Appeal. In the meantime, we would suggest suspending Regulation 69(5) again, as it was for the first two auctions, given its potential detrimental effect (though we recognise that this is a matter for DECC).

Connection Capacity

Changes to the methodology for calculating Connection Capacity could have a significant impact on CM participants and consumers. Accordingly, we support Ofgem's decision to consider this issue further. However, it is not clear how the potential new Rules may be applied to multiple-year agreements, where capacity degradation over the duration of the agreement could be expected. Uncertainty in this area could affect how large new-build stations bid in the next auction. It would therefore appear appropriate for Ofgem to consider further how to address this.

If the results of the analysis looking at the size of the capacity gap (as a result of some generators potentially overstating their connection capacity) suggest a capacity gap of up to 1GW (as is suggested in the consultation document), and taking into account that there is no proposal to implement change in time for the next auction, then we consider that this should issue be considered by NGET in their approach to their Capacity Assessment work.

Wider CM reform programme

It is important to build upon the experience of the first two CM auctions, and whilst the two areas detailed below are not specifically covered by this Consultation, they are crucial issues in the wider CM reform context aimed at ensuring that the market operates as intended and that any barriers to effective competition on a level playing field are addressed. The outcome of the ongoing work in these areas will determine if the overall market will be able to function effectively and accordingly we consider that it is important that Ofgem have this work in mind as background to it exercising its more focussed role in considering possible CM Rule changes.

Addressing over-reward to distribution-connected generation via 'embedded benefits'

- We welcome Ofgem's acknowledgement that it needs to be considered if the transmission charging arrangements for distribution-connected generation are fully cost reflective, and, in particular, whether there is currently over-reward for diesel and other small generators. Our own internal analysis indicates this to be the case and we consider that this will have an increasingly detrimental impact on the system, including significantly distorting investment decisions in the CM. Accordingly, we fully support the review of these charging arrangements and the commitment to setting out conclusions and a proposed way forward in the summer.

- In the meantime (during Ofgem's consideration of the electricity transmission Charging Arrangements and any review which may ensue), distortions to investment could take place based on the current non-cost reflective signals. Accordingly, we have raised CUSC modification - CMP264 'Embedded Generation Triad Avoidance Standstill' that, if implemented, will mitigate these risks by suspending access to Triad avoidance for New Embedded Generators commissioned after 30 June 2017.

Addressing over-reward to distribution-connected generation via CM Supplier Obligation

- We welcome the acknowledgement from DECC that this issue needs to be considered and the proposal to consult on a change to the CM Supplier Obligation so that it is calculated based on a gross basis. We believe that this would address the over-reward related to this aspect of the structure of the CM Supplier Obligation. It is important that DECC's consultation is brought forward in a timely way to ensure that this issue is addressed prior to the collection of sums starting in October next year.

Annex A sets out our responses to the specific questions in the Consultation document.

Finally, on a point of process, we believe that it would have been helpful to have held a workshop where the case for the various proposals could have been debated. We would, therefore, suggest that in future this step is inserted between the nomination of Rule changes and Ofgem's Consultation.

If you have any questions in relation to our response, please do not hesitate to contact me.

Yours sincerely,

Rupert Steele

Rupert Steele
Director of Regulation

ANNEX A

STATUTORY CONSULTATION ON CHANGES TO THE CAPACITY MARKET RULES

SCOTTISHPOWER RESPONSE

Questions on proposals

Question 1

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?

We agree that de-rating interconnectors from Connection Entry Capacity (CEC) rather than Transmission Entry Capacity (TEC) is a more appropriate way to measure the de-rated capacity of Interconnector CMUs. We also agree with the proposal to cap Interconnector de-rated capacity at TEC.

Assuming that these changes are appropriately reflected in the Interconnector de-rating calculations, we would not expect to see any significant change.

Question 2

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 believe that the proposed changes could be beneficial as they would promote competition between DSR providers. However, the Rules should not allow for value to be created by swapping components between agreements and vintages.

Question 3

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?

We agree with Ofgem's reservations about CP95, and, not withstanding our answer to Question 7, consider that CP129, CP130, and CP124 together should provide adequate flexibility.

Question 4

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 continue to believe that a four-hour CM warning period is an important and appropriate element of the CM design. Accordingly, we do not believe that it is necessarily appropriate to align the CM warnings with other existing system warnings.

We consider that there could be instances whereby a Notice of Insufficient System Margin (NISM) is issued, and a CM warning is not. This would be likely when there is a significant operational issue or 'black-swan' type event that affected the near future. If CM capacity were on the hook for penalties during such events this could lead to dispatch distortions. If these events occur they are more likely to raise questions over short term operation reserve levels.

In this context, we would suggest that the delivery of the capacity procured in the Transitional Auctions is used to ensure that the approach taken on CM warnings is appropriate.

Question 5

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?

We agree that the Load Following Capacity Obligation (LFCO) formula will not scale delivery obligations appropriately during the first TA Delivery Year. We believe that if a solution can be found that addresses the issue in a cost effective manner (for example through an appropriate approximation approach), then it should be adopted.

Question 6

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?

Yes, we agree that there is an issue with Rule 10.4.1. Moreover, we believe that your proposed solution to amend Rule 10.4.1 will appropriately address the problem.

Question 7

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

We believe that that the underlying issue is the 50MW size restriction for CMUs with multiple components on different sites. We therefore consider that it would be appropriate to stress test the level of the cap, before proceeding with the proposed solution. We do not believe that an increase to 200 MW would have a significant impact on liquidity and the auction outcome.

We consider that testing DSR on a portfolio level could lead to a significant increase in delivery risk as too much headroom is allowed and also that further cost benefit analysis is required before implementing the proposal.

Question 8

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?

We support the need to facilitate the inclusion of dynamic FFR. However, we believe that it is key that the integrity and objectives of the CM are not compromised. We believe that a more robust solution than the use of non-zero contracted output exists, and therefore further consideration is required before implementing this proposal.

Questions on connection capacity

Question 9

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

The approach appears to be sensible. Moreover, if the results of the analysis suggest a capacity gap of up to 1GW, and there is no proposal to implement change in time for the next auction, this should be considered by NGET in their approach to their capacity assessment work.

Question 10

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?

Certain technologies will only be able to demonstrate their full output capability during cold periods and, given that stress events are likely to fall during the same periods, it would seem to be in consumers' interests that plants are de-rated based on their capability during these periods. If a CMU has a forced outage during this period it would appear inappropriate for it to lose all capacity payments, especially in the case where it has demonstrated a > 90% capability within the same year.

We also believe that a tolerance level that accounts for ambient temperatures should form part of the final solution.

Changes to the methodology for calculating Connection Capacity could have a significant impact on CM participants and consumers. Accordingly, we support Ofgem's decision to consider this issue further. However, it is not clear how the potential new rules may be applied to multiple-year agreements, where capacity degradation over the duration of the agreement could be expected. Uncertainty in this area could affect how large new-build stations bid in the next auction. It would therefore appear appropriate for Ofgem to consider the implications for successful bids in the 2016 auction, and to make a statement that any new rules will not unduly affect multiple-year agreements.

It is clearly in the interest of consumers to procure volume over the life of a station in line with its capability (alternative solutions would lead to over and under procurement in any given year). We believe that a possible simple approach to address this issue would be to introduce a testing tolerance for new build plant. Within this tolerance the level of capacity being procured can be changed, but not all capacity payments would be lost.

Question 11

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, at the margins it is likely that some genuine capacity would be excluded under this approach. As you highlight, short term TEC products may be easier for some generators to procure than others.

We consider that a solution to this issue has been under discussion for time, and that we are unlikely to find a simple "perfect" solution. We therefore believe Ofgem's current proposal to be appropriate.

Question 12

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 there would be a significant risk of capacity withholding if generators were given a free choice of connection capacity. We believe that the structure of the market incentivises generators to sell all the capacity that they have available. Moreover, we agree that the threat of strong enforcement action against providers found manipulating the CM should mitigate this risk.

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