The voice of the energy industry

Energy UK Response to Ofgem's Statutory Consultation: Changes to the Capacity Market Rules (2017)

12th May 2017

About Energy UK

Energy UK is the trade association for the GB energy industry with a membership of over 90 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.

Executive Summary

Energy UK welcomes the opportunity to respond to the Ofgem statutory consultation on changes to the Capacity Market Rules. The Capacity Market continues to prove itself capable of delivering against its objectives of providing security of supply to UK consumers. Furthermore, as recent auctions have proven, it is encouraging the wider deployment of emerging technologies. Ensuring that there is a stable and investable route-to-market for all technologies is critical to industry and customer alike.

Please see below Energy UK's responses to the individual consultation question and in Annex 1, a breakdown of feedback on specific Rule Change proposals. This consultation response has been developed in conjunction with Energy UK's Capacity Market Working Group and we would welcome the opportunity to discuss any of our questions with Ofgem bilaterally or at future meetings.

Responses to Consultation Questions

Q1	**Do you agree with a financial penalty under Rule 6.8.4 for failing to meet refurbishment milestones?**

Bidders in a capacity auction must be clear about the material terms of the agreement that will come into operation if their bid is successful. This is recognised by the grandfathering of key terms of the agreement in the Regulation 31 of the Electricity Capacity Regulations; these grandfathered terms include termination fees. Any penalty introduced under Rule 6.8.4. as a result of Ofgem's proposal should be subject to the same grandfathering protection. This is important so that bidders in a capacity auction have a clear understanding of the risks and rewards under the Capacity Market Rules on which to base their bid and can be confident that they will not be exposed to new or increased forms of penalty after they have entered into a capacity agreement.

Energy UK and our members believe that Capacity Market Units (CMUs) should have the correct incentives to carry out any necessary refurbishments. Ofgem has to consider the balance of advantage for customers if they impose a financial penalty in respect of refurbishing capacity agreements awarded in future capacity auctions if they fail to meet refurbishing milestones. If there is a penalty, bidders for refurbishing agreements may well place higher exit bids, reflecting the extra risk that they will face if circumstances change and they are unable to complete their refurbishment plans. This may lead to higher clearing prices in the T-4 auction and/or fewer capacity providers entering into

refurbishing agreements. As a result, CM clearing prices may be higher but, if capacity providers do still take refurbishing agreements, then there may be greater certainty that refurbishing agreements will be delivered for their full term, which may reduce the risk of higher capacity prices in subsequent years. Either way, the customer impact is likely to be fairly marginal, particularly given the relatively small number of refurbishing agreements that have been awarded.

Q2	**Should the SO be required to update the information included in a CMN and if so what should such updates include? Please clarify why participants need this information in a CMN and cannot access it readily elsewhere? (CP216).**

A Capacity Market Notice (CMN) is likely to be issued ahead of system warning messages. It would be more helpful to align the two to prevent capacity providers responding to the CMN when there is still margin above demand. However, once a CMN has been issued, participants may monitor any changing trends from the de-rated margins data and any system warnings issued by National Grid's control room via the BMRS. We and our members are confident that the System Operator (SO) is already providing the necessary information and we are not aware of additional information that the SO should be obligated to provide within a CMN.

However, Energy UK and our members are supportive of any measure whereby the System Operator (SO) is able to provide greater transparency of their data. In doing so, participants can identify the nature of the problem and dispatch their plant accordingly as there is a risk that short duration plant could exhaust their ability to respond before a stress event occurs or during its occurrence.

Q3	**Do you think there are amendments that could be made to Schedule 4 which reduce the likelihood of future Rules changes being required if balancing service products are altered, which do not undermine the wider functioning of the Rules? (Of14)**

Energy UK and our members would encourage the Regulator to retain cognoscence of the evolving nature of balancing services as emerging technologies become increasingly mainstream; we note that National Grid is planning to set out their vision for balancing services and products when they publish their ancillary services product strategy. Furthermore, a number of other Balancing Services including intertrips are not deemed Relevant Balancing Services for the purposes of the Capacity Market Rules despite that they could prevent CMUs from delivering against their CM obligations - it would be helpful for Ofgem to indicate any basis on which they would judge whether a Balancing Service should be deemed 'Relevant'. As such, it is difficult to amend Schedule 4 effectively, however we would encourage Ofgem to make the relevant definition of Balancing Services more generic to accommodate these changes. Furthermore, to ensure the rules remain compatible and fit for purpose a better approach would be to review the Rules when any changes to balancing services products occur.

Q4	**Do you agree that this is an appropriate solution to the issue identified with the storage output formula under Rule 8.6.2? (Of13)**

Energy UK and our members welcome this recognition of the ability for storage to switch from importing to exporting during a stress event. We agree that the current formula allows storage, under certain circumstances, to receive an over-delivery payment despite only having delivered capacity equal to its obligation during the relevant stress event and continuing to consume energy to charge between the issuing of the CMN and the start of the relevant stress event, which we agree needs amending.

We believe that the term "B" in its original and proposed form is likely to over-reward storage capacity in the Capacity Market and should be removed completely.

Ofgem states that the new proposal would 'align the methodology with DSR'. We do not believe that the methodology should align storage assets with DSR. In other respects, storage is regarded as a form of generation. This position should continue for the Capacity Market and therefore, storage should not be subject to baselining in the same manner as DSR.

We believe that the right answer would be to remove the term B from Rule 8.6.2 altogether; however, Ofgem's proposal is less harmful than the current form of Rule 8.6.2.

Q5	**Do you agree this approach allows DSR providers of frequency response the ability to participate effectively during the testing regime? (Of14)**

Energy UK and our members believe that this approach gives providers of frequency response the ability to participate effectively during the testing regime. Ofgem's decision to allow DSR providers of frequency response to participate in the Capacity Market makes the market more attractive to investment, particularly in disruptive, emerging technologies such as DSR. We also agree with the idea of capping the volume of capacity at the low frequency element of the asset's declared availability.

Q6	**Do you agree that no change is required to the calculation of output during Satisfactory Performance Days and Stress Event periods once all frequency response services are included under Schedule 4? (Of14)**

Energy UK and our members support Ofgem's decision that no changes are required, enabling providers of static FFR and FCDM to prove their ability to deliver the service been based on their actual dispatch response. The dynamic FFR base lining methodology appears to be complex and would benefit from a worked example.

Q7	**Do you agree that the current metering arrangements are suitable for DSR providers of frequency response services? (Of14)**

We do not believe that there is a requirement to amendment the Rules relating to the metering test or general metering arrangements which are required to enable participation of frequency response providers.

Q8	**Do you agree with our conclusions with regard to our preferred testing format? (Of15)**

Energy UK and our members support the principle that CMUs should be able to set and demonstrate their connection capacity. However, a more straightforward approach to demonstrating the ability to deliver would be to use historical output data, should it be available, at the time of prequalifying along with a declaration from a CMU's directors that the chosen figure is based on expected capacity in the delivery year. We would encourage Ofgem to review the responses from our members who have detailed specific issues in need of being addressed. These proposals are specifically for transmission-connected capacity. With the increasing amount of distribution-connected generation competing in the Capacity Market, Ofgem should consider also extending this to distribution-connected generation. This would lead to a consistent approach to ensuring the delivery of reliable capacity from all existing generation assets in the Capacity Market. Ofgem must consider how these proposals will apply in a T-1 auction, as there will not be the opportunity for misquoted capacity to be repurchased following this point. Ofgem must work carefully with National Grid to ensure that the calculation of the de-rating factors remains appropriate with this new methodology.

Q9	**Do you think our proposed approach to setting incentives (threshold and penalty) will effectively reduce instances of overstating capacity? (Of15).**

Following consultation with our members, Energy UK is supportive of the need for a threshold above which a termination fee would not apply. In the interest of security of supply it is important to effectively reduce instances of overstating capacity. TF5, which aligns with the termination fee payable by providers who close down before the Delivery Year, is the correct termination fee to use.

Our members would welcome the opportunity to review the analysis Ofgem has undertaken to reach the 97% threshold and we believe that the analysis should be published. The threshold should be no lower than the threshold for new build and refurbishing capacity for meeting its substantial commitment milestone, which is 90%.

For more detail about the questions posed within the consultation document please refer to the responses submitted by our members. Should you have any questions regarding this consultation response then please do not hesitate to get in touch via the details below.

I can confirm that this response may be published on the Ofgem website.

Yours sincerely,

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Annex 1 - Additional Rule Change Feedback

Of12 (Ofgem) on DSR Portfolio Maintenance (and associated rejection of CP217 (ADE) and CP220 (ADE))

Energy UK and our members welcome the principle behind Of12 and recognise the importance of providing a facility for DSR aggregators to maintain their portfolios so as to continue to deliver reliable performance despite any changes to their customers' activities. However, we have concerns that the proposal requires a new DSR Test of the whole CMU (or multiple CMUs, where a joint DSR Test has been used) could render these provisions useless. It is such a costly and risky exercise that aggregators will only use the provisions of Of12 as a last resort.

The new DSR test achieves little (other than deterring portfolio maintenance), especially in cases where the aggregator is only adding components. There is no way that adding components could reduce the CMU's ability to deliver on its capacity obligation, so there should be no need for a new DSR Test in this instance.

Of14 (Ofgem) on Frequency Response Services

Our members have voiced concern that the proposed testing regime for providers of dynamic frequency response is overly complex. We believe that if a capacity provider has proved to National Grid's satisfaction that a resource can deliver frequency response, this should suffice for Capacity Market purposes.

Of15 (Ofgem) on Calculating Connection Capacity

Energy UK and our members broadly support the Ofgem proposals to permit CM participants to nominate their own connection capacity with appropriate testing in place to ensure that there is no capacity gap. Alternatively, the use of historic data which can demonstrate a full-load capacity at prequalification could help address this concern.

Ofgem proposes to allow for generators to nominate their connection capacity because the current Rules are considered overly complicated and lead to potential overstatement of the capacity available to deliver in a system stress event. Parties should be able to nominate their own connection capacity subject to a cap of TEC/CEC or distribution connection capacity. They should be able to demonstrate that they are able to meet their full connection capacity against which system security of supply is measured. It would greatly simplify the CM Rules to permit a less prescriptive approach to nominating full capacity.

However, Ofgem should consider the effect of their proposals, which could reduce the annual income received, on the current cap on penalties and the rate at which non-delivery payments would be incurred. If additional risk is being introduced for Transmission connected CMUs, it is imperative that Distribution CMUs are treated in the same way to ensure a level playing field for CM participants.

We are confident that this approach will not cause parties to overstate their capacity in any material way. Parties will be incentivised to submit the highest capacity they are confident that they will be able to deliver in a stress event. They will also want to ensure that they are able to meet the annual testing requirements.

CP163/164/204/201/211/212 on CMU Testing Periods

Energy UK welcome the fact that it now appears to be recognised that steps need to be taken to ensure that consumers are properly protected from the risk of CM resources being unable to deliver for the full duration of potential Stress Events. As is noted in the Ofgem consultation document, the System Operator is developing a new de-rating methodology and BEIS will consider amendments in this area following completion of the relevant analysis. Given the importance of this issue, it is vital that this work is progressed in a timely way so as introduce changes before the next T-4 CM auction. Depending on the final design of the new de-rating approach, it may also need to be buttressed by

appropriate changes to the testing regime and we would suggest that this merits further consideration as the de-rating changes become clearer.

CP165 (VPI Immingham) & CP230 (Energy UK) on Credit Cover Timing for Conditionally Prequalified Plant

Energy UK appreciates that Ofgem's position that they do not have the requisite powers and we look forward to hearing back from the Department for Business, Energy and Industrial Strategy (BEIS) who we understand this issue has now been referred to. We would re-emphasise the criticality of this proposal to the investability of the Capacity Market regime.

CP169 Satisfactory Performance Testing in Summer

Energy UK supports the intent of CP169 but does not agree with Ofgem that testing should be extended to summer. CP169 was meant to avoid unnecessary running in winter just in case a stress event happened in the summer. Ofgem's proposed amendment will mean that CMUs will that would otherwise have shut-down for the summer months either to take a long outage or for commercial reasons will instead do the required testing either at the beginning or end of the summer testing period. Ofgem's proposal will not therefore demonstrate that a CMU is available throughout the Delivery Year, it will merely be a 'box ticking' compliance requirement that provides no benefit to the consumer. There are good reasons why the original drafting of the Capacity Market Rules distinguished between summer and winter in this respect and we believe that Ofgem's proposal will lead to a disproportionate increase in risk for capacity providers that will ultimately be reflected in higher costs for customers but that it will not make a significant contribution to security of supply.

Ofgem's proposed amendment to CP169 also fails to recognise that the Secondary Trading arrangements have been put in place to allow CMUs to be unavailable for part of the Delivery Year. This can be achieved through trading on the obligation and also through ex-post volume reallocation where the obligation continues to rest with the Transferor. Volume reallocation is likely to be the preferred route for managing non-delivery due to the strict limitations on who can participate in Obligation Trading. Ofgem's proposal to extend testing to summer would be severely restrictive to those seeking to manage summer shutdowns using volume reallocation as they cannot pass on the testing obligation. It may also be challenging to meter the capacity obligation on CCGTs in summer due to the impact that higher ambient air temperatures have on output.

CP170 (RWE) on Explanations of Prequalification Decisions

Energy UK and our members have already articulated our concern with the handling of prequalification decisions in the 2016 auction and have a dedicated work-stream with National Grid to ensure that these issues do not arise again. Whilst we are confident that this work will help rectify these issues, we would welcome explicit requirements from Ofgem which would ensure that the Delivery Body processes these decisions with the required level of due diligence.

CP171 (RWE) Imposing a Time Limit for the Delivery Body to say Whether a Satisfactory Performance Day was Satisfactory or Not

We and our members welcome the proposal to impose a time limit so as to avoid any potential misunderstandings during the testing process.

CP173 (RWE), CP219 (ADE), CP225 (Centrica) on Supplier Letters for Bespoke-Metered Behind-the-Meter Generators

Our members have voiced concern that these three Rule Change Proposals have been rejected because Ofgem has not yet seen evidence of the problem existing. The proposals have been raised by three organisations separately and clearly explain that the Supplier has no visibility beyond the boundary meter and as a result have no certainty of the net-output. As a result they are unable to provide a supplier letter, as required in 3.6.1(c)(i). In the response to CP173, Ofgem says that 3.6.1 already provides an alternative way to verify output however it's not clear what they mean by this. If

they're referring to 3.6.1(c)(ii), that only applies if the generator has provided balancing services, not more generally.

CP175 (ENGIE) on the Definition of 'Operational' Refurbishing CMUs

CP175 was raised to address the situation where a refurbishing CMU fails to prove that they are 'Operational' at the connection capacity by a small kW margin and as a result loses its refurbishing contract and reverts to a one year agreement. Ofgem's justification that it has no evidence that reaching full connection capacity has been a challenge for refurbishing CMUs or that additional flexibility is needed is unsurprising as the Capacity market has not yet commenced. Furthermore, the CMUs that did enter into three year refurbishing agreements in the 2014 T-4 auction have all reverted to one year agreements. There can therefore be no evidence as to whether this a problem or if it will become one.

Additionally, Ofgem notes that as some refurbishments may only increase capacity by a small amount, allowing a 90% threshold would not give evidence that the refurbishment was successful. The CM Rules and Regulations do not require a refurbishment to lead to a higher output compared to the pre-refurbishment CMU and requiring the CMU to be Operational at the connection capacity therefore creates an inconsistency. In 2016, Ofgem approved Rule change CP126 (raised by Energy UK). CP126 recognised that not all refurbishments lead to an increase in capacity and that the Rules were not suited to such circumstances. This reason for rejection is therefore not relevant.

Energy UK considers that the reasons for rejecting CP175 are flawed and asks that Ofgem reconsider its decision here.

CP180 (E.ON) on Component-Level Termination

Energy UK and our members have concerns with Ofgem's position that volume reallocation and obligation transfer would help avoid termination. This would not be the case where a component becomes permanently unavailable before it had completed its satisfactory performance days or where a termination has been triggered by something else, such as a metering issue or paperwork error.

CP181 (E.ON) on Allowing Easier Participation by Sites Where One Part of the Site is in Receipt of Low Carbon Support

Energy UK and our members would welcome the opportunity to discuss this Rule Change in greater depth with Ofgem. For many sites, expensive bespoke metering arrangements would be required in order for a number of sites to provide a service in the Capacity Market should they, for example, have a small-scale, FiT-supported solar array on the roof of their building.

In general, even if it's not metered, there would be no "cumulation of state aid" from the inclusion of PV in a DSR site. This is because the PV is not controllable, so there's no reason to expect it to be producing greater output during a system stress event than during the intervals that set the baseline against which the performance during that stress event will be measured. In fact, system stress events are more likely to occur when renewable generation is low, so it is more likely that the unmetered PV will detract from the measured performance of the CMU.

CP183 (E.ON) on Reducing Delivery Body Approval Times for Secondary Trading Entrants

We are confident that considering the resource in place at the Delivery Body which has proven itself capable of processing the prequalification of over 50GW of capacity in a month, they would be able to deal with the smaller proportion of secondary trading entrants in a shorter period of time. Whilst Ofgem have suggested that a three month period would reduce Delivery Body costs, the evidence for this has not been provided.

CP186 (E.ON) to Allow DSR Tests During the Prequalification Assessment Window

Following consultation with our members we are confident that there is no evidence that it would cause the Delivery Body any problem to allow DSR Tests anytime. In the absence of any evidence of cost savings that would outweigh the loss of flexibility suffered by all DSR providers, the restriction should be removed.

CP191 (National Grid) on Derating for Distributed Generators

Ofgem proposes to reject this proposal because the methodology proposed is not consistent with the intent of the de-rating process. While Ofgem welcomes further proposals and analysis in this area, the lack of available data makes it very difficult to provide further proposals; we recommend that Ofgem works with BEIS and National Grid to develop solutions to provide much greater transparency of the capacity contribution of decentralised generation.

CP213 (Scottish Power) on Including the Technology Class in the CM Register

Energy UK and our members welcome the transparency that this decision provides. We would, however, encourage Ofgem to make it clear that participants do not have to undertake joint satisfactory performance day (SPD) testing if joint DSR tests have already been undertaken.

CP215 (ADE) on Aggregation of Prospective CMUs

Energy UK and our members welcome this correction.

CP216 (ADE) on More Actionable Capacity Market Notices

We would refer Ofgem to our response to the consultation question 2.

CP218 (ADE) on Avoiding Bespoke Metering for Excluding Renewable Generation When the FIT Metering is Adequate

We would refer Ofgem to the position outlined under CP181. Energy UK welcomes further discussion on this issue and encourages cognoscence of the cost impact of installing additional metering.

CP231 (Energy UK) on a Correction to Joint DSR Tests

Energy UK and our members welcome this correction. However, there is a related change in the drafting (attributed to CP168 and or OF11) that changes the effect of Joint DSR tests in a way that was not included in the original proposal which has not been discussed. Specifically the way in which the term "DSR Portfolio" is used in the proposed new clause (b) of 13.4.1B and 13.4.1C could be construed as meaning that DSR CMUs which have had undergone Joint DSR Test must also demonstrate Satisfactory Performance Days jointly. Whilst this is not the only possible interpretation, we would ask that drafting be amended to clarify that there is no such requirement.

CP233 (ESC) on Division of Auxiliary Load

We do not believe the rule change proposal adequately addresses the problem. We would suggest that the issue would be better addressed by requiring auxiliary load to be metered. Metered auxiliary load could then be allocated by multiplier values to each unit in line with the proposal but allowing the participant to allocate load in line with actual technical plant characteristics so long as 100% of load is accounted for.

We would also suggest that the drafting avoids the use of the term ‘auxiliary load’ in both upper and lower case to avoid confusion. It is not clear whether auxiliary load is to be metered or not.

CP234 (ESC) to Allow BSC Metering

Energy UK and our members welcome this decision so as to avoid wasteful duplication of metering.