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Statutory consultation on changes to the Capacity Market Rules 2014 – RWE Response

Dear Mark,

RWE welcomes the opportunity to respond to the Ofgem statutory consultation on changes to the Capacity Market Rules (the Consultation Document) published on 23rd March 2017. We are responding on behalf of our group companies RWE Supply and Trading GmbH and RWE Generation UK plc (together, "RWE"). This is a non-confidential response.

Our response to the specific question in the consultation document is included in Annex 1 and our response to certain individual change proposals in Annex 2. If you have any comments or wish to discuss the issues raised in this letter then please do not hesitate to contact me.

Yours faithfully

By email

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Annex 1: RWE Response to the specific questions

- **CQ1: Do you agree with the introduction of a financial penalty under Rule 6.8.4 for failing to meet refurbishment milestones? (CP229)**

We agree that CMUs that have not fulfilled the requirements for a 3-year Capacity Agreement should not be prevented from participating in T-1 auctions for the reasons set out in the consultation. However, a financial incentive may be appropriate. The cost to the consumer is similar to that of a CMU that is successful in a T-4 auction not subsequently delivering capacity and that capacity having to be replaced in the T-1 auction. Therefore, a reference for establishing the appropriate rate for a financial penalty should be that faced by a CMU failing to meet milestones to deliver new-build capacity.

- **CQ2: 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 CMN is not specific to a particular Settlement Period and therefore, we do not see the benefit in updating on that basis. We would also note that other Grid Code notices would be expected to be issued in the event that system margins worsened to below the levels that would trigger a Capacity Market Notice (CMN). We do however believe that National Grid may be incorrectly interpreting the current provisions of 8.4.6 (a) (ii), which requires a CMN to be issued if an Inadequate System Margin is anticipated in a Settlement Period falling *at least* 4 hours after the expiry of the current Settlement Period. We understand that National Grid will only issue a CMN between 4 and 4½ hours out, whereas the Rules do not put such a restriction on National Grid and requires them to issue a CMN if an Inadequate System Margin is anticipated, for example, 8 hours out.

- **CQ3: 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)**

We do not believe that it is appropriate to make broad changes to the Rules in order to accommodate future changes to Balancing Services. Decisions were made during the Capacity Market design to include some Balancing Services and not others. It is important that the decision to incorporate Balancing Services and the way in which they are incorporated is considered at the time, taking into account the features of the Balancing Service. However, one approach outside the Rules would be to ensure that Balancing Services result in changes (where appropriate) to the Expected Metered Volume in the BSC via the use of the ABSVD (Applicable Balancing Services Volume Data) provisions. This could be used more widely than is currently the case and ensure that all Balancing Services providers are treated equally under the BSC. In this way, the Rules can remain neutral in their treatment of different Balancing Services since the Expected Metered Volume will be adjusted by the application of ABSVD, giving the correct baseline against which to assess CM delivery.

We are concerned that the proposed changes risk misrepresenting the purpose behind the introduction of the Relevant Balancing Services. The Relevant Balancing Services were introduced to ensure that providers did not prioritise CM delivery over service delivery, and therefore maintained their level of output in the absence of an instruction from the System Operator to the contrary. This approach would allow the System Operator to determine whether to maintain the delivery of the Balancing Service, or to instruct the CMU to deliver its capacity obligation. Enhanced Frequency Response (EFR) as currently contracted is different, in that the design of the

technologies providing the service is such that it is typically unable to deliver sustained output for the potential duration of a System Stress Event. Therefore, while we can understand the rationale for the existing services being defined as Relevant Balancing Services, the proposal appears to be aimed at relieving EFR providers of obligations to deliver energy during System Stress Events, other than those that happen to be delivered as a result of a drop in system frequency. This changes the nature of Relevant Balancing Services materially.

As drafted, the proposals in Of14 risk placing inappropriate incentives on EFR providers. In the event of a System Stress Event, an EFR provider would be incentivised to maximise their output in order to over deliver against their CM obligation, and they are also likely to receive 'spill' payments in the form of System Sell Price (SSP), which during a System Stress Event will be up to £6,000/MWh. This is likely to be very much more than any likely interruption of payments under the EFR contract. As the purpose of the Relevant Balancing Services is to avoid incentives to prioritise CM delivery, we do not consider that Of14 achieves this.

We are also concerned that adjustments to the Rules risk being rushed through in order to accommodate a particular set of participants who, it would appear, may have made assumptions about their ability to participate in the CM without the Rules accommodating their particular delivery model. Effectively changing the Rules retrospectively sets a worrying precedent that others may seek to rely on in making bidding decisions in the CM against CM Rules that do not accommodate a particular method of delivery ,or when tendering for future Balancing Services.

We would highlight that a number of other balancing services that may affect a CM provider's ability to respond during a System Stress Event are not in the list of Relevant Balancing Services, including intertrips and certain Pre-Gate-closure BMU Transactions (PGBTs) (also known as 'Schedule 7A Trades'). If changes are proposed to include one specific service in the list, then other services should be considered at the same time.

- **CQ4: Do you agree that this is an appropriate solution to the issue identified with the storage output formula under Rule 8.6.2? (Of13)**

We have no comments on this question.

- **CQ5: Do you agree this approach allows DSR providers of frequency response the ability to participate effectively during the testing regime? (Of14)**

We would expect any Frequency Response provider intending to participate in the CM to ensure that the Frequency Response contract they were entering into permitted them to meet those CM testing (and delivery) provisions in place at the time that they entered into the Frequency Response contract. Therefore, we would assume that no particular changes need to be made to alter any testing requirements. Changing the Rules to facilitate participation after entering into a Balancing Service undermines the tendering process for that service, since those taking into account the CM Rules are likely to tender at a higher price than those willing to risk a low bid on the basis that the CM Rules may be changed to enable their participation. This sets a worrying precedent in terms of future tenders for Balancing Services. Applicants seeking to prequalify CMUs declare that they are seeking CM Agreements in good faith, which they must assess against the then prevailing Rules. There should therefore not be any incompatibility between Balancing Services already entered into and participation in the CM, including testing and delivery.

• CQ6: 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)

We agree that no change is required to the calculation for output during Satisfactory Performance Days. However, for the reasons set out above in reply to CQ3 and CQ5, we do not believe that the inclusion of additional frequency response services is appropriate.

• CQ7: Do you agree that the current metering arrangements are suitable for DSR providers of frequency response services? (Of14)

• CQ8: Do you agree with our conclusions with regard to our preferred testing format? (Of15)

We have some reservations regarding the detailed proposals. Currently, delivery obligations and the requirements for Transmission CMUs to maintain Transmission Entry Capacity (TEC) only refer to de-rated capacity. Therefore, the review needs to take into account the obligations that would be reasonable with respect to TEC, and these may need amendment. For example, if the obligation to maintain TEC only relates to de-rated capacity, it would be feasible to acquire short-term or limited duration TEC, so as to be able to carry out the necessary Satisfactory Performance Days, while not then being able to deliver the full connection capacity during a System Stress Event as output would be limited by a lower TEC, thus avoiding TEC costs up to the full Connection Capacity.

If requiring CMUs to demonstrate metered output up to the Connection Capacity, the threshold that has been proposed should take into account the variability of different technologies that arises as a result of ambient temperatures. This would not affect security of supply, since any provider should be confident of being able to deliver their load-following obligation during a System Stress Event. However, if a CCGT can only offer a Connection Capacity that it is confident of achieving during a very mild testing period, inefficient Connection Capacities may be offered that are well below the level that would be achieved during a cold winter when System Stress Events may be considered more likely.

Clarity is required as to whether CMUs with long term agreements would need to prove their capacity each year. We would suggest that this should be the case as any existing CMU would likewise be required to prove their capacity annually.

We would strongly recommend that the proposed changes should also apply to Distribution connected CMUs. Many existing CCGTs are distribution connected as are a large number of other technologies. As the proposals introduce increased risks of temporary plant failure impacting the testing period and having a financial penalty applied, even though such failure may not directly impact the delivery year itself, it would be discriminatory only to apply the proposals to Transmission connected CMUs.

• CQ9: Do you think our proposed approach to setting incentives (threshold and penalty) will effectively reduce instances of overstating capacity? (Of15)

Whilst we do not agree with the premise that Applicants adhering to the CM Rules and using Connection Entry Capacity (CEC) as the basis of their Connection Capacity are 'overstating' capacity, we agree that this area of the Rules may reasonably be reviewed. We would note that during the development of the Capacity Market Rules, DECC took a deliberate decision to use

CEC as the basis for Connection Capacities, and alternative options were only introduced late in the process to enable CMUs that would otherwise not be able to meet their de-rated capacity to prequalify.

It is also relevant that during the development of the Rules and Regulations one of the main concerns of DECC and the main reason for not allowing Applicants to set their own choice of connection capacity was that Applicants might withhold capacity, thereby affecting the auction clearing price. Strong penalties against market manipulation exist, but it may be helpful for Ofgem to provide guidelines on how they might approach any such concerns.

We would also ask that Ofgem consider any unintended consequences of the proposals. For example if, because of an inability to meet a certain percentage of the Connection Capacity during the testing period, a negative payment results, what will be the effect of the current annual cap on penalties and at what rate will non-delivery payments be calculated? Normally, non-delivery payments would be calculated with respect to the auction clearing price, but if a negative payment results, is that still appropriate?

Annex 2: RWE Response to individual change proposals

CP163, CP164, CP204, CP209, CP210, CP21 &CP212:
We do not agree with Ofgem's assessment that the best way of addressing the risk of CMUs not being able to deliver during a System Stress Event is through the de-rating factors. A simple example illustrates the point. Two CMUs that are de-rated by a large amount but can only deliver energy during a single settlement period, do not deliver the same level of security as a single CMU that is capable of delivering energy over several hours. In the event of a System Stress Event, because over-delivery potentially has the same payment rate as under-delivery, there would be an incentive on CMUs with limited deliverable energy to over -deliver in the first settlement period of a System Stress Event, even if that resulted in under delivery in subsequent settlement periods. Since the duration of an event is unknown, the value of delivered energy for later settlement periods is therefore also unknown, and it would be financially beneficial do deliver the available energy in a Settlement Period in which the provider is most certain that a System Stress Event is occurring. By requiring CMUs to deliver longer 'proving runs', their ability to deliver for sustained periods during System Stress Events can be demonstrated.

We would also note that as part of the proposals that Ofgem has made in Of15, it would be for providers to set the Connection Capacity such that they are able to meet the testing regime, which, if that required longer runs, would allow Applicants to set appropriate Connection Capacities depending on their particular technology and configuration.

CP168:
The industry, through bodies such as Energy UK and FIA's Power Trading Forum is considering how efficient Volume Reallocation between different Capacity Providers may be facilitated both in advance of System Stress Events and subsequent to such events. It has become clear that the current Rules will make the trading of over and under delivery after a System Stress Event very resource intensive and subject to errors, due to the requirement for two parties to submit identical information. The current Rules also prevent any central clearing to take place, since only participants or their Agents registered at the time of prequalification can make CMVRN submissions, and no Agent can act for multiple parties.

After a System Stress Event, it is likely that every CMU will want to trade, either to secure over-delivery income, which is not certain due to the reliance on under-delivery payments being available at the end of the year, or to reduce the penalty exposure by finding a counterparty willing to accept a lower rate for over delivery, taking into account the uncertainty of over-delivery payments. As there are Rules that limit the ways in which CMVRNs can be allocated, it is quite likely that many CMUs will need to trade capacity with more than one other CMU. Therefore, the minimum number of CMVRN submissions that that might be needed for each settlement period in a System Stress Event would be the total number of CMUs multiplied by 2 (as each trade must be submitted by each counterparty) and the maximum would be far in excess of that. Having the ability to assign Agents could simplify the process enormously and reduce the scope for errors.

CP169:
We welcome Ofgem's proposed decision to take forward the proposal made. However, we do not agree with the additional changes that have been outlined. A CMU is obliged to demonstrate its de-rated capacity (the Capacity Obligation) during the winter months and not, as is suggested in the consultation document, the Load Following Capacity Obligation. This obligation arises whether or not there are System Stress Events during the winter months. In the event of a provider not demonstrating three Satisfactory Performance Days during the winter, capacity payments are halted for at least one month. Therefore, there is a clear incentive to carry out the 'proving runs' during the winter. We do not agree that any further changes in this area are required.

Failure to deliver energy during System Stress Events during Summer months incurs financial penalties, and as such there is a clear incentive to maintain availability. Also, as Ofgem points out in the consultation document, the Load Following Capacity Obligation may be significantly reduced in the summer, and it is therefore likely that many providers will use the opportunity to take necessary outages and, where appropriate, use secondary trading provisions to ensure that they have traded out their delivery risk. Placing additional testing requirements on providers during the summer months may lead to inefficient dispatch, since such testing requirements would not take into account the availability of plant and any secondary trading that may have taken place.

CP170:
We strongly support Ofgem's view that the Delivery Body should, under the current Rules, provide sufficient information for an Applicant to understand the reasons for a rejection. However, our experience is that only generic descriptions are given with the decision, and getting to the details of the decision can be difficult and time consuming. There should be little or no need for the Applicant to contact the Delivery Body directly after the decision has been given, but our experience is that phone lines were over-loaded and we assume that many telephone calls will have been made in order to better understand the sometimes perplexing reasons for rejection.

CP172:
The definition of Secondary Trading Entrant is skewed towards certain technologies. It covers biomass plant exiting the Low Carbon Exclusions in which it participates, existing Interconnector CMUs and Proven DSR. For any other technology (Generating CMUs), a series of tests must be met, which we do not see as relevant. For such CMUs, they must be existing, but under 3.3.3 (f) it was a new-build that was excluded from taking part in an auction due to the Applicant having had a Capacity Agreement terminated on certain grounds and was not existing at the time of the T-1 Auction.

This then only allows Applicants with Generating CMUs who have had previous Capacity Agreements for new-build CMUs terminated within the previous two years, to register as Secondary Trading Entrants. This appears perverse, and will prevent Applicants who do not fall into that category from bringing forward capacity that could participate in secondary trading.

CP173:
The current Rules require either a letter from a supplier that confirms a non-CMRS CMU's historic metered output, or evidence that the CMU discharged a balancing service to deliver the physical net output. In the event that a balancing service has not been provided, the supplier letter is needed. However, for bespoke metering, the supplier is unlikely to have access to meters other than boundary meters, which causes issues when the supplier is asked to confirm the output of a CMU that is metered behind the boundary. Therefore, suppliers have no better insight into the output of such a CMU than any other party. If the Applicant can provide other evidence, this should be sufficient.

CP190:
We do not agree with this proposal, since obliging Applicants to provide Relevant Planning Consents ahead of prequalification by removing the ability to defer, must reduce the ability of developers to participate and add liquidity to the auctions. Even if only a few cases have successfully utilised the ability to defer, we do not consider that this materially increases costs, and since all new-build participants have the ability in any case not to participate in the auction by not confirming participation shortly before the auction, we see no impact on the ability to assess the capacity that is likely to participate in the auction.

The proposed changes may delay many schemes being prequalified by up to a year, and it is not in consumers' interests to in any way limit the participation in the CM auctions. Such delays may also reduce the schemes or their ability to attract appropriate and timely financing.

CP203:
We agree with Ofgem's view that the provision of Black Start is not the same product as the capacity provided in the CM. Even if it were, we do not consider that to be a relevant argument. It is important that other markets, including the wholesale market and ancillary services market, remunerate plant that the system values in order to provide the System Operator with the tools it needs to operate the system and maintain security of supply. This allows CM bidders to offer best value for consumers by taking into account other income streams. Over time, if these markets develop efficiently, it is possible to envisage CM prices tending towards zero, as there would not be any 'missing money'. Therefore, as a principle, the different sectors of the power market should support each other in order to deliver an efficient mix of plant delivering system security.

We would also note that Black Start contracts take a number of forms and it would therefore in any case be inappropriate to treat all Black Start providers in the same way.

CP207:
We agree with Ofgem that the Capacity Market Rules must remain technology neutral. This was part of the State Aid approval decision and in any case ensures that the lowest cost capacity is available to consumers. Any environmental restrictions are a matter for other policy decisions and Applicants are already obliged to take into account environmental regulations relevant to their circumstances. Participation in the CM does not mean that high load factors will be necessary and therefore the impact on emissions is minimal.

CP227:
We agree with the proposal that there is a risk of under-procurement in the case of plant that is opted out of the CM, but declares that it will be open anyway. As the declaration is currently the only 'free option' available for opting out, there is an incentive to do so if there is any doubt as to the future of the plant. We agree with Ofgem that the best view of the plant's likely future is with the Applicant. However, if they declare that they will remain open in the absence of CM payments, it would be reasonable to exclude them from participating in the subsequent T-1 auctions. This should not cause any issue with participants who have already indicated that they will remain open without CM payments. If they remain open at the time of the T-1, auction then their capacity can be taken into account when setting the target capacity. If they have not remained open despite their previous declaration, then the T-1 auction can cover the missing capacity. In parallel, we suggest that the current option for CMUs to opt out stating that they will close should not result in exclusion from future auctions. In this way, if for any reason circumstances change between a T-4 and T-1 auction, CMUs opting out should be free to participate. This should not give rise to security of supply concerns since the capacity will not be assumed to exist when setting the level of capacity to procure in the T-4 auction and therefore it would not be to the benefit of the Applicant to opt out in this way unless there was a clear expectation of closure.