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Sent by email to: [EMR\\_CMRules@ofgem.gov.uk](mailto:EMR_CMRules@ofgem.gov.uk)

Dear Mark,

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

Centrica believes that Ofgem should reconsider its position to require capacity providers to submit new declarations for every capacity auction. This requirement causes issues and is cumbersome for companies like Centrica that are signing up distributed energy on customer sites for participation in the Capacity Market. This administrative burden is reducing the amount of customer-focussed capacity available to bid; for example, small amounts of distributed capacity on sites of big businesses. We agree that Ofgem requires assurances from capacity providers, however, we already obtain these assurances when legally contracting with customers. Ofgem should consider allowing an approach which allows declarations in different formats to the appendices, but are legally equivalent.

We are concerned that Ofgem is considering proposals to reduce the de-rating factors of distribution-connected assets with non-firm connections. We note that Ofgem has not taken forward proposals that would provide distribution-connected assets with equivalent obligations and penalties as transmission-connected assets. With an increasingly decentralised electricity system, Ofgem should be accommodating this transition through allowing equitable access, rather than hindering distribution-connected assets.

Centrica believes that Ofgem should allow unsupported renewables to participate in the Capacity Market and should work with BEIS to ensure the de-rating factors for these technologies are accurate. We disagree that there is a policy decision to be taken to allow post-subsidy renewables in the CM. The Capacity Market is a key part of the GB electricity framework, along with the wholesale market and balancing services. For unsubsidised (either post-subsidy or subsidy-free) renewables to compete with other technologies, it must be able to access the same revenue streams.

We have highlighted to BEIS and to HM Treasury that we believe the de-rating factors of interconnectors in the Capacity Market are too high. We are also disappointed that Ofgem has not taken forward rule changes that would ensure that interconnectors had equivalent obligations as other capacity providers.

Regulations changes should not be used as the sole reason to not take forward a Capacity Market rule change. Ofgem should provide a view, with reasoning, whether such a rule change would ensure better operation of the CM. If so, Ofgem should indicate how it has, and will continue to, worked with BEIS to ensure the rules change is implemented in a timely manner. As part of the 5-year reviews, we will encourage BEIS and Ofgem to approach future annual the rule change processes in a coordinated manner.

Similarly, Ofgem should not use the difficulty of systems changes as the main reason to reject a rule change proposal. Ofgem should determine whether such a rule change would ensure better operation of the CM. If it would, Ofgem should indicate how it has, and will continue to, worked with National Grid to ensure that systems changes are made.

Please find below the detailed responses to the consultation questions. Please do not hesitate to contact me, if you would like to discuss any points raised.

I confirm that this letter and the response to consultation questions may be published on Ofgem's website.

Yours sincerely,

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## **Appendix – responses to consultation questions in Annex B**

We have provided our views to selected rules change proposals below.

### **Rules change proposals affecting several chapters:**

#### **CP349 - Prequalification requirements to necessitate that Distribution Connection Agreements are ‘firm’.**

We strongly believe that Ofgem should not restrict access to the Capacity Market for capacity connected to the electricity system with non-firm agreements, and we believe that it would be inconsistent and wrong to unilaterally reduce the de-rating factors of these assets.

In many areas of the country, assets connecting to distribution networks are only offered non-firm connections due to perceived constraints on the distribution network. Often where firm connections are offered, there can be very large reinforcement costs that are included within the connection offer, meaning in reality these connection agreements are not a viable option.

We do not believe that equivalent treatment is applied to distribution connected assets as transmission-connected assets. Transmission-connected assets are exempted from capacity obligations in some circumstances, whereas this is not the case for distribution connected assets. Rule 8.5.1 (c) removes the Capacity Market Obligation for transmission-connected assets in the case of an Interruption (as defined in the CUSC<sup>1</sup>). In addition, such a plant is likely to receive an Interruption Payment as defined via the CUSC<sup>2</sup>. There is no equivalent exemption for interruption for distribution-connected assets, nor is there scope for an associated payment equivalent to the payment in the CUSC.

Deriving de-rating factors for assets on non-firm connections would be challenging and potentially lead to misleading and substantially different de-rating factors for different locations. The introduction of Active Network Management (ANM) as a way of providing some flexibility to manage local constraints issue is a relatively new mechanism introduced by Distribution Network Operators (DNOs). Therefore, there will be limited data to draw upon to determine the likelihood of distribution-connected assets constrained due to ANM. ANM contracts and their utilisation by DNOs will vary dramatically between different GSPs (and potentially to even greater granularity), and will also be substantially affected by any additional capacity procured in the auction in the same location.

We believe that capacity providers bidding in to the Capacity Market take on the commercial risk of non-delivery in the Capacity Market; this is a decision taken by participants and risk premia are appropriately embedded in to bidding strategies. Capacity providers can make use of secondary trading, either via volume reallocation or obligation trading, to mitigate when assets are forced to be constrained during stress events. As ANM is used to deal with locational issues, there would be scope to be able to transfer an obligation to different assets in a different location., ensuring security of supply.

This all feeds in to a wider question about how distribution-connected are recompensed for providing flexibility compared to transmission-connected assets. At present, transmission-connected assets are paid to reduce output via the Balancing Mechanism (BM) in order to balance the system, mainly locational issues; there is no such provision for non-BM plant. New assets on the distribution network that have to connect with a non-firm connection agreement

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<sup>1</sup> Connections Use of Systems Code ‘Section 11.3 DEFINITIONS’: “Interruption” – p371

<sup>2</sup> Connections Use of Systems Code ‘Section 11.3 DEFINITIONS’: “Interruption Payment” – p372

(e.g. via the ANM schemes), must provide this output reduction for free to the DNOs. This, coupled with lower de-rating factors for the same asset connected to distribution network, will make decentralised assets less attractive and would run counter to BEIS and Ofgem's Smart Systems and Flexibility Plan.

### **CP272, CP281, CP306, OF12 – Amending CMUs following pre-qualification**

We accept that Ofgem does not feel it is appropriate to simply delete Rule 4.4.4. - which currently prohibits changing the configuration of Generating Units or DSR units after a CMU has pre-qualified - and we welcome that Ofgem are considering this further.

We agree that de-rated capacity should not be able to change following award of a Capacity Agreement; therefore, if components change, the CMU must remain as the same technology class. We agree with Ofgem that there should be as much flexibility of changing the configuration of units as possible; this will increase the liquidity and competition in the market. Changes around Rule 4.4.4. should be enabled to allow capacity providers to change components within a CMU, which will better enable Capacity Obligations to be met. The termination fees and penalty regime will incentivise capacity providers to deliver to their auction committed capacity, therefore making use of component reallocation to avoid these penalties.

We are disappointed that Ofgem has taken the decision to once again postpone the implementation of OF12, now until 2019, due to the complexities of systems changes. It is unacceptable for this change to be delayed for the same reason stated in the 2017 Ofgem consultation. Ofgem should provide clarity on the actions National Grid has previously taken to ensure its systems can facilitate this proposed rule change. This should be accompanied with rationale as to why these changes have required 2 years to implement and also the timeline of actions to ensure implementation in 2019.

## **1. General Provisions**

### **CP343 – Extending secondary trading eligibility**

We support Ofgem's minded-to decision to allow recently commissioned, non-contracted CMUs to register for secondary trading. This is a sensible proposal that will help make the secondary trading market as liquid as possible.

## **3. Pre-qualification information**

### **CP253 – Allow historical performance to be evidenced up to the end of the Prequalification Window, and that it be carried out separately for each generating unit.**

We welcome that Ofgem will address the issue that Centrica identified where assets bidding in to the Capacity Market commissioning close to the pre-qualification window could be unable to provide the required historical performance.

However, we are disappointed that Ofgem has not taken forward the remainder of this rule change. We believe that Ofgem's rationale is only considering cases of traditional, centralised assets with high load factors and not those assets that rarely run and/or have not previously coordinated their output prior to the pre-qualification window.

Centrica works with customers to potentially aggregate these in to a single CMU to bid in to the Capacity Market; these are assets that prior to contracting with Centrica have not been associated in any way and therefore, especially for assets with low load factors, the highest

output of the aggregated components is not guaranteed to be aligned. As these assets may be being procured by aggregators for the Capacity Market only, it may not be possible to ensure the components have coordinated full output settlement periods.

Assets will be required to prove capacity in its satisfactory performance data, meaning if an asset could inflate its de-rated capacity - as Ofgem fears - using historical data, it would be discovered via the satisfactory performance days and would not receive any capacity payments, which is a large disincentive to engage in this behaviour.

Ofgem should reconsider their position as we believe that without making this change Ofgem may not be appropriately rewarding aggregated capacity.

An alternative could be to allow components that do not share auxiliary load to demonstrate historical performance on different days. Ofgem's concern is regarding components that could artificially generate at a higher output, by redirecting auxiliary load to different components at different times. Ofgem's concern therefore does not apply to CMUs where components do not share auxiliary load.

### **CP347 and CP348 - Allowing Capacity Market Units to submit a connection capacity at a level up to its average highest outputs**

We welcome that Ofgem has implemented this sensible approach of allowing Capacity Market Units to submit a connection capacity at a level up to its average highest outputs, in advance of a decision on OF15. For OF15, we would welcome clarity from Ofgem on the timelines for the response and implementation, as this was first proposed in 2015.

We appreciate that Ofgem has considered this proposal despite being submitted after the official deadline. This flexibility was especially welcome, as we identified the issue after the Rules change deadline and the change is required in advance of the next auction.

### **CP293 - Allow capacity that opted-out non-operational to compete in T-1 auctions**

We do not support Ofgem's decision to allow capacity that opted-out non-operational to compete in T-1 auctions. In principle, assets should be able to choose whether to participate in a T-4 or T-1 auction, although Ofgem will need to continue to show that there are sufficient anti-gaming measures in place.

However, in the past Capacity Providers submitted 'Opt-out non-operational' submissions knowing that they would not be able to participate in future auctions (without being investigated by Ofgem). The rules should not be changed for these assets as the CMU made this decision with full knowledge of the consequences. Ofgem has set a precedent for avoiding retrospective change and we believe this should continue to apply. We do not agree that this retrospective change is needed to ensure liquidity in the upcoming T-1 auctions, as there was demonstrable liquidity in January's T-1 auction. For complete clarity, we do not believe that assets that have opted-out non-operational in previous T-4 auctions should be eligible for corresponding T-1 auctions.

For future auctions, Centrica believes that there is no need for the different Opt-out categories. These should be removed to avoid CMUs providing information which may confuse the market. There needs to be consideration around how National Grid will account for this opt-out capacity in the auction parameters for future T-4 auctions. Additionally, consideration should be provided for plants that are closing to continue reconfirming opt-out notifications.

**CP254: Allow CMUs which have won agreements in the T-4 Auction to bid “incremental capacity” into the T-1 Auction**

We are disappointed that Ofgem has not taken forward Centrica’s proposal to allow CMUs that won agreements in the T-4 Auction to bid “incremental capacity” into the T-1 Auction.

We believe this contradicts the points made in CP293, where Ofgem is proposing to allow initially ‘opt-out non-operational’ plant to stay open, to enable additional capacity to participate in the T-1 Auction. We believe that CP254 would enable additional capacity however, this capacity would actually be additional genuine capacity, rather than just capacity that had been accounted for differently by National Grid in the case of CP293.

We accept that the different capacity for different delivery years must be clearly allocated. We believe that the penalty regime, over-delivery payments and obligation trading would mean that allocating the delivery during stress events to capacity awarded in different would not be an issue, unless there was an overall under-delivery by the entire asset.

We believe that a simple solution would be for capacity delivered to be allocated proportionally between the original capacity and the incremental capacity. For satisfactory performance days, the overall capacity of the original and incremental capacity would need to be proved during the same settlement periods.

**CP258 - Reinstate the option for Applicants to defer provision of Relevant Planning Consents until after Prequalification for the Sixth Full Capacity Auction**

We believe that Ofgem should reconsider its decision and take forward Drax’s proposal to reinstate the option for applicants to defer provision of Relevant Planning Consents until 22 working days before the auction.

Whilst parties like Centrica have participated multiple times in the Capacity Market and understand the established timelines; the customers that we contract with for the Capacity Market are not necessarily aware of these rules and timescales. We may sign up customers at any point in the year and therefore as much flexibility as possible should be allowed to ensure the auction is as competitive as possible.

Deferring provision of Relevant Planning Consents would have no negative effects on the auction, as the capacity provider would still have to provide planning in advance of the auction. However, as stated by Ofgem, we do not believe that the proposed application fee would be appropriate.

**CP336 – New Build CMU must be a CMRS CMU and that it will be wholly or mainly used to supply energy to the Distribution Network or the GB Transmission System.**

We support Ofgem’s decision to reject this proposal. We support Ofgem’s rationale which rightly states, ‘Demand Side Response is defined as a temporary reduction in demand. Some generators which are located behind the meter may run regularly and should rightly be classified as generation. Some of these generators may not be able to participate in the CM if required to participate as Demand Side Response.’

**CP353 - Create new Demand Side Response (DSR) Technology Classes with different minimum durations, and apply the extended performance tests to these newly created Technology Classes.**

We agree with the requirement to be consistent with the treatment of storage in front-of-meter and behind-the-meter. However, we do not believe that the issue is as substantial as some parties have suggested. This is because if behind-the-meter storage assets were to bid in to the Capacity Market as DSR it can only bid in for one year agreements, whereas new-build storage assets can bid for fifteen year agreements.

For the few cases that DSR assets are solely behind-the-meter storage, we agree that the de-rating factors should mirror those that are front-of-meter storage.

In the case of Demand Side Response CMUs, comprised of component of different technologies, including storage, it would be disproportionate to de-rate these CMUs to the levels of limited-duration storage. This is because Capacity Market testing and obligations are at CMU level rather than component level.

We think it is important to note that Demand Side Response does not have a finite technical duration, in the way that stand-alone storage assets do. Responding to different lengths of stress event means DSR providers manage their aggregated portfolio in different ways; a longer response may result in an increased cost to the DSR provider, but is achievable. DSR providers take on this risk (and embed this cost within their exit bids) when bidding in to the Capacity Market. Additionally, the penalty regime encourages capacity providers to meet their obligations. Lengthy testing periods for DSR would not be appropriate as this would increase the cost of DSR, with higher exit prices for DSR assets in the Capacity Market.

#### **4. Determination of Eligibility**

##### **CP328 - Simplification of the Prequalification Process.**

We support this proposal enabling the Delivery Body, for situation that it believes that capacity would be eligible, but for an error or omission in the application form, to allow an opportunity for the applicant to remedy its error, without rejecting the application.

Whilst we accept that Ofgem cannot take forward regulations changes we do believe that there needs to be a way to remedy minor issues, without declaring assets as rejected. Explaining rejection from the Capacity Market due to a minor issue results in difficult conversations with customers and causes undue concerns about their assets and the capacity mechanism especially for customers for whom the Capacity Market is a new mechanism within which they are participating.

We agree with Ofgem that "We do not think that it would be appropriate to require credit cover from applicants because of errors or omissions in the application form." As part of their five-year reviews, we urge BEIS and Ofgem to look to make the pre-qualification process as simple and seamless as possible.

#### **8. Obligations of Capacity Providers and System Stress Events**

##### **CP267 – Allow a New Build CMU applicant to submit a Parent Company Guarantee (PCG)**

We are disappointed to see that Ofgem has rejected this rule change to allow a new build CMU applicant to submit a Parent Company Guarantee when required to submit credit cover. Whilst we accept that Ofgem are not able to make changes to the Electricity Capacity Regulations without BEIS' approval, we believe that Ofgem should opine on whether they believe such a change would be beneficial. If Ofgem believes that this rule change should be taken forward, it

should set out its engagement plan with BEIS to ensure that the rules change is made in due course.

We believe that Ofgem should allow Capacity Providers to provide a Parent Company Guarantee as an alternative to cash or letter of credit when providing credit cover. By providing Capacity Providers with an alternative route to provide credit cover, we believe this will provide more opportunities to bring forward new build capacity, but would not provide a disadvantage to other capacity providers.

## **9. Transfer of Capacity Obligations**

### **CP248 – Allow the transfer of Capacity Agreements at any time outside of the Prequalification Window**

Ofgem should allow transfers of Capacity Agreements to be permitted at any time, including prior to the T-1 auction. The Capacity Market's objective is to ensure security of supply and CMUs should be encouraged to transfer its obligation as soon as it becomes apparent it cannot meet its obligation, rather than waiting until closer to delivery due to a specific Capacity Market rule. We do not agree with Ofgem's reasoning that it could affect T-1 auction liquidity; we have seen previous T-1 auctions with a good level of liquidity. Ofgem should primarily ensure that GB achieves the required reliability standard rather than ensuring auction liquidity.

## **12. Monitoring**

### **CP312 - Simplify and clarify the timeframes for submitting the construction reports**

We support the decision to take forward the proposal that Construction reports be submitted on 1<sup>st</sup> June and 1<sup>st</sup> December, rather than in relation to months following the auction; as well as limiting when an ITE is required, reducing financial burden on developers.

We believe that Ofgem should consider whether the role of an Independent Technical Expert (ITE) is needed at all and consider the benefits that these reports offer, compared to the costs. The cost of contracting with an ITE remains constant and therefore proportionally the cost of contracting with an ITE and the production of the reports is a much higher cost proportionally for a small new build project, compared to a larger project.

For example, using data from recent new build CMU that Centrica has data on, the costs of producing the reports needed to meet the rules requirements for reports from an ITE, were the same as one year's Capacity Market revenue. Therefore, for small new build projects, these capacity providers are having to place higher exit bids than would otherwise be needed, due to the administrative requirements of the Capacity Market.

Anecdotally, ITEs have highlighted that they do not receive feedback from the Delivery Body about the content or format of the reports, raising the question about whether the reports that ITEs produce are of value or are a costly box-ticking exercise.

We believe that Ofgem and the Delivery Body have sufficient assurances from the required certificates at pre-qualification that the ITE is not required.

### **CP276, CP344, CP277 – Proposals to provide clarification for DSR assets**

We support Ofgem taking forward these proposals to make reasonable changes to enable DSR to access the CM, when it can prove it has genuine DSR capacity that can compete and deliver

in the CM. This acknowledges there are differences between technologies and should help enable access, without providing an unfair advantage to a specific technology.

**CP260, CP332 - Interconnector CMUs should demonstrate Satisfactory Performance Days equal to or greater than their Capacity Obligation, rather than demonstrating an output greater than zero.**

We are disappointed that Ofgem has not taken forward rules changes that would ensure that interconnectors had equivalent obligations as other capacity providers. We believe the rationale provided – ‘interconnectors cannot control the direction of its energy flows’ - shows why relying on interconnectors in the Capacity Market is potentially affecting the CM’s ability to ensure security of supply. We are separately highlighting to BEIS, Ofgem and National Grid that we believe the Capacity Market’s de-rating factors of interconnectors are too low, in part because interconnectors cannot react to market signals to provide capacity when it is needed during stress. There are several pieces of analysis from Aurora, Poyry and LCP (to be published) that evidence our concerns.

We believe that interconnectors should be provided with the same obligations as all other participants within the Capacity Market and therefore Ofgem should take forward these rules changes.

## **15. Schedules & Exhibits**

**CP252, CP285 – Amend certificates requirements at pre-qualification for Generating CMU that are not the Legal Owner of each Generating Unit**

Ofgem should reconsider its position to make capacity providers provide new declarations every year for those assets that the applicant is not the Legal Owner of each generating unit.

We have experienced issues with customers, especially customers that are very large companies with small amounts of capacity on specific sites, where we are required to get certificates signed by directors for contracts of small value to these companies.

These directors are likely to have delegated authority to others within the company, but due to the Capacity Market Rules these representatives are unable to sign the required pre-qualification certificates. This results in a lengthy, and sometimes ultimately unsuccessful, process to gain the required signatures. Such a process is not expected to be easier in subsequent years.

This administrative burden is reducing the amount of customer-focussed capacity available to bid in to the Capacity Market. Ofgem should consider allowing an approach which allows declarations in different formats to the exhibit, but is legally equivalent. For example, we have our own contracts with customers which are legally equivalent to the pre-qualification exhibits and provide the same assurances. We would be happy to discuss this with Ofgem and National Grid to outline how this approach would be legally equivalent to the requirements in some of the pre-qualification exhibits. Allowing this flexibility would allow more capacity from customers’ sites to compete in the Capacity Market but would not reduce the legal certainty to the Delivery Body.

**CP263, CP313, CP314 - Enable onshore wind and other renewable technologies to participate in the Capacity Market**

Centrica believes that renewables not currently benefiting from a support scheme should be allowed to participate in the Capacity Market. We do not agree with Ofgem’s view that there

should be further consideration about whether renewables that have exited a support scheme should be eligible. The Capacity Market is a key part of the GB electricity framework, along with the wholesale market and balancing services. For unsubsidised (either post-subsidy or subsidy-free) renewables to compete fairly with other technologies it must be able to access the same revenue streams.

We agree that as part of the wider 5-year review of the Capacity Market there will need to be careful consideration of the de-rating factors which are not currently published by BEIS. However, at present, National Grid takes a view of renewables de-rating factors, as part of its Equivalent Firm Capacity calculations to appropriately account for renewables when determining the target capacity to be procured in the Capacity Market auction.

There is desire from industry to enter renewables in to the next Capacity Auction and therefore, Ofgem should take forward a simple rule change proposal to enable this. For this upcoming auction, the de-rating factors for renewables should be the same as those used by National Grid as part of its Capacity Assessment. Ofgem should make it explicitly clear to industry that these de-rating factors will be considered in more detail for the following set of capacity auctions and hence subject to change.