

Response to Ofgem Statutory Consultation on changes to the Capacity Market Rules 2014

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About EPUKI

EP UK Investments (EPUKI) is a UK energy company, primarily focusing on power generation from conventional and renewable sources.

EPUKI represents the UK interests of Energetický a průmyslový holding (EPH), a leading Central European energy group that owns and operates assets in the Czech Republic, the Slovak Republic, Germany, Italy, the UK and Hungary. EPH is a vertically integrated energy utility covering the complete value chain ranging from highly efficient cogeneration, power generation, and natural gas transmission, gas storage, gas and electricity distribution and supply. The companies in the group employ nearly 25,000 people.

EPH is the largest supplier of heat in the Czech Republic, the biggest electricity producer and the second biggest electricity distributor and supplier in Slovakia and ranks as the second biggest lignite producer in Germany. It is also an operator of a robust transmission network in Europe, a key transporter of Russian natural gas to Europe and the biggest gas distributor in Slovakia. In total it has 22 GW of heat and power capacity including coal, lignite and renewables.

EPH entered the UK market in 2015 through the purchase of Eggborough Power Limited. In 2016, EPH purchased Lynemouth Power Limited, the owner and operator of a 420 MW coal-fired power station in Northumberland which holds a Contract for Difference for full biomass conversion. In September 2017 EPH acquired Langage and South Humber Bank combined cycle gas turbine (CCGT) power stations from Centrica plc, with a combined capacity of 2.3 GW. EPUKI continues to actively pursue other acquisitions and new build opportunities in the UK electricity market, including the Eggborough and King's Lynn B CCGT projects.

General comments

EPUKI welcomes the opportunity to respond to Ofgem's consultation on proposed changes to the Capacity Market Rules. Our response below addresses those change proposals where we have specific comments. However, there are some general issues raised by this consultation where we consider that further in depth consideration is required.

Participation of interconnectors in the capacity market

Several rule change proposals this year identify areas of the rules where interconnectors are treated differently to other technologies. Interconnectors are clearly not the same as controllable generation or Demand Side Response (DSR) because as transmission assets they cannot contract to deliver energy during a System Stress Event. The current inclusion of interconnectors in the capacity market was intended to be a transitional measure towards the participation of non-GB generators. Although complex, it should be possible to develop solutions which would allow overseas capacity to participate in the capacity market and this would be preferable to the current situation which allows transmission cables with regulated returns to receive additional subsidy from consumers at the expense of GB generation. However, in order to ensure that participation of overseas generators meets UK policy

energy aims, actions will need to be taken to ensure a level playing field with domestic generators. For example, overseas participants in the capacity market should be required to pay the UK carbon tax on their generation. We encourage Ofgem to establish a project assessing the changes to the Rules which would be required to facilitate participation of overseas generation in the capacity market. This should draw on experience from other European capacity mechanisms, such as France and Italy.

Treatment of Demand Side Response

We are concerned that several elements of the capacity market rules relating to DSR are lighter touch than those relating to generation. Given the growth of DSR participation in the capacity market, we consider it necessary to ensure that rules are in place which avoid speculative DSR applications and guarantee that DSR delivers capacity when required. There is little visibility about exactly what technologies and processes are being used to fulfil DSR agreements and this leads to concerns about their ability to deliver in a System Stress Event or the duration of that delivery. Furthermore, we are concerned that the different rules applying to DSR could encourage more generation or storage to locate behind the meter in order to benefit from different and less stringent capacity market rules. This is an area of the Rules that should be reviewed in detail to avoid any perverse outcomes.

Prequalification simplification

We consider that there is significant scope to simplify the prequalification process, particularly for Mandatory CMUs that have previously participated in the capacity market. The prequalification process remains onerous for companies with new data and certificates having to be submitted each year. This is compounded by the EMR Portal, which is not intuitive for users. It should not be possible for a Mandatory CMU which has successfully prequalified in previous years to be rejected the following year on a technicality as EPUKI experienced in 2017. We would therefore like to see the prequalification process streamlined, which may require a substantial revision to Section 3 of the Rules. Ideally, we would like to see an option for CMUs which had prequalified in the previous year and where no changes have been made to the configuration of the CMU to automatically prequalify for an auction. This would reduce the burden on applicants and the EMR Delivery Body.

Governance of Capacity Market Rules

We have concerns about the current governance process for the Rules. A large number of rule change submissions are being made each year. The rule change proposals often identify areas of the Rules where a holistic rethink is required. In these cases it may be appropriate to establish specific working groups to review all the issues and develop drafting which addresses the concerns identified. In other cases, changes are identified that need to be progressed urgently (eg. in the run up to prequalification) but these fall outside of the annual window for consideration by Ofgem. There should therefore be a mechanism for urgent modifications. It is also frustrating that some rule changes are taken off the table because they require changes to Regulations. There should be a clear process for identifying required amendments to regulations and proposing them to BEIS.

Specific comments

Demonstrating historic output (CP253, CP347, CP348)

As Ofgem is aware, Rule 3.6.1(a) resulted in a number of problems for applicants during prequalification for the 2017 capacity auctions. Ofgem's proposal to require historic outputs to be demonstrated from the 24 months prior to the end of the prequalification window (rather than the 24 months ending one month before the start of the prequalification window) is a sensible one as it would allow applicants that identified issues with their historic data during prequalification to demonstrate output at a sufficient level during the prequalification window if necessary. It is understood that this would have prevented some of the issues encountered with Rule 3.6.1(a) last year.

However, there may be legitimate circumstances in which an applicant for an Existing Generating CMU has capacity which has not been demonstrated in the specified 24 month period (for example, because a unit was mothballed) but could be entered into a capacity auction. Rule 3.6.1(a) currently envisages that this capacity should be able to participate through the derogations in 3.6.1(a)(i) and

(ii). Although the drafting of these derogations is inadequate and confusing, Ofgem's proposed changes would completely remove the ability to use them and would restrict an applicant to using only the specified 24 months to prove output. This could lead to unintended consequences in some cases. Although these cases may be rare, we consider that there should be flexibility for an applicant to enter its maximum capacity into an auction.

Given these concerns, we consider that it would be preferable to remove Rule 3.6.1(a) in its entirety. We unclear what additional delivery assurance this rule provides given that Existing Generating CMUs are required to demonstrate their derated capacity in Satisfactory Performance Days during the Delivery Year and failure to do so is a termination event. Furthermore, if Of15 is progressed, an additional test of connection capacity will be required for transmission connected CMUs prior to the T-1 auction for a Delivery Year. Rule 3.6.1(a) therefore appears to be unnecessary going forward.

Allowing CMUs which opted out at T-4 to participate at T-1 (CP293)

EPUKI is the proposer of CP293 and therefore supports Ofgem's minded to decision to allow CMUs which opted out as non-operational in the T-4 auction for a Delivery Year to participate in the T-1 auction for that year. We consider that the gaming risks associated with this change are minimal, especially given other anti-market manipulation legislation.

Allowing incremental capacity to participate in a T-1 auction or secondary trading (CP254, CP341 and CP342)

We consider that there is merit in allowing genuine incremental capacity that has been delivered between the T-4 and T-1 auctions to participate in the T-1 auction for a Delivery Year. For example, it may be the case that an existing plant has undertaken upgrades that have increased the capacity that the units can deliver since the T-4 auction or a new build has been able to install capacity above that which was envisaged at prequalification for the T-4 auction (for example, by using larger turbines). We consider that this genuine capacity should be taken into account in the capacity market. Providing this flexibility may help mitigate any incentive on applicants to overstate their connection capacity at prequalification for the T-4 auction. We consider that incremental capacity could be treated similarly to a CMU taking on obligations through secondary trading with respect to penalties and testing.

Introducing additional flexibility around the provision of planning consents (CP258 and CP315)

We agree with Ofgem's minded to decision to reject these proposals. We consider that sufficient notice has been given to applicants that they will need to provide a copy of their planning consent at the point of prequalification from the sixth full capacity auction onward. The delayed implementation has provided a transition period for any projects that had begun to progress through planning on the understanding that they would be able to defer provision of consents to participate in the capacity market. We consider that the ability to delay evidence of planning consents indefinitely would provide little benefit to applicants because it only provides an additional couple of months to resolve planning issues. Instead, it would be preferable to incorporate additional flexibility for new build projects elsewhere in the Rules, for example by allowing configuration changes or permitting incremental capacity to participate in a T-1 auction. We therefore consider that CP258 and CP315 are unnecessary.

Using output data to calculate the derating factor for Distribution Connected CMUs (CP318)

We agree with the proposer that utilising transmission-level data to calculate the derating factor for distribution-connected CMUs is not appropriate. CP191 suggests that the current methodology is overstating the derating factors for distribution connected CMUs. A large volume of embedded plant is participating in capacity auctions. Excluding storage, over 6 GW of embedded capacity accepted a capacity agreement in the most recent T-4 auction, while a further 4.5 GW participated in the auction but did not accept an agreement. Even overstating the derating factor for these CMUs by a few percent could mean that several hundred MWs of distributed plant are being over-contracted. We therefore consider that an alternative approach to derating distribution-connected plant is required. We recognise the difficulties of finding a robust methodology, but consider that, in the absence of any other viable alternative, utilising historic output data as proposed by National Grid is a reasonable approach.

Requirement for a 'firm' Distribution Connection Agreement (CP349)

We agree with the intent of this proposal to require all distribution connected plant to have a firm connection agreement. We do not consider it equitable that transmission connected plant are required to hold firm grid access for a Delivery Year at the point of prequalification (and cannot, for example, rely on buying Limited Duration Transmission Entry Capacity in the Delivery Year), whereas distributed plant are able to have an interruptible connection which means they may be restricted from delivering during a System Stress Event. Given the volume of distributed plant participating in the capacity market, we consider that guaranteeing delivery during a System Stress Event is crucial. In general, EPUKI supports creating a level playing field between transmission and distribution connected plant wherever possible. Connection arrangements are one area of the Rules where less stringent rules are applied to embedded plant, not only regarding the firmness of access but also the ability for new build CMUs to defer evidence of a connection agreement at prequalification.

Limited duration Demand Side Response (CP353)

We support this proposal to introduce new Technology Classes with different minimum delivery durations for DSR that contains storage and apply the extended performance tests to these Technology Classes. The current treatment of DSR compared to storage could encourage storage to locate behind the meter so that it is less heavily derated. This would create a risk that some DSR is not able to deliver throughout an extended System Stress Event. We consider that the proposal adequately addresses this risk.

However, EPUKI is concerned that DSR which does not contain storage could also be limited as to how long it can deliver. Given this concern, we consider that the use of Technology Classes with different minimum delivery durations should be adopted for all DSR. This would alleviate any risk that DSR might not be able to deliver during an extended System Stress Event. The impacts of this change would be minimal as it would only require a small amount of additional testing to demonstrate duration.

Making amendments to CMUs following prequalification (CP272, CP281, CP284, CP287, CP306, CP308, CP310, CP322, and CP340)

We consider there is merit in allowing some changes to CMU configuration following prequalification. In particular, as Ofgem has identified, there would be benefits in amending Rule 4.4.4 to allow elements of the physical configuration of the CMU, such as the relative sizes of the generating units on a site, to be amended following prequalification. The current rules require applicants to specify at prequalification the size of units which they will build and therefore effectively lock the applicant into a choice of technology or equipment supplier at that point. However, given the long gap between prequalification and the auction (over 18 weeks in 2017) and ongoing developments in technology, an applicant may not finalise their selection of equipment and configuration of units until closer to (or even after) the auction. We consider that allowing amendments to the configuration of units while maintaining the same overall capacity of a CMU would make no difference to the outcome of the capacity market in terms of security of supply, but could benefit consumers by allowing developers to select a solution that best meets the requirements of the market and which can be delivered at lowest cost. We therefore consider that an amendment to Rule 4.4.4 which facilitates this flexibility should be progressed ahead of this year's auction.

Preventing the auction from clearing when there is no exit bid (Of16)

We are not convinced that this change to the clearing methodology is necessary. As Ofgem points out, the likelihood of this situation arising is low and the proposed change is unlikely to result in significant savings to consumers because if the auction is able to clear without an exit bid being submitted then auction participants would be aware that the surplus capacity remaining in the auction is at a de minimis level and we consider it likely that exit bids would be submitted so that the auction cleared.

Furthermore, we are unsure how the Net Welfare Algorithm would function if Ofgem's change is implemented. The Net Welfare Algorithm assesses whether it is beneficial to procure more capacity at

a higher price or less capacity at a lower price by comparing the clearing bid to the next highest bid in that round or, if no lower bid has been submitted, by comparing to the price floor for that round. Under Ofgem's proposed drafting a comparison with the bidding round price floor is no longer possible and the logic of Of16 is that the clearing price should not be at the price floor because all remaining CMUs would accept a lower price than this and so allowing the auction to clear at this price would not be beneficial to consumers. If an exit bid is submitted in a round which causes the auction to clear and no lower exit bid is submitted in that round, we are unclear how it would be determined whether to accept the clearing bid and what the auction clearing price should be.

Fixing the timing of the capacity auctions (CP316)

We appreciate Ofgem's concern about fixing the timing of capacity auctions. However, we would encourage BEIS, Ofgem and National Grid to ensure that T-4 auctions are held at least 45 months prior to the Delivery Year (eg. in December 2018 for the Delivery Year beginning 1 October 2022). Delaying the auctions beyond this date not only reduces the construction period for new build CMUs which receive an agreement in the auction, but also creates challenges for CMUs which are unsuccessful in the auction. For example, a new build CMU which does not receive a capacity agreement may wish to amend the connection date in its Bilateral Connection Agreement to prevent cancellation liabilities increasing on 1 April. The application process can take 3 months and delaying the capacity auction beyond December means that an application to change the date may need to be submitted before it is known whether that plant has received a capacity agreement, potentially unnecessarily incurring an application fee and utilising National Grid resource.

Failure to hold TEC because the SO did not deliver a connection would not be a termination event (CP329)

We support this proposal as it would remove an unintended consequence of the Rules.

Participation of renewable technologies in the capacity market (CP263, CP313 and CP314)

In order to create a level playing field, we agree that the capacity market should be open to renewable energy projects which have never received subsidy through other support schemes where these technologies can make a contribution to security of supply (for example, we do not consider it appropriate for solar PV to participate in the capacity market as it is unlikely to be able to make any contribution during a System Stress Event at winter peak). As Ofgem recognises, the participation of these technologies should not impact the clearing price, provided that the forecast of future renewables deployment is accurate when setting the target capacity to procure in the auction.

However, we agree with Ofgem that there are significant policy questions surrounding the participation of renewables in the capacity market once their accreditation for the Renewables Obligation or other support schemes has expired. For example, it may be appropriate for power stations with ongoing fuel costs (eg. biomass) to participate in the capacity market once their eligibility for renewable energy schemes has expired, whereas it may not be appropriate for plants with no ongoing fuel cost (eg. wind).

We therefore consider that the policy issues surrounding participation of renewables in the capacity market should be considered as part of the EMR Five Year Review.