

# Annual report on the Delivery Body's Performance of its functions in relation to the Capacity Market

## Report

**Publication date:**

**18 June 2018**

**Contact:** Milja Keijonen

**Team:** Wholesale Markets

**Tel:** 020 7901 7000

**Email:** [EMR\\_CMRules@ofgem.gov.uk](mailto:EMR_CMRules@ofgem.gov.uk)

### Overview:

The Electricity Capacity Regulations 2014 require us to provide the Secretary of State with an annual report on the Delivery Body's performance of its functions in relation to the Capacity Market.

This is the fourth of these annual reports, following the T-1 Auction in January 2018, and T-4 Auction in February 2018. It covers the period from 1 April 2017 to 31 March 2018.

# Contents

---

<b>Executive Summary</b>	<b>3</b>
<b>2. Background</b>	<b>5</b>
Scope of the Report	5
Capacity Market deliverables as outlined in Regulations	5
Financial and reputational incentives on the Delivery Body were introduced to drive up standards	6
<b>3. Review of NGET Performance</b>	<b>8</b>
Overview	8
Performance against the key deliverables and financial incentives	8
Customer and Stakeholder Engagement	9
Financial incentive on customer and stakeholder satisfaction	10
Process for Prequalification decisions and Tier 1 dispute resolution	10
Financial incentive on dispute resolution	11
Information Technology	12
Delivery Body resourcing	12
<b>4. Conclusion</b>	<b>13</b>

# Executive Summary

---

- 1.1. The Electricity Capacity Regulations 2014<sup>1</sup> (the Regulations) require us to provide the Secretary of State with an annual report on the Delivery Body's (National Grid Electricity Transmission plc, NGET) performance of its functions in relation to the Capacity Market (CM). This is the fourth of these reports, following the Capacity Market auctions held between January 2018 and February 2018. It covers the period 1 April 2017 to 31 March 2018 (the reporting period).
- 1.2. This report covers the fourth year of auctions, and the first Delivery Year. We conclude that NGET met its CM deliverables and obligations.
- 1.3. The scale and complexity of delivering and facilitating the CM has risen annually. The increased number of capacity agreements following each auction has increased demand on NGET in relation to CM Agreement management processes. This year, they also managed the highest number of Prequalification Applications, whilst a regulatory change prevented the Delivery Body from being able to consider new information from Prequalification Applicants during the appeal process increasing workload on the Delivery Body. The Delivery Body took a proactive approach in facilitating this process to reduce the potential impact on CM participants. Their auction system management also continues to receive positive stakeholder feedback.
- 1.4. Alongside the positive developments, there are important areas that NGET should address in the next reporting period.
  - The CM Portal continues to lack the functionality required to facilitate the CM process as effectively as possible. We are concerned that the Delivery Body is not always using the Portal to meet the information sharing arrangements specified in the Capacity Market Rules. This must be addressed as a matter of priority.
  - Stakeholder feedback suggests that parts of the Portal's design unnecessarily increases complexity for CM participants. Furthermore, while NGET has taken a largely collaborative approach to facilitating proposed changes to the CM Rules and policy development, its IT system arrangements have slowed down implementation. We recognise there are wider CM framework issues to consider here as part of the CM Five Year Review. However, we would like to see NGET take active steps to improve its ability to respond to necessary policy amendments effectively.
  - NGET should consider its current approach to resourcing the Delivery Body's functions, given the current and (to be expected) increasing scale of demand.

---

<sup>1</sup> See Electricity Capacity Regulations 2014:  
[http://www.legislation.gov.uk/uksi/2014/2043/pdfs/uksi\\_20142043\\_en.pdf](http://www.legislation.gov.uk/uksi/2014/2043/pdfs/uksi_20142043_en.pdf)

- 1.5. We incentivise NGET's performance through financial and reputational measures. We set out in the report their performance against the relevant incentives, including for Contracts for Difference (CfDs). This year was the first time stakeholders rated NGET's performance in delivering a CfD allocation round. Feedback was very positive, setting a high benchmark for future years. However, NGET's performance against the CM incentives was down on the baselines, resulting in a financial loss.

## 2. Background

---

### Scope of the Report

- 2.1. This report examines the performance of National Grid Electricity Transmission's (NGET's) functions as the Delivery Body (DB) for the Capacity Market (CM), which are set out below. The report also records material operational issues during the reporting period.
- 2.2. The report is one of two reports that we are required to provide to the Secretary of State after each T-4 capacity auction, under the Electricity Capacity Regulations 2014 (the "Regulations").<sup>2</sup> The second report is on the operation of the CM which we will be publishing in summer 2018.
- 2.3. We have received feedback on NGET's performance in its role as the CM Delivery Body from a number of stakeholders during the year, including CM participants, other Delivery Partners, and officials from the Department for Business, Energy and Industrial Strategy (BEIS). We welcome this feedback and have reflected on it feedback as part of this report.

### Capacity Market deliverables as outlined in Regulations

- 1.4 NGET's deliverables in relation to the CM are set out in the Electricity Capacity Regulations 2014:<sup>3</sup>
  - Preparation, delivery to the Secretary of State and publication of an annual Electricity Capacity Report, containing an assessment of the amount of capacity that is needed for a delivery year.
  - Publication of Auction Guidelines before the start of a Prequalification Window, containing information on when the auction is to start, details on how to apply to Prequalify, the timetable and the de-rating factor of each Generating Technology Class set out in the Capacity Market Rules.
  - Determining the Prequalification of all applications and notifying each applicant of its decision.
  - Reconsidering its Prequalification decision if requested by the applicant.
  - Notifying Prequalification results to the Secretary of State.
  - Advising the Secretary of State on the need to adjust the demand curve for the Capacity Auction.
  - Holding the Capacity Auction and notifying the auction results to the Secretary of State, bidders and the public.

---

<sup>2</sup> Regulation 83. See Electricity Capacity Regulations 2014:  
[http://www.legislation.gov.uk/uksi/2014/2043/pdfs/uksi\\_20142043\\_en.pdf](http://www.legislation.gov.uk/uksi/2014/2043/pdfs/uksi_20142043_en.pdf)

<sup>3</sup> Regulations 7, 8, 21-25, 31, 34, 35, 39.

- Establishing and maintaining the Capacity Market Register, containing – amongst other things – details of each Capacity Agreement awarded following a Capacity Auction.
- Termination of Capacity Agreements when required under the Regulations.

## Financial and reputational incentives on the Delivery Body were introduced to drive up standards

1.5 In 2015, we determined funding arrangements for NGET’s EMR roles from August 2014 to March 2021, and introduced incentives to NGET’s licence to drive performance in its Delivery Body functions. Ofgem introduced financial and reputational incentives on the Delivery Body to ensure efficient and economic delivery of the CM, to encourage transparency and to drive behaviours that promote competition and benefit consumers.

1.6 There are currently four financial and reputational incentives that adjust the Delivery Body’s annual revenue depending on its performance against the criteria set out in the Special Condition 4L<sup>4</sup>:

- The Delivery Body is obligated to carry out a **Customer and Stakeholder Satisfaction Survey** after each Capacity Auction, and CfD allocation round. The aim of this incentive is to increase transparency to CM stakeholders on the quality of service delivery and engagement with CM participants. Section 2.3 of this report outlines the 2017/18 survey results, and the financial incentive outcome.
- The **Dispute Resolution Incentive** adjusts the Delivery Body’s revenue depending on the number of reviewed decisions the Authority overturns following the eligibility checks the Delivery Body performs on the Capacity Market and Contracts for Difference (CfD) applicants. In section 2.4, we outline our decisions on both of the 2017/18 dispute resolution processes.
- The **Demand Forecasting Accuracy Incentive** seeks to ensure the Delivery Body procures a correct amount of capacity for each Delivery Year, whilst securing value for money for consumers. The verification process of the forecast for the 2017/18 Delivery Year<sup>5</sup> is still to complete. The maximum value the Demand Forecasting incentive for a year ahead auction is £2 million.
- The **DSR Incentive** aims to ensure the Delivery Body facilitates DSR participation in the Capacity Market, and refers to the T-1 Auctions only. The 2018 T-1 Auction sets the baseline and the first assessment of this incentive is due to take place once the 2018/19 CM Auction Prequalification has completed.

---

<sup>4</sup> These [incentives](#) were introduced in September 2015.

<sup>5</sup> Forecast for the Early Capacity Auction delivering capacity in 2017/18.

- 1.7 We introduced these incentives in their current format in the second year of the Capacity Market auctions in 2015. The number of Prequalification Applicants and auction participants has changed considerably since then. It is important that the Delivery Body incentives reflect changing operational challenges, in order to drive performance for consumers' benefit. More widely, Ofgem has consulted on its approach to incentivising the Electricity System Operator's (ESO) performance. We anticipate that it will be beneficial to align our approach on the Delivery Body with wider arrangements for the ESO. However, in the interim, we intend to carry out a light touch review of the existing Delivery Body incentives over the summer to refine the existing arrangements where appropriate. We will consult on any proposed changes ahead of a decision.

# 3. Review of NGET Performance

## Overview

2.1 This section sets out our review of NGET’s performance of its CM functions in the 2017/18 reporting period. We look at the deliverables NGET was required to provide as the Delivery Body, the stakeholder engagement it undertook and its performance in the Prequalification and Tier 1 dispute resolution processes. We also discuss operational issues relating to the CM IT system.

## Performance against the key deliverables and financial incentives

2.2 Table 1 sets out the deadlines and delivery dates for NGET’s Capacity Market key deliverables during the reporting period as set out in the CM Rules, Regulations or agreed with the Delivery Partners and outlined in the Operational Plan.

**Table 1: Performance against key deliverables<sup>6</sup>**

<b>Deliverables</b>	<b>Deadline</b>	<b>Date Delivered</b>
Publication of Capacity Market Auction Guidelines	Prior to PQ Window (opened on 24 July)	7 July 2017
Completion of Prequalification for the CM T-4 and T-1 auctions	29 September 2017	29 September 2017
Issue decision notices on all requests for Reconsidered Decisions (Tier 1 disputes)	10 November 2017	10 and 13 November 2017
Notifying the Secretary of State of Prequalification results	8 December 2017	8 December 2017
Completion of CM T-1 Auction	1 February 2018	1 February 2018
Provision of T-1 Auction Monitor report to the Secretary of State	5 February 2018	5 February 2018
Completion of CM T-4 Auction	8 February 2018	8 February 2018
Provision of CM T-4 Auction Monitor report to the Secretary of State	12 February 2018	12 February 2018
Publication of CM T-1 Auction Results	13 February 2018	13 February 2018
Publication of CM T-4 Auction Results	20 February 2018	20 February 2018
Issue of T-1 Capacity Agreements	13 March 2018	13 March 2018
Issue of T-4 Capacity Agreements	20 March 2018	20 March 2018

2.3 The Delivery Body delivered most of the required outputs on time. However, due to a loss of functionality on the EMR Portal, the Prequalification Decision letters were not accessible to all Applicants within

<sup>6</sup> National Grid (November 2017): [Electricity Market Reform - Capacity Market Operational Plan](#) (Capacity Market Auctions in 2017/18).



working hours on the Prequalification Decision day. This raises questions over the resilience of the CM IT infrastructure. The Delivery Body responded to the situation proactively, and sought to limit the impact on applicants by extending applicants' deadline to submit requests for Reconsidered Decisions by a day. The Delivery Body subsequently delivered their decisions and the wider CM deliverables to the original timeframe.

- 2.4 The Auction Monitor assessed the Delivery Body's actions in performing the 2017/18 Auctions, as set out in the Capacity Market Rules<sup>7</sup>. In the 2018 T-1 Capacity Auction report, the Auction Monitor reported two minor CM Rule breaches. One to do with a delay in publishing the identity of the auction monitor, and one relating to publishing details of individual CMUs' de-rating capacity. The latter occurred due to the changes to the battery de-rating process following changes BEIS made to the CM Rules in December 2017. The Auction Monitor concluded that the Delivery Body complied with all of its responsibilities in delivering the 2018 T-4 Capacity Auction.
- 2.5 In addition to the key deliverables above, the Delivery Body has a critical role in managing the CM agreements and in supporting implementation of changes to the CM Regulations and/or Rules. Year on year, there has been an increased demand on the Delivery Body in relation to its CM agreement management processes. This is due to the increased number of capacity agreements following each auction. The number of Financial Commitment Milestone notifications increased by a third, for example, and the numbers of DSR tests and Satisfactory Performance Day (SPD) assessments continued to rise. The Delivery Body reported an increasing deferral of documents required at Prequalification, requiring them to be considered separately. With the CM entering delivery, workload outside the Prequalification and the Auctions will continue to increase. As we discuss below, it is important that NGET consider this sufficiently in its management of the Delivery Body functions.

## **Customer and Stakeholder Engagement**

- 2.6 The Delivery Body has a key role in providing information for the market participants enabling them to participate successfully in the Capacity Market. The Delivery Body continued to develop and implement its Prequalification and Tier 1 processes, their IT systems, and processes designed to support effective CM participation. A particularly welcomed example was the introduction of a milestone tracker for all historic auctions.
- 3.7. Stakeholder feedback on the Delivery Body's success in this regard has been mixed. In their annual customer satisfaction survey, the Delivery Body received a lower score from stakeholders than last year on overall satisfaction (from 7.3 out of 10 last year to 6.8).
- 3.8. This year, the Delivery Body adjusted its approach to customer engagement ahead of Prequalification. As well as System Specific Training, which covered the Registration, Prequalification and Auction Guidelines,

---

<sup>7</sup> Chapter 5 of the Capacity Market Rules and the Data and Auction sections of the Capacity Market Auction Guidelines.

the Delivery Body ran one-to-one surgery appointments with Applicants to facilitate the Prequalification and Tier 1 processes. They also held a coordination event, a workshop, and a series of webinars covering the metering processes, auction readiness, Prequalification and Tier 1 disputes. The Delivery Body's approach to the surgeries and Prequalification readiness received largely positive feedback from stakeholders, both at the time and in the customer satisfaction survey.

- 3.9. Customers also report high levels of satisfaction with the auctions themselves, including the auction related information and the online auction system.
- 3.10. Although stakeholder feedback about the service provided by individual team members has generally been positive, stakeholders also refer to a lack of consistency in the service provision and ranging quality (and timeliness) of advice by the different parts of the Delivery Body. Indications are that this has been particularly the case during busy periods of the delivery year. We share stakeholders' views that NGET should consider developing a clearer stakeholder engagement process, with greater transparency about timeframes and processes for responding to queries. We understand that the increase in applications this year partially contributed to these issues during Prequalification but we do not consider the issue to be limited to this part of the process.

### **Financial incentive on customer and stakeholder satisfaction**

- 3.11. This financial incentive on the Delivery Body consists of CM and CfD customer and stakeholder satisfaction surveys, and the total value of the incentive is £600,000 each year, equally split between the CM and CfD surveys.
- 3.12. The 2017/18 Customer and Stakeholder Satisfaction Survey incentive has a value of ±£300,000 for the Capacity Market. For the previous reporting period, 2016/17, stakeholders rated NGET's overall performance in delivering the Capacity Market functions at an average of 7.3 out of a maximum of 10. In this reporting year, the average score was 6.8, 0.7 points lower than the baseline score of 7.5. This implies that the Delivery Body loses £190,909 on the CM Customer and Stakeholder Satisfaction Survey (CSSS) Incentive in the 2017/18 reporting period.
- 3.13. In September 2017, the Delivery Body also conducted the first Contracts for Difference (CfD) Customer and Stakeholder Satisfaction Survey. In the 2017/18 survey, stakeholders gave the Delivery Body an average performance score of 8.5. This result sets the baseline against which the next survey will be compared, and the incentive assessed. This is significantly higher than the benchmark for the CM CSSS incentive. Generally, the CfD participants have been positive on the Delivery Body's approach to delivering CfD application process.

### **Process for Prequalification decisions and Tier 1 dispute resolution**

- 3.14. The Delivery Body has continued to develop its Prequalification decision-making processes, and reduced the processing time of individual CM applications. During the 2017/18 Prequalification Window, the Delivery

Body received and processed all 1,950 Prequalification Applications to time, an increase from around 1,700 Applications in 2016/17. In addition, a regulatory change prevented the Delivery Body from being able to consider new information from Prequalification Applicants during the appeal process ("Tier 1 disputes"). This had a significant impact on Applicants, and increased the workload on the Delivery Body both during the Prequalification submission window and at Tier 1.

- 3.15. The Delivery Body increased their support and guidance to applicants during Prequalification in response. They trialled a different approach to engagement, running 280 surgeries with 150 different organisations. These received predominantly positive feedback from Applicants.
- 3.16. Despite the regulatory change and increased numbers of Applications, the numbers of Tier 1 disputes to the Delivery Body fell from 715 the previous year to 620<sup>8</sup>. This is a positive step. We consider an important factor in this reduction was the Delivery Body's proactive response to a challenging situation for all affected parties. We would expect to see this trend in reduction of Tier 1 disputes to continue as Applicants become more accustomed to the process.
- 3.17. While the Delivery Body resolved a large proportion of the issues raised at Tier 1, over 140 CMUs appealed their Reconsidered decisions to us. A large number of these related to a single issue. However, we would like to see a reduction in the proportion of Tier 1s requiring a Tier 2 dispute. We encourage the Delivery Body to consider its approach to handling issues raised at Tier 1 to minimise unnecessary burden on affected parties.

### **Financial incentive on dispute resolution**

- 3.18. On appeal, we overturned 68 of the Delivery Body Tier 1 decisions (Reconsidered Decisions)<sup>9</sup> with 50 of these decisions being on a single issue. The remaining of the Reconsidered decisions were related to a policy interpretation of an existing CM Rule or issues with the Delivery Body processing of information in the Prequalification decisions. For the purposes of our overturned decisions and the Dispute Resolution incentive, we grouped these decisions based on themes as we have in previous years. This resulted in three overturn categories. As a result, in 2017/18, the Delivery Body will lose £65,000 on the Dispute Resolution Incentive relating to the CM.
- 3.19. In 2017/18, the Delivery Body received two CfD Applicant appeal notices for the CfD Allocation Round 2 for their non-qualification determination. The Delivery Body upheld these decisions following the appeal process, and the Applicants submitted further appeals to Ofgem<sup>10</sup>. In both cases, we upheld the Delivery Body's Reconsidered decision, and as a result, the

---

<sup>8</sup> In 2016/17, the Delivery Body received 386 Tier 1 appeals for the 2016 T-4 Auction, 313 for the 2017 Early Capacity Auction and 16 for the 2017 Transitional Arrangements.

<sup>9</sup> Our CM Prequalification Appeal determinations can be found on our website.

<https://www.ofgem.gov.uk/electricity/wholesale-market/market-efficiency-review-and-reform/electricity-market-reform/electricity-market-reform-emr-dispute-resolution>

<sup>10</sup> CfD Appeal Register – CfD Allocation Round 2

<https://www.emrdeliverybody.com/Contracts%20for%20Difference%20Document%20Library/APPEALS%20REGISTER%20-%20Allocation%20Round%202.pdf>

Delivery Body will receive £100,000 on the CfD Dispute Resolution Incentive.

## Information Technology

- 3.20. We have raised concerns over NGET's IT arrangements for the CM in previous years. It continues to be the area of most needing attention. In particular, we are concerned that the Portal still lacks the full functionality required by the CM Rules. NGET must address this as a matter of priority.
- 3.21. It is also notable that stakeholders continue to express frustrations with the Portal from a user perspective. It remains one of the lowest scoring areas of the customer satisfaction survey. While the majority of participants were able to use the portal during the Prequalification process, we have repeatedly heard of confusing complexities in the system and its accompanying guidance. We are aware that the Delivery Body has made some improvements in this area but it is an issue warranting further action.
- 3.22. Overall, the IT arrangements have slowed down effective implementation of proposed changes to the CM Rules. We recognise that there are wider CM governance arrangements outside of the Delivery Body's control, which make system changes more challenging at times. We welcome the Delivery Body's engagement on policy development and resulting system changes. However, the system's relative inflexibility does not facilitate responsive policy development. This is an area needing further work.
- 3.23. The Delivery Body reported two Confidential EMR Information (CEMRI) incidents in the 2017/18 reporting period for unwarranted sharing of CEMRI data. They self-reported these incidents to the affected parties and Ofgem as soon as the issues had been identified. There is no evidence that any commercial or sensitive material was affected. In response, we required NGET to appoint an independent external auditor to examine the policies and procedures in place for handling CEMRI, and to ensure compliance with Special Condition 2N and Regulation 65(1). We expect NGET to set out clear actions in response to the auditor's recommendations, which we will be monitoring.

## Delivery Body resourcing

- 3.24. The scale of CM operational requirements on the Delivery Body has increased over the last four years. This is largely to be expected and is a trend that will continue as the numbers of issued Capacity Agreements increase. It is not clear to us that NGET's current approach to resourcing the Delivery Body is sufficient to manage these changes as effectively as expected.

Based on the wider stakeholder feedback and our monitoring of the Delivery Body's operations in 2017/18, resources allocated to delivering its functions seem constrained. Evidence from a range of stakeholders suggests this was sometimes to the detriment of its engagement with CM participants. This is an area we will be considering further over this reporting year.

## 4. Conclusion

---

- 4.1. NGET met the requirements for performing its role as the Capacity Market Delivery Body in the year 2017/18. There were important positive areas in its performance and approach this year, despite increased challenges. These were particularly in relation to Prequalification preparations and running of the auctions. It is also important to recognise the positive response to their management of the CfD allocation round.
- 4.2. However, there remain critical issues with the Delivery Body's CM portal, which undermine positive development elsewhere. We are concerned that at this stage of the process the EMR portal continues to lack some of the key functionalities as required by the Prequalification and CM Auction processes. Although the Delivery Body made improvements to its IT system this year, stakeholders continued to report technical issues with the Portal. We further note that the IT system related issues have slowed down effective implementation of proposed changes to the CM Rules. A well-functioning IT system is essential to the efficient delivery of the CM and we expect this to be an area of particular interest to our performance monitoring this year.
- 4.3. We are not persuaded that the overarching resources or Delivery Body's arrangements have kept up to speed with the changing CM framework and operational demands. We are interested to see how NGET respond to the challenge, and we expect to report on NGET's progress in the next reporting period.
- 4.4. We are now in the fifth year of the CM's operation. Policy and delivery challenges have evolved since the CM framework was first established. This has implications for how NGET approaches the Delivery Body functions. As part of the CM Five Year Review process, we expect to consider wider governance arrangements, including with regard to the Delivery Body role. We are interested in early stakeholder views on this matter.
- 4.5. We also think there is benefit to a more immediate review of the existing EMR Financial Incentive framework for 2018-21 period. We are keen to ensure that the incentives drive NGET's behaviours as effectively as possible for consumer benefit. We anticipate publishing a consultation on our proposals later this year.