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Dear Johannes

Ofgem 5 Year Review of the Capacity Market

Welsh Power is a leading developer and operator of gas-fired reserve and peak power plant. With 426MWs of small scale generation in operation or under construction, we play an important role in balancing the GB electricity network which is increasingly reliant on renewable but intermittent energy sources. Welsh Power has participated in each of the CM auctions held to date and has therefore accumulated a significant amount of experience in interacting with the CM Rules and processes.

We remain of the view that the CM plays an important role in delivering security of supply to the GB system at least cost to consumers and should remain a core pillar of the GB market arrangements. By securing capacity in annual auctions the CM delivers a high degree of confidence in there being a stable level of generation available to serve demand in a fast changing market.

We believe that, to a certain extent, the CM is yet to be properly tested. The GB market has to date benefited from a significant capacity overhang from previous investment and as yet the CM has not needed to bring forward new generating capacity at scale nor has the system been fully tested through stress events. In the coming years as nuclear, coal and older gas-fired generation is retired from the system, the CM will need to deliver new-build capacity in larger volumes than in past auctions.

We believe that the CM is best placed to deliver this capacity and support OFGEM's reiteration of its technology neutral stance and pragmatic steps to moderate the administrative burden on all parties of participating in the CM.

While we have tried to answer all of the questions, if you or your colleagues have any questions please do not hesitate to get in touch.

Yours sincerely

Matthew Tucker
CFO

Welsh Power response to the questions.

Question 1: Do you have any views on the interactions between the CM and other wholesale markets; such as forward markets, the balancing market, and markets for ancillary services?

The principle aim of the CM is to ensure that sufficient capacity is operational to meet the governments prescribed security standards and loss of load probability. The balance between demand and the available supply of electricity has an impact on all aspects of the wholesale markets and as such there is a clear interaction between the capacity secured by the CM and its effect on energy markets. In the absence of CM payments it could be argued that there would be less operational capacity and prices in wholesale markets and the cost of ancillary services would likely increase due to a tightening of available supply.

The creation of the CM was in part a response to a failure of the wholesale markets to fully value scarcity and provide sufficient investment signals for new capacity to be built and for existing capacity to remain operational. This policy decision clearly affects prices in the wholesale market where prices respond to lower system margins.

Question 2: Do you have any evidence that design choices in the CM are driving inefficient outcomes in other markets?

Whilst not necessarily a design choice, we are of the view that reductions in the volume of capacity to be procured in the upcoming 2019/20 T-1 auction serves to undermine confidence in the liquidity of the T-1 auction. The ESO recommended a reduction in the capacity to procure as a result of its belief that a CMU which withdrew its capacity from the auction would remain open through the winter. The ESO, and in turn the Secretary of State, has therefore chosen to place reliance on a non-binding commitment from a generator that has chosen to withdraw from the auction. This will almost certainly result in the CM auction clearing at the lowest price to date and could result in a generator that may have remained operational with the support of a CM contract exiting the auction without a contract and potentially announcing an earlier closure decision. It runs contrary to the aim of the CM to ensure sufficient capacity is available in the GB market instead placing reliance on a generator which is not subject to the performance obligations or penalties of a CM committed party.

Question 3: Do you have suggestions for how these markets can be better aligned and how any inefficiencies can be mitigated?

We are of the view that the CM is the result of a government policy decision to ensure sufficient capacity remains connected to the GB system. As stated in our response to question 1, we believe it inevitable that this will have an impact on wholesale and ancillary markets due to its effect on the balance of supply and demand for electricity. Whilst this effect is inevitable we believe regulation and policy should, as far as reasonably possible, ensure that all market participants compete on a level playing field. Whilst many of the benefits available to smaller distributed generation have been removed, market access on equal terms to larger market participants remains some way off. The value of the ESO's BSUoS spend currently available to smaller parties amounts to less than 10% of the total spend and is currently reducing. This presents a far bigger obstacle to a functioning market than any inefficiencies inherent in the CM design.

Question 4: Do you have any views on whether the proposed membership of the CM Advisory Group is appropriate, the form of participation from industry, along with any further points regarding meeting frequency and function?

Welsh Power welcomes Ofgem's proposals to improve the governance of the CM Rules. We believe that greater participation by the market parties will help make the changes more robust and hope that they can be done in a more timely manner.

With the aim of achieving efficient and timely change in mind we would make the following observations:

- The membership of the group needs to be broad, but should have appropriate representation of smaller parties on it as they hold more individual CMUs than larger parties. We are not suggesting a specific allocation based on CMU numbers, but it is important that they are well represented.
- The group must not add to the number of consultations that are undertaken. To that end we would like to see each change proposal added to a "CM documents" website as soon as it is raised. The group can then meet and discuss the proposal(s), working it into a sensible solution to the issue identified before giving it to Ofgem for approval/rejection. We also think "issues groups" may be a good way to resolve complex issues like secondary trading rules, allowing experts in an area to look at a variety of solutions.
- Parties must not be required to provide the legal drafting with each modification as this will create a barrier to smaller parties who may not have any in-house legal expertise to call on.
- The group, and the whole change process, must be transparent. This should include publishing any alternative ideas to a solution, analysis of problems, meeting notes, contact details for group members, etc.
- The Delivery Body (DB) must not run the process. They have a poor reputation as a Code Administrator, as illustrated in Ofgem's assessment of code administrators, and have had a habit of promoting changes they favour over everyone else. As they are bound by the CM Rules, to allow them to run the change process is not acceptable as the perception of bias will remain even if there is no actual bias. We would suggest that Elexon run the change process as much of the CM Rules rely on the BSC data flows and Elexon have a very good reputation as a code administrator.
- There are a lot of Rules that could be removed or clarified without system changes. These should be progressed urgently. In a world where the systems allow CMUs to easily roll forward there would be less need to make system changes to accommodate new Rules. If a new piece of evidence is required, etc. then the DB can always use a manual work around if they cannot deliver the system on time.

Question 5: Do you believe the proposed framework and function of the CM Advisory Group is appropriate and would better facilitate the efficient operation of the CM Rules change process?

As well as the points above, Welsh Power would like to see a new "CM documents" website holding all of the Rules, Regs (consolidated), guidance, change documentation, etc., in one place.

The change proposals, papers, decisions, etc. being on a dedicated website would make them easier to find and the process easier to track. The guidance and most recent CM Register for each Delivery Year should also be placed on the website, where they can be found, searched, changes tracked, etc., and the sign-posting must be very clear. While we have generally been against the industry creating yet more websites, we believe that, like industry codes, these arrangements are now a vital part of the market and need to be managed in a more pragmatic and transparent manner.

In the long term, and with BEIS, we would like to see a set of "Master Rules in force" holding all consolidated changes. For example, where rules on, say, SPDs have altered over time, the "Master Rules" would say "SPDs for 2017 CANs are.., for 2018 they are..," etc. The need to persistently refer to parts of old Rules, where the legal drafting often does not work with subsequent changes, is overly complicated.

Welsh Power would also like to see the ability to appeal the DB's decisions to Ofgem to clarify the rules. The lack of clarity around some Rules leaves DB interpreting them and parties having no right of appeal over those decisions. When asked to point to the Rules they are relying on, the DB is able to state it is their interpretation and there is nothing a party can do about that. An appeals process could help clarify the Rules, updating guidance; though we would rather the Rules themselves were clear.

Question 6: Do you have any feedback on our proposal to move to an 18-month implementation timescale; consulting on rule amendments which would subsequently be implemented the following Delivery Year?

Yes this seems appropriate.

Question 7: Do you have any views on the proposed process, the implications of the change to the Prequalification procedure and whether it would be a positive change in removing an administrative burden?

Welsh Power welcomes Ofgem's proposals, but believes that they could go far further. All existing CMUs should only need to confirm the details still held are correct and add new certificates as required. While DB has some cloning ability, we have found that this functionality has not always worked as it should.

For new CMUs the process should be more iterative, with early submission to the DB, some checking and then feedback. We are not convinced that year round PQ would work though as there must be a cut off for NG and DB to consider the forecasting of requirements, get ready for the auctions, etc. However, PQ for new plants could be open earlier, run on a two part process (initial submission reviewed by DB before final submission), and then a short window for all parties to confirm information and upload certificates.

Ofgem asks about secondary trading, and we think PQ for that and for new entrants ready for the next auction are effectively the same processes. Therefore, if Ofgem moves to open PQ for extended periods then the DB should be reviewing and reporting back on each on a set timescale.

Question 8: Do you believe the current length of the Prequalification window is appropriate and if allowing Prequalification submissions to take place throughout the year would be beneficial?

We believe the current prequalification period length is appropriate and are not in favour of a year round prequalification process. As detailed above, we believe a more iterative process would be beneficial to all avoiding a binary pass or fail followed by an administratively intensive appeal process. We would strongly recommend Reg 69 be removed to allow for further information where clerical errors are made.

As noted above, Welsh Power believe that existing CMUs should simply have their detail roll forward and the applicants be required to tick a box confirming the details are correct and upload a new directors' certificate. Everything, on the vast majority of CMUs, will be remaining the same from year to year. The fact the DB cannot track the units between years is an issue that needs urgent resolution.

Question 9: Do you have any feedback on the options presented in relation to the submission of planning consents and if there are any alternative options that we have not yet considered?

Ofgem and BEIS will want some degree of confidence in the volume of new plant that will be capable of being built, but it should also be recognised that local planning has no statutory timetable, so parties cannot guarantee that planning with take X months. To this end we would suggest that planning should be in place to allow for participation in the auction, but not for PQ.

On a related issue, we note that losing planning does not result in termination. We think there is a fundamental point that if there is a PQ requirement on specific issues (planning, land use, connection, etc.) then logically these must also be termination events. We would not necessarily say losing planning is an automatic termination, as parties can reapply, appeal, etc. However, we do believe that if a party knows that it cannot deliver a CMU then the options to move the location, trade the obligation or terminate should all be in place. By default, we would like to see parties able to trade out obligations they cannot meet, not simply be terminated.

Question 10: Do you have any feedback on the amendments to the Prequalification data items listed in Table 1?

Welsh Power supports the amendments detailed in the table, but would note that the DB may struggle to check historic output without access to meter numbers. Again, this is back to the systems issues. For existing CMUs, were the data to be rolling forward, the CMU's meter id would be known to the DB and therefore they can check output.

We also believe that parties should be able to upload some of the data items at any time. For example, when a site has a new meter then it needs to provide those details into a number of codes, including the CM, so should be able to do that itself and the DB then check. The notify DB, wait for them to update, then check DB has updated it correctly, is all very inefficient. Again a good IT system should be pulling these data items from the BSC when they exist there, which will be the vast majority of CMUs.

Ofgem should also do a sense check with the DB about the information provided at PQ, that may not fail a site, but would be needed for a secondary trade being uploaded at the point of PQ. We are concerned that if Ofgem says that parties do not need a piece of data, say a meter certificate, the DB may stop parties providing it, even though it is not something to fail PQ on, but the party knows they need it later. It is this sort of pragmatic flexibility we need to see in the systems.

Question 11: Do you believe that removing progress reports and the associated ITE assessments in all cases except those outlined, alleviates the regulatory and administrative burden, while still providing the necessary levels of assurance?

Welsh Power supports Ofgem's proposed changes. A declaration from a statutory director should be sufficient without the need for an ITE certificate.

Whatever assurances are required to be given, we would expect an update prior to the T-1 auction to be given to inform the setting of the target capacity. It would also seem more logical to a risk based approach with more checking on sites running further behind, or having had dates extended via an appeal, etc.

Question 12: Do you have a view on which of the sub paragraphs of Rule 9.2.6(d)(i) – (ix) should only apply to Eligible Secondary Trading Entrants and which to the other categories of Acceptable Transferees?

It is vital that the secondary trading Rules are redrafted so that all parties can trade out of their CM agreements to another party who is able to deliver the obligation. The Rules are far too restrictive and do not move obligations with agreements in a manner that makes sense. When a party trades they should see all the obligations associated with that agreement move at the same time, such as SPDs, etc. Once a party takes on an agreement then they take on all associated liabilities.

Question 13: Is it appropriate to allow all parties who have prequalified for the CM for that year to become prequalified for secondary trading? Are there any unintended consequences?

Yes. The whole section on eligibility needs to be rewritten so a party can easily qualify as an eligible transferee. Any CMU that has prequalified or already holds an agreement for another Delivery Year should be eligible to trade (noting that where a new PQ requirement has been put in place additional data may be needed). The Trading Register should show them as PQ'ed, not holding agreements and therefore "Eligible to Trade". All other CMUs would need to go through the PQ process.

Welsh Power also believes we need a trading portal where all plant unable to deliver advertise their CAN. We feel it is unacceptable to have plants on outage, reported on REMIT, etc. and making no attempt to get another party to deliver. The load following obligation makes this low risk for portfolio players, but does not offer good value for customers. We appreciate that the rules must allow trades of parts of obligations as otherwise larger plant will never find eligible capacity to trade to.

We would note that the PQ process seems to be onerous on new trading entrants with the DB requiring CMUs to prove their full capacity rather than the capacity that they are taking on. A party can only hold agreements it has proved it can deliver, but it should not matter if the agreement(s) traded only account for 50% of the sites capacity.

Question 14: What form should a register of Acceptable Transferees take? How should it be populated? And who should be responsible for maintaining it?

Given parties could be eligible transferees for a number of years they should appear in two places; the register for the auction for which they did PQ and a new register should be created of eligible traders for the relevant Delivery Year, which can be added to as more parties qualify.

Question 15: Do you agree that it would be desirable to allow obligations to be traded between parties in amounts greater than or equal to 0.5MW?

If they have gone through PQ then yes.

Question 16: Do you believe the current time period of five Working Days before the date of the trade by which applicants must submit a request to trade is appropriate or should this period be reduced? Do you have any suggestions on a revised length of this period?

Once a party is eligible to trade we are surprised that the checks could take more than a day. Liquid trading will only be possible if parties can affect a trade quickly.

Question 17: Do you believe that the current period of three months in which NGESO have to notify a Secondary Trading Entrant of the Prequalification decision is appropriate or do you feel this should be shortened? Do you have any suggestions on a revised length of this period?

Again we see no reason that this takes any longer than a day.

Question 18: Do you agree with adding a provision for the time frame over which NGESO must respond to requests for a trade?

Yes. The actual checks they do for a trade should take a day, no longer (given how many they currently do in PQ), and we suspect the DB is working to do the checks on the last rather than first day. There is then the risk that they then find a problem, setting the whole trade back in time. The timescales should therefore be shortened substantially, ideally to within a few days.

Question 19: Do you think it is appropriate to extend the defined trading window to the results day of the T-4 Auction for the relevant Delivery Year?

No we believe there is a risk that making CM obligations easier to transfer may lead to speculative behaviour in the auction encouraging parties without a realistic prospect of building a new plant to take on CM obligations with a view to monetising the contract. We believe it important that new build CMUs have to deliver their minimum completion requirement by the long-stop date in order to be able to trade out an obligation.

Question 20: Does it continue to be appropriate for Transferors to be required to meet their SCM prior to engaging in trading?

Yes, we believe it important that participants are held accountable for delivering their CM obligation. The ability to trade prior to meeting an SCM is likely to encourage speculative behaviour.

Question 21: Does it continue to be appropriate for Transferees to be required to meet their SCM prior to engaging in trading?

Yes we believe this is sensible.

Question 22: How should we address the risk of a trade being withdrawn where a Transferor is terminated after a trade has been registered?

Once a trade occurs there should be no risk to the buyer of anything related to the seller. It is irrelevant if the old holder of the CAN is terminated to the buyer's ability to deliver. Once an agreement is being delivered on it should not be subject to termination for anything a third party has done.

Question 23: How should we address the transfer termination risk where a partial or full Capacity Agreement is traded for part of, or the entire duration of a Delivery Year?

The terminations rules should apply to each agreement held by a party. If there is a partial trade then each party holding the obligation can be terminated on their part of it, but not a related part of an agreement. So a party expecting to be terminated should be encouraged to trade out, but if they get left with, say, a 10MW agreement that they cannot deliver then they will be terminated only on that 10MW.

Question 24: Are there any amendments that could be made to the SPD framework following a secondary trade, specifically relating to partial agreement trades? e.g. SPD obligations applying to trading parties in aggregate following a trade, specifically relating to partial agreement trades? e.g. SPD obligations applying to trading parties in aggregate following a trade.

We do not believe that any single agreement should end up subject to more SPDs than another as a result of trading. Parties have to prove they can deliver the capacity they are taking on, so there is no reason for them to prove further when they collect an agreement..

Question 25: Do you believe the options presented related to SPD data submission are suitable and are there any options we may not have considered in order to help mitigate the impact on capacity providers?

We welcome Ofgem's proposals to improve data flows, with automated processes.

Question 26: Which aspects of a CMU configuration do you think should not be able to be amended following Prequalification?

Welsh Power can see no reason to not allow any changes on the condition that the de-rated capacity can be delivered. Rule 4.4.4 is unnecessarily restrictive, as those in the know simply do not describe the components at the time of PQ. Parties should be able to change configurations, technology, etc. on the condition they can meet the de-rated capacity.

We have already seen times when change would have been in everyone's best interest, for example a move away from diesel when the environmental and health impacts became apparent. The UK should also not want to close the door on emerging technologies and changes to the wider policy framework.

Question 27: Is there any other data that would be useful to add to the CMR and why?

There should be a field on SCM, like there is on FCM. All the CMUs need to link between years, which would help market participants and analysts see how sites are obligated over years. It would also be useful if, every time the register is published, the DB could put changes in yellow to make it easier for parties to track the changes.

It needs to be far easier to find all the applicable registers.

Question 28: How should the ALFCO formula be adjusted for Interconnectors when their output is affected by actions by NGESO?

Welsh Power agrees that ALFCO should be amended, and think "min" needs to be added to the equation.

Question 29: Should system to generator intertrips be included as a RBS in Schedule 4 to relieve providers of their obligations when affected by such an intertrip? Do system to generator intertrips provide a similar parallel benefit to the system as other RBS do.

Yes, as like other ancillary services it is important the calculations reflect other obligations and actions taken by CMUs as required by the ESO.

However, there is also a need to address the unfair Rules around network issues where a TO connect has their obligation lifted where there is a transmission network problem, but a DNO connected CMU does not. This should be made the same irrelevant of the voltage of connection.

Question 30: How should we differentiate between firm and non-firm connection agreements at the Distribution level?

Welsh Power has serious concerns that Ofgem could alter the Rules to make "non-firm" connections not allowable, when in reality many DNO connections are drafted as non-firm. They often allow for the DNO to interrupt a site in the same way the ESO can take large sites off to manage constraints, but with the drafting done in the agreement not the market rules. The ability to interrupt all TO connects exists in their bi-lateral connection agreements (BCAs), but the fact they hold TEC is seen as a “firm right”. This definitional clarity simply does not exist in DNO connection agreements, as despite feeling our connections are “firm” we do not have the equivalent of a defined TEC right. Hence the agreements are not clear like a BCA.

Ofgem’s charging review may alter the definition of capacity rights. There may also be short term capacity products, etc. Therefore any change now may risk making the CM Rules restrictive to Ofgem’s charging review. With short term products, parties may choose to manage their CM risk buying short term products, which may be efficient if it frees capacity for, say, solar over the summer. Generally we believe parties should be left to manage their own capacity risks and all they need to show is that they have a connection agreement that allows physical exports up to their de-rated capacity, nothing more. The more complicated the Rules are made, the more difficult they are to manage and enforce.

Question 31: How should Distribution-connected generators with non-firm connection agreements be de-rated to accurately account for their contribution in a stress event?

As noted above, we do not think this is as simple as Ofgem suggests and we believe changes at the current time could prove premature. With easier trading a party with a connection that is being interrupted should trade out. They should manage their risk. In reality no one has a 100% guarantee of access, so derating should just assume parties are sensibly managing their risks until Ofgem has proof this is not the case.

Question 32: Do NGESO’s current financial incentives on demand forecasting accuracy, dispute resolution, DSR Prequalification, and customer and stakeholder satisfaction drive the intended behaviours by NGESO?

Question 33: Do the financial incentives listed above remain fit for purpose?

Question 34: What behaviours and outcomes should NGESO’s financial incentives drive? What form should these incentives take?

Question 35: Do you agree that a demand forecasting accuracy incentive remains appropriate?

Yes.

Question 36: Do you agree that the dispute resolution incentive should be based on a proportion of Prequalification or Reconsidered Decisions overturned by the Authority rather than on the absolute number?

While a proportion seems sensible, the focus should be on avoiding disputes. We also think there should be an incentive not only on how many, but how many Ofgem then subsequently over turns.

Question 37: Do you agree that the DSR Prequalification incentive should be replaced by an incentive intended to drive NGESO to aid smaller providers, new entrants, and innovators navigate the CM?

This should simply not be about special treatment. The DB needs to help all of the parties and anything else is not appropriate. If a lot of DSR requires specialist expertise in the DB, then fine, but the CM is technology neutral and DB should be as well.

Question 38: Do you agree that an incentive on NGESO's customer service and stakeholder engagement remains appropriate? What form should this incentive take?

Yes. The DB must monitor all calls, queries, Register updates, etc. and report on their performance. Failure to resolve issues in a timely manner [5 WDs] should result in them losing money, or even compensate the party impacted.

Question 39: Do you agree that the incentives on NGESO for delivering the CM should be aligned with NGESO's incentive framework? Should the CM incentives be incorporated into NGESO's incentive framework in the longer term?

While we do not know what the future ESO incentive regime looks like, it is difficult to comment. However, we do not believe that parties should be rewarded for doing their job, with rewards only where they have gone above and beyond a business as usual do rewards accrue.

Question 40: Does the separation of the EMR Delivery Body from NGESO continue