Five Year Review of the Capacity Market Rules – First Policy Consultation

E.ON Response

Executive Summary

E.ON fully endorses the aim of the Capacity Mechanism to provide security of supply at the lowest price to consumers and believe it is the correct regulatory instrument to achieve this.

We welcome Ofgem's *Five Year Review First Policy Consultation* and fully support the objective of achieving the Rules with less burden on participants. We agree with Ofgem's observation that the complexity of the Rules and the regulatory burden they place on participants may be a barrier to uptake of the Capacity Market (CM) and, at the very least, complicate the process of participating in the mechanism. As stated, this may in turn lead to inefficient bidding in the auction and higher costs on consumers' bills which is something we would always look to avoid.

Ofgem's outlined prioritisation areas are in line with our own assessment of issues which could benefit from review, particularly prequalification and secondary trading. We also support a more fluid Rule change process as well as ensuring NGESO is appropriately incentivised.

We look forward to participating in the next stages of implementing these changes.

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?

We believe that the Capacity Market (CM) interacts with other wholesale markets such as the forward, balancing and ancillary services markets although evidencing this would be extremely challenging. It is logical to assume that revenues from wholesale markets, the Balancing Mechanism (BM) and ancillary services help determine the merit order in the CM and therefore what receives a contract (and the price) and subsequently what the ongoing generation mix is. This generation mix then impacts the prices in the wholesale, BM and ancillary services market. Evidencing the exact nature of this inter-relation is extremely difficult though. Theoretically, these markets can all work together in an efficient manner assuming market participants have the relevant capability and information to inform their decisions. If this is not achieved, then this could introduce a distortion in one (or more of these markets) which, in turn, could impact all of the other markets. For example, if a less efficient generator were too optimistic in its revenue assumptions compared to a more efficient generator, then this could result in it being inefficiently awarded a CM agreement. This may then lead to higher prices in the other markets either as the generator sets a higher marginal price or as the generator does not deliver on its capacity agreement resulting in a tighter market than governed by the reliability standard.

In terms of balancing markets specifically if the CM is, as has been speculated, keeping plants open that would close without it, this could have a perverse effect in the balancing market. Large, inefficient generators could be being kept open artificially which could result in an inefficient, polluting plant being chosen over a cheaper, greener alternative.

All units participating in the ancillary services market do so on the basis they can stack up revenue from the various income streams. If these assets are also receiving CM income, it is logical to assume that there would be a bearish effect on their ancillary services bids. Equally, if the CM income is lower than they had allowed for, ancillary service providers may charge higher prices for their ancillary activities as they look to make up for lower capacity revenues.

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

The initial intent of the CM was for it to be technology agnostic. However, recent changes (such as those made to the de-rating factors for storage) have started moving it away from this intent. This can lead to increasing amounts of inefficiency in the CM, which then feeds through into the other markets as outlined in question 1. Again, theoretically this inefficiency could result in cleaner, more efficient generation not participating in these markets.

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

The recent changes that have moved the CM away from being technology agnostic either need to be reversed or applied on an equitable basis to all types of generator.

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?

We support the proposed members of the CM Advisory Group, its stated function and the meeting frequency. We reiterate Ofgem's point over how essential it is that the industry-nominated parties represent the full spectrum of participants.

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?

We believe the proposed framework and function of the CM Advisory Group is appropriate and that it would better facilitate the efficient operation of the CM Rules change process. We also agree that Ofgem should retain the final decision regarding whether a CM rule change is instigated.

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?

We support the proposal to move to an 18-month implementation timescale, allowing more time for complex Rules to be integrated into, for example, IT systems.

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?

We believe the principle of evergreen applications is appropriate. This would reduce administrative burdens for both the Delivery Body and applicants. Under 3.11.2, the proposal appears to be for the applicant to submit "new application year-specific exhibits". We believe that this should not be necessary and that the Director's declaration to confirm nothing has changed since the previous year should be taken to extend to exhibits as well (where they still remain valid).

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 would support having a longer prequalification window. It would be useful to understand whether, for early prequalification submissions this would also result in the Delivery Body assessing these applications early, allowing them to spread workload? We would also value clarity on how and when results would be disseminated under a longer window – for example would they all still be released once, annually or would there be several publications of prequalification outcomes across the windo? As these results have implications for the market in terms of the visibility of available capacity we believe the information needs to be released in as transparent a way as possible and according to a set timetable.

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?

Our preferred option for the submission of planning consents is Option 1. If the current deadline were to be retained, we would suggest that proof of having applied for planning permission rather than having proof of approval of planning permission should be sufficient in recognition of how long a planning application can take.

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

We agree with the proposed amendments to prequalification data.

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

We agree that removing progress reports and the associated ITE assessments in all cases except those outlined, alleviates the regulatory and administrative burden on applicants, whilst still providing the necessary levels of assurance. This proposal supports our position that the onus should be on the Provider to deliver their obligation and that an ability to provide capacity should be assumed from successful prequalification.

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?

On the basis that the conditions outlined in sub paragraphs (i) – (ix) of Rule 9.2.6 are likely to lead to fewer instances where a secondary traded obligation is not met and therefore improve security of supply, we would support making all of the sub paragraphs applicable to both Eligible Secondary Trading Entrants and Acceptable Transferees. This would also simplify and clarify the criteria required for any type of unit to participate in secondary trades as the same selection parameters would apply to every prospective Transferee.

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?

We believe it is appropriate to allow all parties who have prequalified for the CM for that year to become prequalified for secondary trading. The only exception would be for unproven DSR in which case the ability to become a secondary trading participant should be dependent on it demonstrating that it is proven DSR. In order to avoid any unintended consequences, we would suggest that qualified secondary trading parties are made responsible for notifying the Delivery Body if there are any changes to the asset/its status between prequalification and the delivery period.

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

Ultimately, we would like to see secondary trading working as effectively as a live, liquid market, facilitating trading in a similar way to the stock exchange. A register goes some way towards this. We would expect the Delivery Body to maintain it, having a central record of all CMUs. CMU IDs, de-rated capacities and respective contact details would be essential items to include.

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?

We agree that it would be desirable to allow obligations to be traded between parties in amounts greater than or equal to 0.5MW.

The specified “Minimum Capacity Threshold” referenced as the minimum threshold for secondary trading to take place (Rule 9.2.4) actually precludes some CMUs from being able to participate in secondary trading. This is because it is possible for a CMU to acquire an obligation through an auction for less than 2MW (for example once a battery with a 2MW Connection Capacity has been de-rated). We would therefore encourage removing reference to a MCT and instead setting a clearly minimum tradeable clip. To avoid further confusion between connection capacity and de-rated capacity, it needs to be made clear what the 0.5MW refers to – i.e. a de-rated capacity or connection capacity.

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?

We 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 not appropriate and that the period should be reduced to between 2 and 3 Working Days. This would enhance the ability of prospective secondary trading participants to trade which we believe would contribute to a more liquid secondary trading market. Improved liquidity in secondary trading should enhance security of supply by reducing the risk of energy not being delivered in times of peak demand, supporting lower wholesale prices. It could also result in potentially lower clearing prices in CM auctions as bidders would factor in lower secondary trading costs into their risk premia.

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?

Whilst we recognise the workload on NGESO can limit the speed at which they are able to review Secondary Trading Entrants' applications, we agree that a 3 month period is excessive. We would support reducing this period to 6 weeks or less as proposed.

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

We agree with Ofgem's proposal that there should be a time frame by which NGESO must respond to requests for a trade. We would nonetheless urge responses from NGESO to be made as soon as possible after a request to trade has been made and ask that NGESO do not treat these timeframes as targets. We support the proposition that the Transferee should become the Registered Holder once confirmation of the trade has been received by the two parties involved, effective on the date of the notification pursuant Rule 9.3.1(b).

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?

We strongly support the extension of the defined trading window to the results day of the T4 auction. As per point 5.2.3, the current embargo on trading until the T-1 auction has implications for deadlines carried out before delivery year such as metering assessments.

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

On the basis that Transferors want to carry out a trade because their asset is unavailable, we do not believe it is appropriate to mandate that they should meet their SCM beforehand. We do recognise however, the need to ensure that applicants do not prequalify an asset with no intention of ever building it and even securing multiple agreements which they never intend to fulfil. Therefore, we would suggest that, in cases where applicants secure a multi-year agreement, some form of commitment would need to be demonstrated early on (for example within 2 years) to discourage speculative bids.

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

Please see our response to question 20.

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

We believe that the risk of a trade being withdrawn in instances where a Transferor is terminated after the registration of the trade needs to be managed. It is our view that, where a trade has been made from a Transferor to a valid Transferee that trade should still stand, even if the Transferor is terminated. This is so the agreements between the two parties are not voided.

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?

We believe trading requirements should be consistent between trades for part of the year and for a full year. This means that, as the Rules state that the obligation is not terminated when traded for a full delivery year, this should also become the case for trades made relating to a partial year.

Question 24: Are there any amendments that could be made to the SPD framework following a secondary trade, specifically relating to partial agreement trades?

We agree that SPD requirements should be transferred proportionally where the trade is only partial. We also feel the situation could be made clearer by establishing, for example, that where a Transferor trades away a partial agreement for part of a Delivery Year, it only needs to demonstrate output of up to the partial agreement capacity for the SPD falling within that part of Winter.

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 agree with the options presented relating to SPD data submission under 6.8 and support the proposed idea under 6.9 whereby the data that ESC has received will be sent to the CM Provider. We support this as we believe this will facilitate the remedying of data issues ahead of any suspension of payments which encourages the smooth running of the CM.

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

The current prohibition on making changes to a CMU's configuration has had a particularly severe impact when aggregating small generating units. In the event that a single generating unit becomes unavailable, this can invalidate the whole CMU which we believe is disproportionate. We would therefore support the ability to withdraw or change generating units where these generating units are below a specified size. We agree that it should not be possible to amend de-rated capacity and technology class once a CMU has prequalified.

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

We are satisfied with the current details supplied by the CMR and do not propose adding any additional data.

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

No comment.

Question 29: Should system to generator intertrips be included as an RBS in Schedule 4 to relieve providers of their obligations when affected by such an intertrip?

On the basis that the inter-trip signal is from the TSO to the Capacity Provider, it seems reasonable that the Capacity Provider should not be penalised in this scenario.

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

We believe distribution connected assets would be most likely to maintain their connection at the times a System Stress Event is most likely to occur. We therefore deem the risks from non-firm connection agreements to be low. If Ofgem has reservations about non-firm connection agreements, we would ask for consideration of the Average Output as a method for determining connection capacity. This would reduce the perceived risk of over-stated capabilities within non-firm agreements as it would be based on actual performance of the asset.

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?

We do not believe that distribution connected generators with non-firm connection agreements need a differential de-rating compared to assets with firm connection agreements. This is supported by the fact that the Panel of Technical Experts has verified National Grid's current de-rating methodology and has not queried it. As per our response to question 30, if de-rating were to be reviewed we would propose historic data is used where possible.

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?

No comment

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

No comment

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

No comment

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

Yes, we agree that a demand forecasting accuracy incentive remains appropriate.

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?

Yes. We 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.

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?

We agree with Ofgem's analysis that the DSR market has matured since the inception of the CM and that DSR aggregators are better equipped with the necessary know how to be able to participate in the mechanism. Whilst we support the drive to aid smaller and new entrants as well as innovators to navigate the CM, we do not think this means it is appropriate to completely remove DSR incentives. Instead we believe the DSR Prequalification incentive should be refined to support entry of innovative, small scale <500kW DSR components. This is necessary because, for a lot for small providers, the bureaucratic overhead created by having large numbers of small components to upload in CM systems one at a time creates a barrier to their participation. Overcoming this obstacle could be achieved at minimal cost by streamlining data entry systems allowing bulk uploads for CMUs made up of several small components.

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

We agree that an incentive on NGESO's customer service and stakeholder engagement remains appropriate.

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?

We agree that the incentives on NGESO for delivering the CM should be aligned with NGESO's incentive framework. We support the CM's incentives being incorporated into NGESO's incentive framework in the longer term.

Question 40: Does the separation of the EMR Delivery Body from NGESO continue to remain appropriate given the separation of NGESO from the rest of NGESO plc?

No comment.