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

We welcome the opportunity to respond to the Five Year Review of the Capacity Market Rules consultation on behalf of National Grid Electricity System Operator (ESO). This response is not confidential. The ESO fulfils the role of EMR Delivery Body (DB) for the Capacity Market (CM) and is responsible for pre-qualifying auction participants, running the capacity auctions, issuing and monitoring agreements, and for issuing CM notices. It is also responsible for providing security of supply analysis and for setting de-rating factors for most technology types.

The ESO agrees that the Rules are meeting their first objective to deliver electricity security of supply during times of system stress at the lowest cost to consumers, but the complexity of the Rules and the regulatory burden they place on participants slows prequalification and agreement management processes, and may act as a barrier to participation in the CM. While supportive of the high-level principles and intent of Ofgem's proposed changes to simplify the CM, we consider there is more work to be done in certain areas and we explore this further in Appendix 1.

The CM has been evolving year on year since 2014 and we expect the current level of change to continue unless a holistic review of the rules is undertaken. Much of the change has been driven by the emergence of new technologies and evolving markets with greater numbers of active and diverse participants. Moreover, the practice of making incremental changes to the Rules on a yearly basis has made it extremely difficult to evolve the CM's framework and the Rules change process at the same pace. We observe that piecemeal changes made in isolation have made the prequalification and agreement management processes unduly complicated and there is now significant effort required to participate in the CM.

As DB we expect that it is our role to facilitate and guide applicants through the complexities of the CM. However, the context within which we fulfil this role has changed significantly. For example, our role has required us to interpret the Rules, where they are not clear, and communicate this to industry, with a caveat that participants must seek their own legal advice, to avoid misinterpretation. Further, the number of applications is now much greater than was originally envisaged, with 1660 applications made in the 2018 Prequalification Window. For the DB to perform its role in an efficient and pragmatic way, it is necessary for the baseline CM Rules, current framework and incentive package to be reflective of the current operational context. We therefore welcome the opportunity to simplify the prequalification and agreement management and Rule change processes by:

- increasing industry engagement via the CM Advisory Group;
- moving to an 18-month process for consultation and implementation of Rule changes;
- removing certain data submission requirements at Prequalification;
- reducing barriers to participation in secondary trading; and
- aligning the incentives on NGET for delivering the CM with the ESO' incentive framework, and reviewing current business separation arrangements between the ESO and EMR Delivery Body.

Whilst at a high level the changes proposed in this consultation are welcomed, we believe that any incremental changes should be designed and implemented as part of a roadmap, leading to a holistic review. The roadmap should deliver priority change and ultimately a simplified version of the Rules, with no scope for ambiguity of interpretation and meaning.

We are supportive of the proposed CM Advisory Group and the inclusion of the ESO, as well as the EMR Delivery Body, within the core membership. Indeed, this level of involvement from the ESO is a positive step towards realising our RIIO-2 ambition to '*take on responsibility for the development and management of the Capacity Market Rules … to make the rules clear, proportionate and equitable … which will be developed through industry engagement*'.[1] A move to increase transparency and industry involvement in the change process and policy development feels appropriate against a backdrop of ubiquitous change. There is value for Participants, Delivery Partners and wider industry stakeholders in creating a collaborative forum to develop and drive targeted changes that are expressly framed to support and adapt to market needs, to better facilitate the effective operation of the Rules and change process, and to ultimately support the achievement of the CM objectives.

[1] ESO RIIO-2 Ambition April 2019 https://www.nationalgrideso.com/document/141256/download

Over time the annual Rules change process has become complex and resource intensive, with the number of change proposals increasing year on year; this renders it difficult to establish a dynamic change process capable of delivering urgent changes and the certainty required to implement large-scale IT changes. Current timings mean that applicants may have only a few weeks to confirm which Rule changes have been implemented and to understand the implications. We recognise that the proposed 18-month implementation timescale is a good step forward, but there is scope to explore this further and for a better solution to be found. A longer implementation period will allow for more central, holistic change and will provide the confidence and associated governance for us to invest in our IS systems and to realise our RIIO-2 ambition to '*deliver a new platform for the Capacity Market within the single, integrated ESO markets platform'.*[2]

We welcome Ofgem's intention to simplify the CM and implement a more transparent Rules change process in the short term, but ensuring that the governance framework and Rules of the CM are truly adaptable to changing market conditions requires a comprehensive holistic assessment of the structure, Rules and operation of the CM. The output should be a CM framework and Rules that can drive forward the right changes in terms of policy, benefits realisation for customers and value for consumers rather than incremental change because this is all that can be achieved within the constraints of the current framework and change process. The value derived from small scale, short-term changes is also debatable from a cost benefit perspective. If these changes are unlikely to deliver significant benefit now, then arguably it is more efficient to wait for a holistic review that will deliver long-term transformative change.

We support the principle of reducing barriers to participation in secondary trading to create a liquid market. However, we are concerned that the approach taken so far has been restricted to incremental change rather than a full assessment of the environment supporting the secondary trading market (e.g. penalty regime and commercial value). Further work is needed to review and evaluate the root cause(s) of why secondary trading has not received the uptake Ofgem was looking for; this may require policy discussions between BEIS and Ofgem to identify an appropriate solution.

We agree that the current EMR financial incentives framework is not reflective of today's market and is no longer appropriate. We support a move to a relative rather than absolute measure for the incentives, and believe that the design of the incentives does not remain appropriate for the following reasons:

- the mechanistic approach to the **dispute resolution incentive** does not reflect the higher degree of difficulty and cost of achieving 0 overturned decisions where the volume of applications, the number of applicants and the complexity of the prequalification process and associated Rules have all increased considerably;
- the **demand forecasting accuracy incentive** should be reassessed to review the demand definition utilised and to consider moving to Underlying Demand (on which the CM is based) and away from Transmission level demand, using distribution generation data from Electralink;
- the volume of **Prequalified DSR capacity** has grown over time as the DSR market has matured, which makes it difficult to delineate ESO value-add in driving increased DSR participation from other factors; and
- the **customer and stakeholder satisfaction survey** is a single simplistic metric and as customer needs and journeys differ, then process efficiency and customer satisfaction should be gauged via a set of measures that are i) specific to DB activities; ii) more holistic in scope; and iii) more objective (e.g. qualitative and quantitative).

We agree that the EMR incentives should be considered as part of a holistic ESO incentive package from the 1st April 2021. We need to ensure strong incentives with clear success criteria are designed to truly drive improved ESO performance and delivery of greater consumer benefits. We also broadly agree with Ofgem's position that it may be appropriate to reduce the severity of the conflict of interest mitigations following the legal separation of the ESO from National Grid's Transmission Owner business. Removing the ring-fence is an opportunity to realise the synergies between the ESO's existing and DB specific functions and deliver a Prequalification and auction process truly appropriate for an efficient, simplified and transparent CM framework.

We enclose in Appendix 1 our detailed responses to the specific questions in the consultation document. Should you require any further information or would like clarity on any of the points outlined in this response then please contact Laura Brock in the first instance at laura.brock@nationalgrideso.com.

Yours Sincerely

Cathy McClay
Head of Future Markets

[2] ESO RIIO-2 Ambition April 2019 https://www.nationalgrideso.com/document/141256/download

# Appendix 1

## ESO response to Ofgem's Five Year Review of the Capacity Market Rules – First Policy Consultation

**Q1: 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?**
Market participants rarely operate in a single market; they seek to stack revenue across markets, where possible, and in doing so increase competition. When making changes to any market there is a need to be cognisant of the potential harmonising and distorting effects on other markets. We should be seeking to harmonise within markets where appropriate. More specifically the CM Rules should be framed to reduce barriers within other markets unless security of supply issues, for example, prevent us from doing so.

Beyond any potential harmonisation or distortion concerns, we should seek to align the data underpinning each of our markets. This data and the registration of assets at component level will, in the future, be key to flexible market participation. We foresee a growing need for industry wide understanding of data, a platform to register asset data and a structure that allows flexibility across markets.

**Q2: Do you have any evidence that design choices in the CM are driving inefficient outcomes in other markets?**
We do not believe that the present design choices in the CM are limiting outcomes in other markets. However, emphasis should be given to the importance of progressing with those actions, outlined in our response to Question 1, that will create common industry wide understanding of data and thus make it easier to achieve flexibility across all markets.

**Q3: Do you have suggestions for how these markets can be better aligned and how any inefficiencies can be mitigated?**
We should be looking to harmonise the use of terminology and data across the industry. We believe there is real industry benefit in aligning the definitions of common terms across the various markets and that this is key to future flexibility between markets.

We also consider it important to look at the interactions between the different CM Rules before looking at interactions or alignment with other markets. As a general principle, we believe that minimising complexity in all CM related interactions is appropriate. Introducing short term, incremental amendments in isolation year on year serves only to complicate the experience for applicants and delivery partners alike. We strongly believe that a holistic review of the Rules is timely. As an industry, our fundamental aim should be to deliver the substantial changes necessary for the CM framework and policy to be adaptable to changing market conditions on an enduring basis. By undertaking a transparent wholesale review, we can ensure that the Rules are well defined, clear and concise and not open to interpretation.

**Q4: Do you have any views on whether the proposed membership of the CM Advisory Group is appropriate, what form participation from industry should take, along with any further points regarding meeting frequency and function?**
In principle, we favour the move to a more transparent and industry involved change process and would welcome the opportunity to support in the co-creation of the proposed CM Advisory Group. The ESO has extensive experience in supporting the development of code governance and has first-hand experience (as Code Adminstrator) of electricity code governance arrangements. We believe the ESO is well placed to lend this experience to helping Ofgem shape the process around the Advisory Group function.

We would suggest that more work is required to provide detailed information on the proposed composition of the Advisory Group, before a cogent response can be given. For example:

- How will industry parties be nominated?
- How many industry parties will there be?
- Will there be representation for categories of market party or could all be elected from one type (e.g. synchronous generation)?
- Will parties need to act independently?
- Will there be a secretariat?

We reiterate our willingness to work with Ofgem to help address these questions in more detail, based on our code administration experience.

**Q5: 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 Rule change process?**

As noted in the ESO's RIIO-2 Ambition document, published April 2019, it is our ambition to *"Take on responsibility for the development and management of the Capacity Market Rules… to make the rules clear, proportionate and equitable… which will be developed through industry engagement."* We support the implementation of the proposed CM Advisory Group and believe that this approach better aligns to other industry frameworks and will facilitate the efficient operation of the CM Rule change process. We would welcome a formal role within the Rule change process, recognising the existing involvement of the DB in policy discussions. This approach will of course require active participation at Group meetings and a shift in the way we currently assess change. We envisage the requirement for a full impact assessment and size estimates for rule proposals where currently we only estimate relative size. This will have an incremental resource and cost impact to our IS supplier engagement. We would propose there being one organisation, with responsibility for administration within the Group and for control of proposals and governance. We would be happy to facilitate this.

We believe greater transparency across industry is appropriate, given the increased number of changes to the Rules year on year. For the CM Advisory Group to be successful there should be full transparency with industry about the scale of the backlog of existing change across Delivery Partners (including regulatory, customer and technical driven change) and our prioritisation criteria for implementation. Without this it may be difficult to understand the timescales for implementation of any new changes agreed. We would like to propose consideration of an environment where industry raise their own change requests in both the DB and Electricity Settlement Company's (ECS) respective IS portals, recognising the not insignificant implementation timeline of this approach.

We question whether it is appropriate for all change to be facilitated through the proposed Advisory Board, including proposals raised by BEIS. We believe it is more efficient to have one industry wide and transparent forum for change, through which all proposed changes to Rules and Regulations are considered, prioritised and implemented to the agreed timetable. Regarding the membership of the CM Advisory Group, we agree that the ESO should be represented as an entity separate from the DB.

**Q6: 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 are supportive of the intent of the proposal but believe the technicalities of the proposal require some refinement. As currently drafted, we do not believe the proposal facilitates a sufficient implementation timetable for anything more than minor change.

For changes classified as 'urgent', we would expect that delivery would remain extremely tight and would not necessarily be implemented in time for the relevant prequalification. This would necessitate us to continue to work with offline processes prior to system implementation, which in turn exacerbates customer frustration and creates unnecessary compliance risk. Where change is deemed to be 'non-urgent', we believe a prioritisation approach is required and this would be best placed within the CM Advisory Group's remit.

We would suggest that greater consideration should be given to when the clock starts for implementation. We believe that the 18-month period begins from the point Ofgem publish an indication of the Rules drafting, from which we develop our process and system changes. If any earlier, then we could not be certain that developments were made in accordance with the latest policy thinking.

We observe that the proposed timetable is focused primarily on prequalification. However, we believe that consideration should be given to changes that are not required for prequalification. Do these have the same weighting? Perhaps these can be teased out in a prioritisation exercise via the proposed CM Advisory Group. As referenced above, consideration also needs to be given to the backlog of existing identified change, as well as any other potential change proposed by the Commission in preparation for the re-establishment of the CM.

We are happy to work with Ofgem to refine the proposed timetable to deliver an 18-month implementation timescale. We believe this will lessen the burden and risk that very short timescales place on market participants and Delivery Partners. A longer implementation period also provides the confidence and associated governance for us to invest in

our IS systems and realise our RIIO T2 ambition to *deliver a new platform for the Capacity Market within the single, integrated ESO markets platform.*[3]

**Q7: 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 are supportive of any approach that reduces the burden for Applicants but would suggest that a rolling prequalification is only appropriate in a minimal/static change environment. The CM is not static and therefore we consider that a holistic review of the rules is appropriate prior to progressing any further changes to the Rules which are not imperative to the CM's function.

The concept of a rolling prequalification is sensible from an administrative and resource burden point of view because it would rationalise the data that is collected as part of the process and allow assets to be pre-registered, all of which makes it easier to engage with and administer the prequalification process. It also mitigates the risk of mistakes arising and applicants having to then go through the disputes process. However, we believe this system functionality already exists within our system since Applicants can copy over one CMU and the associated data from year to year. This means that the information applicants submit at each prequalification is significantly reduced, with only an update to historic performance data and associated Exhibits and reconfirmation of the requisite declarations required. We question whether further amendments to introduce rolling prequalification is an efficient use of spend. Should year on year change to the Rules continue at the same rate as now, then industry must accept that as the changes take effect, by necessity, they will have to allocate time and resource to amending the content of their application. Our change process is fixed upon delivery for the relevant prequalification round and we believe this brings a challenge to the concept of a rolling prequalification. Importantly we need to ensure that the Rules provide a framework that drives changes aimed specifically at delivering benefits realisation for customers and value for consumers. We also suggest that any proposed change should take in to account existing functionality and industry feedback to this and previous consultations.

**Q8: 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?**

From experience, we observe that applicants prefer to submit their application in the final week or two of the submission window and therefore question whether the formal introduction of a rolling prequalification would drive a significant change in this behaviour. Of course, we recognise that the trend for submission in the final weeks of prequalification is also due in part to internal governance processes and the associated administrative burden. We are not sure that this proposal will realise any true benefit for applicants or Delivery Partners, especially if we continue to see the same volume of change to the Rules and Regulations on an annual basis.

We would also flag that all our current processes set within the Rules are linked to a defined end date and should the concept of a rolling prequalification be progressed, there would first need to be a holistic review of the Rules to ensure they are fit for purpose and capable of accommodating a rolling prequalification process.

**Q9: 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?**

We are supportive of removing the submission of planning consents. The current process assumes the DB to have substantive planning knowledge and requires the DB to evaluate the documentation - this is a false assumption.
We propose an alternative approach that would see a declaration by the applicant, with an expectation that post Financial Commitment Milestone (FCM) the applicant re-confirms this declaration. We believe there should be an appropriate termination event associated within this prerequisite. Existing Substantial Completion Milestone (SCM) / Minimal Completion Requirement (MCR) obligations require a site to be operational and this could be taken as an indication that planning consents have been met.

The requirement for submission of planning consents was introduced to prevent speculative applications to the CM. However, we foresee that this can instead be policed as part of the Fraud and Error activities investigated by BEIS, Ofgem and the Delivery Partners.

[3] ESO RIIO T2 Ambition April 2019 https://www.nationalgrideso.com/document/141256/download

**Q10: Do you have any feedback on the amendments to the Prequalification data items listed in Table 1?**
As a general principle, we are supportive of the proposals to move requirements from Prequalification to reduce the administrative burden, noting that the mechanism for deferral needs to be captured in Rules drafting. Based on initial analysis of IS development time, we are assuming a small/medium system change, however this will not be implemented prior to prequalification 2019.

The OF12 change allows for the collection of metering information to be deferred and entered at a later date for all applications. A change to when other data sets are required would necessitate a thorough understanding of the Rules and require significant IT system change, which would not be effective from July 2019. It is important that where data collection is deferred, there is a stipulated requirement to collect it at some point and this should be reflected in the Rules.

We have reviewed the proposed rules changes in Annex A and request consideration be made to wider rule implications around the changes listed in the table below.

| Change | Current Rule reference | Area for rules Amendment |
|---|---|---|
| Secondary Trading details | 3.4.1(c) ii | The rule change currently states that an Applicant "may elect" to defer. We request that the rule be updated to align with other deferral options in the rules, making it clear that the applicant must also declare that they whilst they may choose to defer, they are still required to provide the requisite details in the timelines stated.<br><br>In addition, the consequences of not completing any update in the deferral timelines should also be stated in the rule. |
| MPAN/MSID Meter ID | 3.4.3(a)(ii) | This rule change proposes a specific declaration to be provided within the application to defer, but does not clarify what is expected to happen if the Application/Capacity Committed CMU does not provide these details within the timeline proposed. This should be addressed. |
| BMU/Component ID | 3.4.3(a) (iii) | This rule change proposes a specific declaration to be provided within the application to defer, but does not clarify what is expected to happen if the Application/Capacity Committed CMU does not provide these details within the timeline proposed. This should be addressed. |

**Q11: Do you believe that the proposal to remove progress reports and the ITE reports in all but for the cases presented is an improved method for monitoring capacity providers, which reduces the regulatory and administrative burdens? Are there other options we have not considered?**
We support the principle of removing cost where value is not realised. The concept of ITE reports was originally driven by BEIS to provide independent assurance that the capacity was on track for delivery and we would refer back to BEIS to understand if this is still considered appropriate. Whilst we would argue against the assumption that the removal of ITE reports reduces the regulatory and administrative burden, we believe it would significantly reduce the cost for applicants.

On this topic, we question whether there is still value in applicants submitting progress reports, as this continues to provide assurance of delivery without the financial burden of instructing an ITE.

**Q12: Do you have a view on which of the sub paragraphs of 9.2.6(d) should only apply to Eligible Secondary Trading Entrants and which to Acceptable Transferees?**
We believe that sub-paragraphs (i) to (ix) inclusive apply to all; this aligns with the recent perspective given by BEIS. We do support a change to remove ambiguity in the current rules with regards Secondary Trading, noting that any change to the validation rules will require a large system change and that the associated implementation time should be considered.

As a general point, we agreed with Ofgem, as part of their 2018 Rules change process, that ST needed to be considered holistically. We believe this requires further consideration. We are unsure as to whether there was consensus from the ST working group as to how the ST market needs to be reformed. Rather than make piecemeal changes to the Rules associated with ST on the views of a subset of the Industry, we believe there needs to be wider understanding and collaboration from the industry as to next steps in this area. We do not believe that the ST market will be encouraged without a wider assessment of the market context and reasons to trade.

**Q13: Is it appropriate to allow all parties who have prequalified for the CM for that year to become prequalified for secondary trading? Could there be any unintended consequences?**
The Rules already permit all participants who have prequalified for that year to become eligible for secondary trading. Thus, we interpret the focus of this question to be whether participants who have previously qualified are then eligible for secondary trading irrespective of the year in which they prequalified.

The significant year on year volume of change to the CM Rules has resulted in differing requirements as to the amount of information applicants are required to submit, depending on the year of prequalification. If applicants are able to ST based on an application made against historic rules, there may be unintended consequences if that participant then becomes responsible for the delivery of another participant's obligation against a different set of CM Rules. The result would be multiple parties entering the next delivery year under different rule obligations - to manage this would be complex for participants as well as the Delivery Partners.

In addition, there will be system delivery requirements to support this proposal. We would expect this to be classified as a large system change due to the need to manage historical applications and merge this information with additional data items.

**Q14: What form should a register of eligible secondary trading transferees take? How should it be populated? And who should be responsible for maintaining it?**
The Capacity Market Register (CMR) currently lists eligible transferees, including a Secondary Trading contact email/phone number, as well as confirmation of who prequalified. However, we do see additional value in having a more active register of those parties who are interested in trading. It is important to be aware that at present the ST details are company rather than CMU level specific.

If this is purely an administrative function, then we are happy to facilitate it although it will have a cost and resource impact for the DB. However, should industry be keen move to a trading platform, then maintaining a register of eligible ST transferees may sit better elsewhere.

**Q15: Do you agree that the current minimum trading threshold restricts effective management of obligations? Do you agree that decreasing it from 2MW to 0.5MW could alleviate this?**
We are supportive of any mechanism to reduce barriers to entry in the CM, noting that this will require a system change. We will continue to monitor developments linked to the Clean Energy Package (CEP) and Project Terre within the context of CM participation.

**Q16: Do you believe the current time period of 5 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 recognise that a delay of five days to process trades could be perceived as a potential barrier to making those trades in real time. To date, our experience of this type of trade has been minimal and we believe that market arrangements (i.e. volume reallocation and the penalty regime) are more aligned to longer-term trading.

Pending significant change to our IT systems to facilitate automation, coupled with a reduction in the DB's involvement in the process means that we continue to believe the current period of five working days is realistic.

**Q17: Do you believe that the current period of 3 months in which NGET 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?**
We support a shortening of the current 3-month period to assess and notify ST entrants of the Prequalification decision. Historically, although we schedule assessment around resource availability and other CM obligations, the period for completing applications has been achieved in less than the 3 months, prescribed in the Rules.

**Q18: Do you agree with adding a provision for the time frame over which NGET must respond to requests for a trade?**
Currently, we respond to all requests for a trade within five days, as per the existing Rules. Were this timeframe be shortened, then either a reduction in the level of checks undertaken by the DB or a move to fully automate our IT systems would be required. The latter would require significant change and could not be implemented immediately.

We note the level of usage for trading has been primarily focused on termination and is not related to plant maintenance issues.

**Q19: 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?**

Before the DB can assess rule changes in this area, consideration should be given specifically to:

- Whether trades should be permitted for full obligation periods (up to 15 years) from the T-4 Results Day in a single trade or whether the intention is to only permit the first Delivery Year relevant to the T-4 obligation and
- Implications for those Acceptable Transferees taking a trade for a Delivery Year that is also subject to T-1 prequalification/auction participation on a specific de-rated capacity level.

We believe that the current rule drafting proposed in Annex A, which suggests amending rule 9.2.5(a), does not consider wider implications and requires reassessment. Implementation of that change alone would, in our opinion, lead to further ambiguity in the rules. This would be counterproductive to the intent of this consultation.

**Q20 (21): Does it continue to be appropriate for transferors to be required to meet their SCM prior to engaging in trading?**
We consider this to be a policy question on the avoidance of speculative applications against the value of avoiding an unfair penalty for genuine participants. If we continue to relax the Rules we are allowing industry to make applications safe in the knowledge that there is a safety net. Albeit this carries a low risk, we consider it important to highlight from the perspective of security of supply and the original intent of the CM to contract with firm capacity.

We also consider it important to highlight the disparity between DSR and traditional generation in this regard. Unproven DSR can trade prior to being 'proven' post DSR test, whereas traditional generation must meet SCM before they can trade away their obligation.

**Q22: How should we address the risk of a trade being withdrawn where a transferor is terminated after a trade has been registered?**
We support the proposal to allow the transferred part of an agreement to continue. We agree that Regulation changes (30A) would be required to manage a change in this area. A separate Capacity Agreement Notice (CAN) is already generated for the Transferred part, which comprises associated rights and obligations on the transferee. System changes would be required to support any rule change in this area and implementation would not be immediate. To terminate the transferred part would be to add unnecessary risk of a shortfall in MW should there be a stress event.

**Q23: 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?**
As above.

**Q24: Are there any amendments that could be made to the SPD framework following a secondary trade, specifically relating to partial agreement trades?**
We believe that the current rules already support the provision of SPD's against a capacity obligation level, which may have subsequently been reduced from the original obligation due to a partial trade. Further guidance in this area would be helpful, in particular for partial obligation transfers and the number of days of SPD's to be undertaken. We recommend a wider review on the topic of ST, with consideration given to payments based on evidence of SPD provision. This area of our IT system has become complex, based on the different scenarios to be validated and so our continued recommendation is for a holistic review of how all the Rules in relation to SPDs correlate.

**Q25: 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 see significant value in the changes being proposed in relation to this question. We are in discussion as to how ESC delivery might be extended to support enhanced data flow and ultimately improve the overall SPD validation process. This will necessitate IS system changes, as part of a full SPD process improvement review.

**Q26: Which aspects of a CMU configuration do you think should not be able to be amended following Prequalification?**
Prospective CMU's have highlighted the challenges created by the current rules when making an investment decision. We believe it is timely to consider the level of assurance that is provided. We believe that Rule 4.4.4 cannot simply be amended to stipulate what cannot be changed as part of a CMUs configuration. This will create more confusion for applicants and must be considered in light of interrelated rules throughout the CM Rules document. We support the principle of change but believe a fundamental investigation rather than a blanket decision to allow change (with stipulated exceptions) is needed.

To be clear, the DB uses the term configuration in relation to the Generating Unit (CMU Component). We would welcome a clear definition of the term 'configuration' to minimise confusion in how it is applied and interpreted.

**Q27: Is there any other data that would be useful to add to the Capacity Market Register and why?**
We would be happy to work with Ofgem and industry to ensure the correct and necessary information is included in the Capacity Market Register (CMR). Any new data would need to consider at what level that data is held (i.e. CMU, component or auction application) and, as such, the data will only be available at the level at which is collected in accordance with the Rules. For new data items on the CMR, it will be necessary to review and define associated changes to the Rules to distinguish when the data items are collected and when the CMR should be updated accordingly.

DB notes that Annex A includes some administrative amendments we referenced in our response to Ofgem's open letter. In assessing the changes made to rule 7.4.1, we would also request that equivalent amendments be made for the same items in 7.5.1.

**Q28: How should the ALFCO formula be adjusted for Interconnectors when their output is affected by actions by the ESO?**
Regarding the participation of inter-connected capacity, we note that the Clean Energy Package (CEP) has already determined that a transition to the direct participation of interconnected capacity is the clear direction of travel and dates have been set for implementation. In light of this, we suggest that caution should be shown around how much change is introduced for Interconnectors since activity under the CEP will require us to rethink the interconnector model in the very near future.

Due to the nature of interconnector agreements we anticipate it will be difficult to formulate a straightforward approach which encompasses all interconnectors. Interconnectors are subject to different connection agreements; these are unique to their location and when connected to the transmission network. Therefore, any adjustment to the ALFCO formula would need to either be generic or specific to each Interconnector.

It should also be noted that any ESO action which will be financially rewarding for the interconnector means that any reductions in penalties for non-delivery during a stress event will mean an interconnector essentially gets paid twice for the same event.

**Q29: Should system to generator intertrips be included as a Relevant Balancing Service in Schedule 4 to relieve providers of their obligations when affected by such an intertrip?**
There are two types of intertrip - operational and commercial. The CM Rules allow for operational intertrips. Where an applicant has a contractual arrangement in place, they are expected to deliver during a stress event and should be penalised if they do not deliver. Generators take these contractual arrangements into consideration when entering the CM; the commercial decision and risk lies with them.

**Q30: How should we differentiate between firm and non-firm connection agreements at the Distribution level?**
There is significant challenge to endeavouring to fix a de-rating position based on all types of "non-firm" connection as each DNO has independent arrangements.

**Q31: How should Distribution-connected generators with non-firm connection agreement be de-rated to accurately account for their contribution in a stress event?**
See our response to question 30.

**Q32: Do NGET's current financial incentives on demand forecasting accuracy, dispute resolution, DSR Prequalification, and customer and stakeholder satisfaction drive the intended behaviours by NGET?**
The current incentives framework is not reflective of today's market and is no longer appropriate. We support a move to a relative rather than absolute measure for the incentives, and believe that the design of the incentives does not remain appropriate for the following reasons:

- the mechanistic approach to the **dispute resolution incentive** does not reflect the higher degree of difficulty and cost of achieving 0 overturned decisions where the volume of applications, the number of applicants and the complexity of the prequalification process and associated Rules within which we operate have all increased considerably since the incentive was originally developed;
- the **demand forecasting accuracy incentive** should be reassessed to review the demand definition utilised and to consider moving to Underlying Demand (on which the CM is based) and away from Transmission level demand, using distribution generation data from Electralink;
- the volume of **Prequalified DSR capacity** has grown over time as the DSR market has matured, which makes it difficult to delineate ESO value-add in driving increased DSR participation from other factors; and
- the **customer and stakeholder satisfaction survey** is a single simplistic metric and as customer needs and journeys differ, then process efficiency and customer satisfaction should be gauged through a set of measures that are i) specific to the DB's activities; ii) more holistic in scope; and iii) more objective (e.g. a combination of qualitative and quantitative measures).

We need strong incentives with clear success criteria to truly drive improved ESO performance and delivery of greater consumer benefits.

**Q33: Do the financial incentives listed above remain fit for purpose?**
We support the use of robust incentives to focus the DB on areas that create most benefit for consumers, driving performance above baseline expectations. Given the changes that have occurred since the inception of the CM and EMR (outlined above), it is appropriate to review the DB incentives. We consider that the incentives should be:

- more specific to the DB's activities, i.e. focusing on work areas/outputs that the DB can directly influence;
- more holistic, i.e. looking at various aspects of our customers' journeys; and
- more objective, i.e. a combination of quantitative and qualitative measures.

At present, all EMR incentives have the same upside and downside potential. In our view, there is potential for asymmetric incentives, where appropriate, especially when looking at arrangements post March 2021. Depending on

our funding model and agreed levels of return, a greater overall potential incentive upside may be more appropriate for a legally separate ESO. We need to remain financeable, but stakeholders want us to continue to have strong, realistic and transparent incentives to drive our behaviour. If we are only able to absorb a small incentive downside over the price control to remain financeable, having an overall symmetric incentive pot would limit the strength of incentives to deliver additional benefits. Positively-skewed upside incentives may be appropriate for those areas where we can deliver the greatest consumer benefits, or where they will be realised over a longer term.

**Q34: What behaviours and outcomes should NGET's financial incentives drive? What form should these incentives take?**

We consider that the incentives should be designed to reward where the ESO is driving value for the consumer and they should focus on the DB's role to ensure that:

- the appropriate amount of capacity is procured through the auctions; and
- the CM process operates as efficiently as possible for participants, within the framework set by the CM rules, thus encouraging participation and market liquidity.

In considering the individual incentives below, we set out how the incentives could be improved to better align with these two focus areas.

**Q35: Do you agree that a demand forecasting accuracy incentive remains appropriate?**

A key outcome for the EMR DB is to ensure that the appropriate amount of capacity is procured through the auctions. We therefore agree that it is appropriate to have an incentive on demand forecast accuracy. However, it is our view that the demand definition utilised for the incentive should be reviewed. Specifically, we consider that the measure should move from Transmission level demand to Underlying Demand, which the CM is based on. This would also more adequately reflect a whole system approach and a focus on end consumers.

With regards timescales, the further out a forecast is, then the more complex and uncertain it becomes and the more difficult it is to forecast accurately. The margin of error for the T-1 forecast is challenging but generally seems appropriate. However, the T-4 forecast is so far out that it would seem appropriate to review the error margin that underlies the incentive. Better access to data is key to improving forecast accuracy, especially the further out the forecast period.

Whilst data access has improved (e.g. ElectraLink data), there are still important areas where data is limited or not available, especially access to data below Transmission level. For example, ElectraLink provides distributed generation outputs but not distributed generation capacity data which would help to enhance the calculation of de-rating factors. This will become an even greater issue in the future, with the move towards more distributed and a wider range of technologies.

We agree that all ESO incentives should be aligned to ensure they are not pulling in different directions. In considering this, it is important to note that the EMR forecasting incentives focus on the medium to longer term, whereas the other ESO forecasting incentives are focused on the short term. They employ different methodologies which are tailored to their respective requirements, and there are limits, therefore, to the degree to which they can and should be aligned.

The ESO already makes its short term and longer term forecasts available to the market. As part of that, we publish the EMR methodology as well as the data, and we also publish an annual letter explaining the forecasting accuracy as well as any improvements we have made. Any licencing obligations or confidentiality requirements need to be respected.

**Q36: Do you agree that the dispute resolution incentive should be based on the proportion of Reconsidered Decisions overturned by the Authority rather than on their absolute number?**

As acknowledged in the consultation document, there are shortcomings in the way this incentive is currently defined. We agree with Ofgem that the current incentive is no longer appropriate considering changes to the CM since 2014. We support a move to a relative rather than absolute measure. Though we continue to make improvements to the assessment process, the DB can make up to 150,000 decisions annually (based on 2,000 applications); the incentive as currently drafted seems disproportionate when considered in this practical context. We look forward to engaging further with Ofgem about what the appropriate levels should be.

**Q37: Do you agree that the DSR Prequalification incentive should be replaced with an incentive intended to drive NGET to aid smaller providers, new entrants, and innovators navigate the CM?**
In considering the appropriateness of this incentive, it should be noted that policy and rules are the biggest drivers for encouraging participation of any technology in the CM. It should be recognised that this is outside the direct control of the DB. Our main lever is to make the process as efficient as possible for participants. Therefore, we consider that there should not be a separate incentive for participation of specific technologies, but instead the DB should be incentivised for operating the process efficiently. This could be measured via an enhanced customer satisfaction incentive – see below. We consider that the DSR participation incentive is no longer necessary or appropriate.

**Q38: Do you agree that an incentive on NGET's customer service and stakeholder engagement remains appropriate? What form should this incentive take?**
We consider that a key driver for the DB is to ensure that the CM process operates as smoothly as possible for participants, within the framework and rules set by BEIS and Ofgem. Process efficiency could be measured via an enhanced customer satisfaction incentive. The current CSAT score does not achieve this.

As customer needs and journey differ, process efficiency and customer satisfaction should be gauged through a set of measures that are more specific to the DB's activities, more holistic and more objective. By 'specific' we mean that the incentive should be driving outcomes or behaviours that the DB can directly influence. By 'holistic' we mean that the incentive should be based around a composite of measures that reflect the complexity of the process and the different needs and journeys that market participants have (e.g. response time to customer queries, quality of the agreement management process). To be more objective, the incentive should be more rounded and possibly comprise of a combination of quantitative and qualitative measures.

**Q39: Do you agree that the incentives on NGET for delivering the CM should be aligned with the ESO's incentive framework? Should the CM incentives be incorporated into the ESO's incentive framework in the longer term?**
In principle, we agree with the intention to bring all the ESO's incentives under one framework from April 2021. Further thinking needs to be done as to how this will work depending on how the incentives are designed. We need to ensure strong incentives with clear success criteria are designed to truly drive improved ESO performance and delivery of consumer benefits.

We understand that Ofgem will publish a consultation on the ESO's RIIO2 incentives in Summer 2019 and we will engage with this and respond with our views on how future ESO incentives should be designed.

**Q40: Does the separation of the EMR Delivery Body from the ESO continue to remain appropriate given the separation of the ESO from the rest of NGET plc?**
We broadly agree with Ofgem's position that it may be appropriate to reduce the severity of the conflict of interest mitigations once the success of the legal separation of the ESO has been established. A review of the existing ring-fence around the EMR DB seems sensible at this time. We believe that the potential conflicts of interest identified when NGET was first given the DB function cease to be a valid concern, with the legal separation of the ESO from the rest of NGET plc. As a legally separate entity, the ESO does not have an ability to exert influence over decisions made by others to favour NG plc businesses nor does it have an ability to exercise discretion in the operation of the EMR in such a way as to favour or advantage NGET and other NG businesses. We observe that an administrative (or operational) ring-fence may continue to be appropriate to ensure data confidentiality and non-disclosure of commercially sensitive information.