

## Capacity Markets – Industry Issue Resolution

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### Introduction

#### Introduction from Lesley Potts and Fergal McNamara

- This session will focus on;
  - Providing an update on the consultation process
  - A recap of where we got with the issues which were discussed on 6<sup>th</sup> December
  - Defining a CMU and how it can be applied in practice.
- This is the last scheduled Collaborative Development session however the CM Expert Group will continue into March.
- On 13<sup>th</sup> March consultation will open on the Capacity Market Settlement Body

#### Consultation Responses:

- 10 – 30 responses were received in relation to the Capacity Markets
- 4 key issues arose from the responses
  1. General issues around investability in the CM.
    - Comments related to contract length. Responses ranged from repeated auctions with one year iterations with a CM price everyone could access. The other extreme was that the contract should be up to 25 years (rather than the 10 year positioning of DECC)
    - Issues around penalties : predictability, capping, force majeure, and situational issues such as gas emergencies.
    - Issues around termination provisions and rights to remedy
  2. Governance
    - How would Ofgem go about changing CM Rules, rule change objectives and potential constraints.
    - Guidelines for the process will be developed later in 2014
  3. Simplification (complex design)
    - Anti-competitive measures were a major concern
    - Potential to increase the efficiency of the auction
    - Pre population of prequalification form
    - Certification process

4. Demand side response

- Broad support for the participation of DSR
- Transition arrangements - Guarantee at T-1 still needed at all? Or, needed in perpetuity?
- Difference in penalty regimes between BM and non-BM units.

Other areas receiving a high volume of comments and questions:

- Payment Model – comments on the billing determinant
- Credit and Settlement timeframes.
- Auction – process around the parameters, involvement of industry in assumptions, is price maker / taker needed?
- Secondary Trading – systemically important
- No support for portfolio cap
- Process – timeline for appeals seen to be too short, suggestions around Auction Monitor
- Capping of penalties seen as very important

**Questions**

**Q. Issues around storage** – Industry noted that little attention has been paid to this.

A. Next Expert Group has a Penalty Regime on its agenda and a paper is currently being developed which will address this

**Q: Consultation responses** – will the consultation responses received by DECC be published?

A: *Exact format and timing for publishing responses is being discussed. DECC will be in touch with individual organisations to agree which extracts can be published.*

**Q: Capacity to be auctioned** - When will the amount of capacity to be auctioned be published? Can we get a rough estimate of the capacity earlier?

A: In its March Implementation workshop National Grid will produce an illustrative example of the process and the type of information that will be provided using dummy numbers.

**Review of progress on issues from 6 December 2013**

**2.1 Bid Bonds**

- The issue focused on whether it was possible to have rolling credit rather than fixed term credit.
- Cheaper to have a rolling form of credit which ought to be renewable. There would need to be an overlap period for renewing the bond.
- DECC's view is this is now closed upon consent from Elexon
- There are existing processes in the BSC and CUSC for credit. The intention is that the rules for credit in the Capacity Market will be aligned with these existing arrangements which include the ability to renew and/or change forms of credit.

**2.2 Reconciliation Timing**

- Earlier discussion was that annual reconciliation would be easier than monthly reconciliation.
  - The underlying issue is two fold;
1. The rate of over delivery payments is not equal to penalty application
    - The CM Settlement Body has a budget for the year which it cannot breach. A budget breach can only be funded out of exchequer funds which would have a fiscal impact and an appearance before Parliament. Monthly symmetry is therefore needed in order to avoid cashflow imbalances at the end of the year.
    - DECC are seeking to arrive at a solution using a particular accounting treatment that will allow CMSB to apply monthly symmetry without at cashflow implication.

## 2. Issue around reconciliation

The budget balance is over a year therefore the monthly reconciliation process as already set in the BSC with subsequent reconciliation runs when new information is available will be used.

On the issue of funding the Capacity Payments to Capacity Providers

- A rate is calculated from the budget and the forecast of the billing determinants.
- A provisional bill is calculated for each supplier based on the best meter data available each month
- Reconciliations are carried out as revised data becomes available and/or when errors are corrected– all of this is BAU
- A final reconciliation is calculated when the year is over and this trues up forecasts (per step 1) and actuals – note: we are currently considering how long reconciliation should run after the end of the relevant period (eg starting 1st March).
- Over Delivery and Penalties:  
DECC is working on solving the symmetry of the penalties and over delivery RATE issue.
- Resolution of this issue will be made through the Expert Group on 7 February 2014. This paper is intended to resolve this issue. Energy UK is also working with DECC to develop solutions to managing penalty risks where symmetry cannot be achieved on a monthly or annual basis.

## 2.3 Market Share

- Discussion around Peak load pricing
- An Expert Group paper to be published proposed recovering the CM revenue between 4pm – 7pm on winter days – see publication at the following link: <https://www.gov.uk/government/policy-advisory-groups/capacity-market-emr-expert-group>
- The Expert Group proposed some changes to the timings for peak load calculations (for example from seven days a week to Monday – Friday)
- Issue to consider – what will happen if smart meters are not rolled out?

## 2.4 Balancing Services and Performance Testing

- Capacity Providers must prove that they can operate at their de-rated capacity for three 30 minute periods over the winter months. There might be an issue if any of NG's balancing services contracts prevented a capacity provider from generating at their full capability in every half hour period throughout the winter.
- Currently no contracts constrain a Capacity Provider in this way. If however a contract form were to be introduced with this constraint, allowances would be built in to allow a Capacity Provider to demonstrate their capacity.
- Not viewed as a huge issue at the moment

## 2.5 Publication of Data

There will be three points in time that DECC will have information which they may wish to publish. The current proposal for data sharing is;

### 1. Following prequalification:

- Who's qualified for the auction and at what de-rating, and whether as existing, new or refurb – but not whether they qualified as price maker or taker)
- How much capacity has opted out and will be deducted from the demand curve
- How much capacity has said it will be retiring / unavailable (and so not deducted from the demand curve)

### 2. During the auction

- How much spare capacity there is at each round (rounded to nearest [100]MW)

3. After the auction
  - How much spare capacity there was in each round (unrounded) – but not the price at which individual units exited
  - Who received contracts and at what de-rating/contract length
- An Industry participant asked the rationale for not publishing Price Maker / Taker status? Other industry members felt that this would be commercially sensitive information
- Discussion focused around whether or not to publish Opt Out status. Final decision that there would be no harm in publishing this information as industry could deduce this from the other published information.

| CMU Issues   |
|--|
| <p><b>Introduction</b></p> <ul style="list-style-type: none"> <li>- In the proposals to date, the aggregation specifications have not worked and they would result in unintended consequences which exclude some CMUs.</li> <li>- The aim of this session is to decide what the appropriate level to define a CMU is and can we make sure this works for data provision</li> </ul>   |
| <p><b>3.1 Definition of a CMU</b></p> <ul style="list-style-type: none"> <li>- Comment from industry: “We know what is required but the prescriptive rules may not account for all configurations. Therefore a pragmatic set of arrangements are required so that a CMU can be defined by reference to what would “normally” be expected to be a CMU. This may require some sort of adjudication body”</li> </ul>                  |
| <p><b>3.2 Linking CMUs</b></p> <ul style="list-style-type: none"> <li>- Comment from industry: “How are CMUs linked together both for the purpose of definition (e.g. the TEC is defined at a power station level and the CEC at a unit level – how should this be allocated) and for the purpose of allowing linked bids in the capacity auction (without undermining the intent of the CMU related bidding approach)”</li> </ul> |
| <p><b>3.3 CMU Eligibility</b></p> <ul style="list-style-type: none"> <li>- Comment from industry: “once a CMU is defined we need to consider how the party responsible for the CMU determines its eligibility in the Capacity Market. This eligibility process should be independent of the CMU definition”</li> <li>-</li> </ul>  |
| <p><b>3.4 Relevant Questions</b></p> <p><b>1. Should the CM design allow for applicants to choose the scope of their individual CMUs (e.g. aggregation of several BMUs), rather than adopting a prescriptive approach? Or would a default position applying at the Trading Unit level, minus any RO/CfD supported capacity, be more appropriate?</b></p> <p>Responses:</p>   |

- One industry table group highlighted that a CMU being equal to a BMU unit would not work due to issues around station load
- There needs to be flexibility subject to complex definitions – need industry experts to verify this to ensure people are not playing the system.
- Needs to be appropriately metered
- Some considered that it would be helpful to have a default definition. Changes or alterations to these definitions would come with several caveats;
  - Would need to be on the same site and physically connected
  - Would not need to be the same fuel type
  - Would be able to aggregate up subject to trading unit cap
  - If there was no BMU unit then would need an applicant defined quasi BMU. This could be National Grid ancillary service agreement definition
- If you have consumption it must be allocated proportionally (metered output basis)
- Some considered that the way forward was to give choice on how to group units.
- It was suggested that a trading unit with mixed technologies would be appropriate.
- A flexible testing mechanism would need to be in place where several BMUs have been aggregated

#### Conclusions:

- All three of the tables showed a clear steer towards flexibility and aggregation
- Nuances around treatment of technical issues. For example, station load and consumption BMUs should be allocated to those generation BMUs which need it.
- Flexibility to aggregate up – more thought needed on the entity level one could aggregate from and to, for example to a trading unit level.
- Default position = BMU with refinements as starting point. Verification and arbitration role (if this is necessary could it be done via the Imbalance Settlement Group or Expert Group and would require BSC change. The Rules would need to be updated to include a statement saying that the group's decision is binding – process questions arise from this).
- Set of rules and choices via an agreed decision tree

### 3.4 Relevant Questions

#### **2. Where relevant, should the constituent BMUs that an applicant wishes to aggregate as a CMU have to be physically located at the same site, be of the same fuel type and status (new/refurb/existing) and have a common BSC lead party?**

##### Responses:

- The participants consider that the benefits of flexibility must not outweigh the costs.
- The consensus was that certain variables either could or couldn't be aggregated to the CMU level
- Things which could not be aggregated include:
  - Contract length
  - Status (prospective generating plant versus existing generating plant)
- Things which could be aggregated include:
  - Sites, although there is some difference in view across industry as to the scope of a site. For example some participants considered it should stop at the trading unit level. Participants noted that for CDR and DSR sites will invariably be apart.
  - Technologies
  - Fuel types (with weighting)

Participants noted additional complications regarding refurbishment, and the contractual obligations that this would entail.

### 3.4 Relevant Questions

#### 3. Does this provide parity between parties with different sized portfolios of BMUs?

Responses:

- Would prescriptive limits be in place for aggregating up and down? Not unless there was a reason for these
- CM should admit aggregate units which are of the same order as in the BSC.
- There may be an impact on secondary trading which would need to be taken into consideration.

Conclusion:

- There are no unintended consequences at a portfolio level of the proposals

### 3.4 Relevant Questions

#### 4. What would be the most appropriate measure of capacity for centrally de-rating such an applicant-specified CMU?

Responses:

- Policy should take into consideration the objective of the de-rating, whether it's to calculate capacity for security of supply purposes or payment purposes.
- All of the current consulted definitions were considered to be inappropriate to DSR and CDR
- Derating should reflect expected use of the transmission system in the future delivery year. All the options listed on the slides were considered inappropriate. These were;
  - Registered capacity
  - Connection Entry Capacity
  - Transmission Entry Capacity
  - Generation Capacity
  - Rated MW

Two options raised by participants were;

1. BMU Output Max – each max BMU de-rating would be aggregated to create a CMU max de-rating. Possibility to self-declare below CMU max in order to accommodate potential decreased load for specific BMUs
2. Option 2 is equivalent to above but is based on historic output combined with self declaration; “nominate and justify”. This could include a percentage of tolerance around a declared figure. Using historical data would work for existing plants but not for new plants. New plants would need to justify their self-assessment.  
Others considered that this option should be amended slightly so that all plants start out at a default de-rating based on a particular methodology (which could differ for new and existing plants). There would need to be an appeals mechanism in case the default was inappropriate. The appeals mechanism would need to be in the Rules and Regulations and appropriate Secondary Legislation

Conclusion

- No clear consensus
- Sway towards measuring capacity based on historic output with self-declaration
- Requires elements of flexibility
- Simon stated that these options would be further considered and taken to the expert group.

### 3.4 Relevant Questions

#### 5. What would be the equivalent level of flexibility for non-BM capacity? Having the ability to aggregate up from the level at which National Grid ancillary service contracts are held?

Responses:

- The minimum level is a solution that could use the current settlement rules in terms of metering requirement.
- Others considered that in principle any solution should be demonstrable and controllable as an entity at CMU level
- Others considered that geographic equivalents may be a principle to take into account in any solution
- Any balancing services delivered could take into account historical data, testing and the principle of nominate and justify.
- DECC considered that this would be best taken forward by the expert group.