

Consultation on Possible Models for a Capacity Mechanism

Response form

Responses are welcome by email or post. You may find this document helpful for structuring your response, but can reply in a separate document if you prefer. If replying in a separate document please make clear which questions you are answering.

Respondent Details	
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Tick this box if you are requesting non-disclosure of your response. ☐

Please return by 4 October 2011 to:
<p>Department of Energy & Climate Change, Electricity Market Design – Security of Supply 4th Floor, Area D 3 Whitehall Place, London, SW1A 2AW</p> <p>You can also submit this form by email to: DECC.capacity.mechanism@decc.gsi.gov.uk</p>

Consultation questions

Note: the references in square brackets refer to page and figure numbers in the consultation document where more information can be found, and the questions are set out in context. The consultation document is Annex C of the Electricity Market Reform White Paper, and is available here:

http://www.decc.gov.uk/en/content/cms/consultations/cap_mech/cap_mech.aspx

Targeted mechanism

Consultation question [page 167]	
1	Does this table [see Figure C3] capture all of your major concerns with a targeted Capacity Mechanism? Do you think the mitigation approach described will be effective?
Response	<p>No. As mentioned in our original response we are concerned that the proposals are looking at how to meet system peaks rather than a lack of availability driven by lack of intermittent generation. We are also concerned that DSR is being thought of only in terms of current industrial contracts rather than a genuine market where aggregators could play a role using Distribution network embedded demand response or on site generation. The emphasis on fixed offers made well ahead of real time probably excludes a lot of DSR, as it does interconnection and storage. A more flexible approach is required.</p> <p>Finally, we feel the interaction between the capacity market and FiT with CFD market has not been properly thought through. We also note that there has been no consideration of constraints caused by location thus rendering the plant as unavailable.</p>

Consultation question [page 168]	
2	How long should the lead time for Strategic Reserve capacity procurement be and why?
Response	This would have to be a variable approach. For example procuring DSR could be done almost to real time, where as a strategic reserve requiring the building of flexible plant would need to be procured over a long time.

Consultation question [page 168]	
3	Should the length and nature of contracts procured by the Strategic Reserve procurement function be constrained in any way?
Response	Yes. There should be an emphasis on procuring capacity that is as low carbon as possible. Ideally only zero carbon plant should be procured. As stated above, contracts should be flexible enough to allow intermittent sources to be used, either generation or DSR.

Consultation question [page 169]	
4	Which criteria should providers of Strategic Reserve be required to meet?
Response	<p>All Strategic reserve must deliver low carbon capacity. The fact that it “may” be used sparingly does not justify ignoring the need to decarbonise energy production.</p> <p>Flexibility of availability should be allowed, especially for DSR where the procurement executive can mix and match different portfolios to maintain a minimum amount of capacity over a portfolio of options.</p>

Consultation question [page 169]	
5	How can a Strategic Reserve be designed to encourage the cost-effective participation of DSR, storage and other forms of non-generation technologies and approaches?
Response	<p>Flexibility is the key. A lot of DSR is deterred by the need to commit firm reductions if called many months if not years in advance. If the procurement function can use a mixed portfolio of DSR providers to guarantee that a certain amount will be available when called, this could encourage more people into the DSR market.</p>

Consultation question [page 175]	
6	Government prefers the form of economic despatch described here. Which of the proposed despatch models do you prefer and why?
Response	<p>We do not believe a targeted approach will work, but believe that economic despatch is preferable for the reasons mentioned.</p>

Consultation question [page 175]	
7	How would the Strategic Reserve methodology and despatch price best be kept independent from short-term pressures?
Response	<p>By ensuring that any change to the methodology can only be implemented should it meet an agreed set of criteria, such as those in place for BSC modifications.</p>

Consultation question [page 175]	
8	Do you agree that a Strategic Reserve should be periodically reviewed? If so, who would be best placed to carry out the review and how often should it be reviewed?

Response	Yes. Strategic reserve should be kept under constant review, however it is unclear how any such review would handle a reduction in reserve if it is overly dependant on long term contracts.
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Consultation question [page 176]	
9	Into which market should Strategic Reserve be sold and why?
Response	Without a clear understanding of how Ofgem intends to reform market liquidity and cash out arrangements it is not possible to answer this question.

Consultation question [page 178]	
10	Do you have any comments on the functional arrangements proposed for managing a Strategic Reserve?
Response	The functional arrangements must be transparent and operate to published specifications. This is essential to secure both investment and the smooth operation of the market.

Consultation question [page 179]	
11	Given the design proposed here and your answers to the above questions, do you think a Strategic Reserve is a workable model of Capacity Mechanism for the GB market?
Response	No. The concept that a strategic reserve can sit out side the market and not impact the operation of the market is unlikely to be the case. If the market knows there is a reserve then it creates a barrier to more generation being built, and thus the use of that reserve more often than anticipated. Given the inference from para. C2.41 that most strategic reserve will be unabated carbon based, this is not acceptable.

Market-wide mechanism

Consultation question [page 182]	
12	How and by whom should capacity in a GB market be bought and why?
Response	Capacity must be bought by a central body. In a competitive supply market, customers can change suppliers and suppliers can enter or leave the market. This would lead to inefficiencies and potentially a shortfall. A central body could forecast demand nationally, as it will not be impacted when customers change suppliers.

Consultation question [page 183]	
13	What contract durations would you recommend for a Capacity Market?
Response	A central purchasing body should have the flexibility to offer a range of contract durations. Long term to encourage new plant, although potentially daily for DSR. This would allow the portfolio to be adjusted as forecast in the near term get fine tuned.

Consultation question [page 184]	
14	How long should the lead time for capacity procurement be? Should there be special arrangements for plant with long construction times?
Response	Flexibility should be the key, so that a diverse portfolio can be kept. There should be special arrangements for plant with longer construction times, but only if it delivers reliable non-carbon energy, e.g. Tidal arrays.

Consultation question [page 185]	
15	Should there be a secondary market for capacity? Should there be any restrictions on participants or products traded?
Response	Yes. This will encourage greater participation from DSR and storage.

Consultation question [page 186]	
16	What are the advantages and disadvantages of making a central, administrative determination of (i) the capacity that can be offered into the market by each generator; (ii) the criteria for being available; and (iii) the penalties for non-availability? In outline, how would you suggest making these determinations?
Response	Whilst independent verification of capacity and availability is important, it must be done using a robust methodology and verifiable data. This may be problematical for new sites where such data is lacking. Penalties for non-availability must reflect the technology, so that non-availability by a gas CCGT is more onerous than that for DSR for example (with prices reflecting this mismatch in penalties).

Consultation question [page 191]	
17	How should the reference market for reliability contracts be determined and what would be an appropriate reference market if it is set by the regulator? How could any adverse effects of choosing a particular option be mitigated?

Response	Any reference market must be transparent in order to work. That is why other examples of reliability market in electricity work in a Pool like environment. The UK market is currently illiquid and opaque and as such there is currently no suitable market to be designated as the reference market.
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Consultation question [page 192]	
18	For a Reliability Market, how should the strike price be determined? If using an indexed strike price, which index should be used?
Response	This would be very difficult in an opaque market structure. If a significant amount of generation is funded through FiT with CFD, then the strike price is even more complex as the market price for generators is about their variance to the FIT CFD strike price.

Consultation question [page 193]	
19	For a Reliability Market, what level of physical back up (if any) should be required for reliability contracts and how should it be monitored?
Response	This should be de-rated capacity. Without physical back up, then speculators could enter the market, if they failed to deliver, then they would face a financial penalty, but the UK would still face a shortage of capacity leaving the Government to explain why this has happened. Although basing it on de-rated capacity could cause more generation to be built than actually necessary.

Consultation question [page 194]	
20	Do you agree that a vertically integrated market potentially raises issues for the effectiveness of a Reliability Market? If so, how should these issues be addressed?
Response	Yes. This can be mitigated by a central body procuring capacity rather than suppliers. This way, the industry collectively procures capacity and thus removes an option to game. It also means that procuring capacity does not act as a constraint on new market entrants in either supply or generation.

Consultation question [page 195]	
21	What could we do to mitigate interactions between a Capacity Market (especially if a Reliability Market) and Feed-in Tariff with Contract for Difference without diluting the effectiveness of either?
Response	As part of the FiT with CFD then a central body will be responsible for deciding how much generation is required from each technology. If, as part of this deliberation the central body was to take account of the capacity requirements and an element of the capacity payment available to the

	generator could be included in the calculation, then it is possible to bring forward sufficient plant. For example, a generator could apply for funding through FIT with CFD at a strike price for actual energy and for capacity. Reliable plant could bid a low energy strike price and focus on capacity strike price to make up the shortfall, where as intermittent plant could bid a higher energy strike price, believing they had limited potential in the capacity market.
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Consultation question [page 196]	
22	How can a Capacity Market be designed to encourage the cost-effective participation of DSR, storage and other non-generation technologies and approaches?
Response	The key to encouraging DSR, storage and non-generation technologies is to look at contracts been offered closer to real time and for short durations.

Consultation question [page 199]	
23	Do you have any comments on the functional arrangements proposed for managing a Capacity Market?
Response	No. The proposals are sensible.

Consultation question [page 199]	
24	Do you think that a trigger should be set for the introduction of a Capacity Market? If so, how do you think the trigger should be established, and how should it be activated?
Response	Yes. The trigger should be transparent using available data. This way investors should be able to forecast whether the trigger is likely to be operated at some point. If the market works correctly, then this trigger should not need to be activated.

Consultation question [page 199]	
25	What is the most appropriate design of Capacity Market for GB and why?
Response	<p>This is impossible to answer without greater detail on how FIT with CFD will work, how Ofgem proposes to improve liquidity and any changes to the cash out arrangement.</p> <p>Only once these changes are sufficiently understood, can a decision be made on the most appropriate type of capacity mechanism, although both options proposed do not seem to be focused on the need to have capacity</p>

	<p>available at the times when intermittent generation is at a low, but seem focused on times of system demand peaks. Additionally, a reliability market has never been implemented outside a pool style market, something that seems to be underestimated in the proposals.</p> <p>We Believe that the Government should consider extending the remit of NGC's STOR arrangements as we believe this could also provide the necessary results without creating a whole new market.</p>
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Capacity mechanism Assessment

Consultation question [page 210]	
26	What are your views on the costs and benefits of a Capacity Mechanism to industry and consumers?
Response	Any capacity mechanism needs to be flexible enough to encourage significant demand side response including aggregators. A mechanism that does nothing but provide an income stream to fossil fuel generators to sit on stand by would show a lack of commitment to decarbonise the energy market.

Consultation question [page 211]	
27	Which Capacity Mechanism should the Government choose for the GB market and why?
Response	As stated above, without a clearer understanding of FIT with CFD, liquidity changes and cash out arrangements it is not possible to decide if any mechanism is needed nor which one should be developed in any. We also believe that the Government has not fully evaluated the option of extending the current STOR arrangements.

Please select the category below which best describes who you are responding on behalf of.

- ☐ Business representative organisation/trade body
- ☐ Central Government
- ☐ Charity or social enterprise
- ☐ Individual
- ☐ Large business (over 250 staff)
- ☐ Legal representative
- ☐ Local Government
- X Medium business (50 to 250 staff)
- ☐ Small business (10 to 49 staff)
- ☐ Micro business (up to 9 staff)

- ☐ Trade union or staff association
- ☐ Other (please describe):

Thank you for taking the time to let us have your views.

The Government does not intend to acknowledge receipt of individual responses unless you tick this box. ☐

