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Capacity Market – enforcement, dispute resolution and information flows

Section 1 - Summary

1. This paper builds on previous submissions to the Expert Group regarding the design of scheme penalties (section 2) and dispute resolution processes (section 3). It also sets out indicative thinking on transparency and information flows in relation to the Capacity Market (section 4).
2. The proposals are being presented at this stage to provide confidence to key stakeholders that issues are being considered in a holistic manner and to provide the opportunity for feedback to be considered as part of the emerging thinking. It is, however, recognised that the final details are dependent on the broader design of the Capacity Market.
3. It is recommended that the Expert Group:
 - **Agree** the proposal that no new significant processes will be necessary for the enforcement of the Capacity Market's obligations.
 - **Agree** the recommendation that appeals against issues of rights/entitlements are resolved via a new tiered approach, whilst appeals against enforcement action are resolved via existing processes.
 - **Note** that transparency is the most appropriate ethos for dealing with information flows, with limited exceptions, and that existing information systems should be utilised where available.

Section 2 - Capacity Market scheme penalties¹ and enforcement

4. A benchmarking and mapping exercise has been undertaken to identify the enforcement processes in the current energy market and the types of penalty that could potentially be utilised in the Capacity Market. As a result of this gap analysis it is proposed that no new significant processes need to be put into place to address compliance with obligations and duties in the Capacity Market. The following sections consider each obligation by grouping them together according to which existing procedures may be appropriate.
5. Note that as part of these exercises and this paper, we have considered all enforcement processes and penalty types in the mechanism to ensure a comprehensive analysis, including those proposed under pre-qualification and

¹ The term 'penalty' is used throughout this paper to refer to all consequences of not meeting obligations imposed through participating in the Capacity Market.

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the penalty regime. However these are not its main focus given they have previously been discussed at length. We also recognise that some of the following proposals may not necessarily be suitable for demand side response participants and further work is being developed to consider these.

Obligation to meet pre-qualification criteria

6. There will be no penalty applied to not meeting this obligation – potential capacity providers unable to meet the prequalification criteria will be ineligible to bid into that specific auction. In addition it is proposed that licensed generators failing to submit a pre-qualification response will be subject to licence breach proceedings by Ofgem - subject to the final decision on whether participation in the pre-qualification stage is mandatory for licensed generators.

Obligations particular to new build capacity providers

7. These obligations cover new build providers detailing their status to the System Operator (SO) after they are in receipt of a capacity agreement and in the run-up to the delivery year. This will include details of whether providers are meeting year out critical path points and the final “go-live” date. We propose that the decisions on whether these obligations are met could be determined by the System Operator using its current processes for connecting new plant onto the transmission system. New build would start receiving capacity payments once the SO has issued an Energisation Operational Notification (EON) confirming its readiness to provide capacity; prior to issuing of the EON, no capacity payments will be made. If a provider has not been issued an EON by their Long Stop Date their capacity agreement will be terminated. Further consideration is being given as to whether it is appropriate or necessary to levy a termination fee.

Obligation to deliver electricity/reduce demand during stress conditions

8. Financial penalties will be applied for providers failing to deliver to the level of their adjusted capacity commitments at times of system stress. The SO would determine where financial penalties are applicable for non-performance.

Failure of System Operator administered test

9. Such testing of plant would be used by the SO in exceptional circumstances to confirm a provider’s ability to supply reliable capacity, particularly in the event where they may be holders of a capacity agreement but had not delivered energy for a period of time. Penalties for failing a test would be the suspension of capacity payments until the provider was successfully retested, and the imposing of a monetary penalty as though the provider had been called upon to deliver

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capacity under stress conditions. The imposing and enforcement of penalties would be administered by the SO.

Obligation to provide accurate and timely information

10. There are two issues with the provision of information in the Capacity Market: whether information is provided when requested; and whether the information provided is accurate.
11. Breaches of the obligation to provide information in a timely manner could be enforced through a sliding scale of penalties with the severity of the penalty increasing depending on how overdue the information is; the details of this approach are still to be worked through. It is proposed that the SO would be the primary enforcement body, given it is likely that the SO would be requesting this information for the operational aspects of the Capacity Market.
12. It is proposed that failures to provide accurate information could in the first instance be handled through the SO's current processes for validating data received from generators for operational and business needs. This validation process involves the SO identifying any missing data and numbers that look out of line with normal submissions, contacting generators whose data fails these checks in order to obtain further information.
13. In addition it is proposed that an obligation to provide accurate information for the purposes of the Capacity Market's efficient operation could be introduced through an amendment to the Electricity Act 1989 and the expansion of its definition of 'relevant requirements' on licensed generators. Under such circumstances Ofgem's existing enforcement powers could be used for more persistent and serious breaches of the obligation. This relevant requirement would also apply to non-licensed participants as there is a provision in the Capacity Market clauses of the Energy Bill for requirements in relation to capacity agreements to be imposed on persons other than licence holders.

Obligation on providers and supplier to make payments within agreed timescales

14. Separate work on payment flows has proposed that payment processes would follow a similar model to industry codes such as the Balancing and Settlement Code and many of the processes of enforcing this obligation would be the responsibility of the Settlement Agent. In the case of monetary penalties being imposed on capacity providers for non-delivery at times of system stress, payment would be drawn from future payments due to them in order to meet the

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obligation to pay any penalties owed within an agreed timescale. For suppliers, any non-payment of due costs would be a code and licence breach (since all suppliers in the Capacity Market will be licensed) and therefore Ofgem would be the enforcement body. The Settlement Agent will operate prudential requirements for any credit it extends to a party.

Obligations to do with the prevention of gaming

15. We are continuing with work to further define this issue, but we believe that any breaches of these obligations could be enforced through existing legislation, in particular UK and EC competition and consumer protection law, the enforcement body for both being Ofgem, as it is within the current market. Under the Competition Act 2002 Ofgem has investigative powers, can apply for enforcement orders and impose fines of up to 10% of business worldwide turnover. Among its powers under the Enterprise Act 2002, Ofgem can make a market investigative reference to the Competition Commission and make application for enforcement orders.
16. Ofgem's existing powers under REMIT may also be appropriate for enforcement under this obligation and we are continuing with further work on this to assess its suitability. Ofgem is responsible for enforcing the key provisions of this legislation, including addressing market manipulation and insider trading.
17. We also propose that, since there is the potential to game the Capacity Market through the provision of information intended to mislead, breaches of this obligation could be enforced through making provision of accurate information a relevant requirement under the Electricity Act as described above in paragraph 13.
18. Having considered existing processes in the electricity market, it is proposed to use these as described above and that no new significant processes will be necessary for the enforcement of the Capacity Market.

19. Question - Does the Expert Group agree that the existing processes identified are appropriate for the enforcement of the Capacity Market as described above? Are there any areas in the processes that may not be suitable for mapping across?

Section 3 - Capacity Market Dispute Resolution Process

20. Following an internal review of the existing appeals mechanisms available in the energy market and an analysis of the potential requirements for resolving

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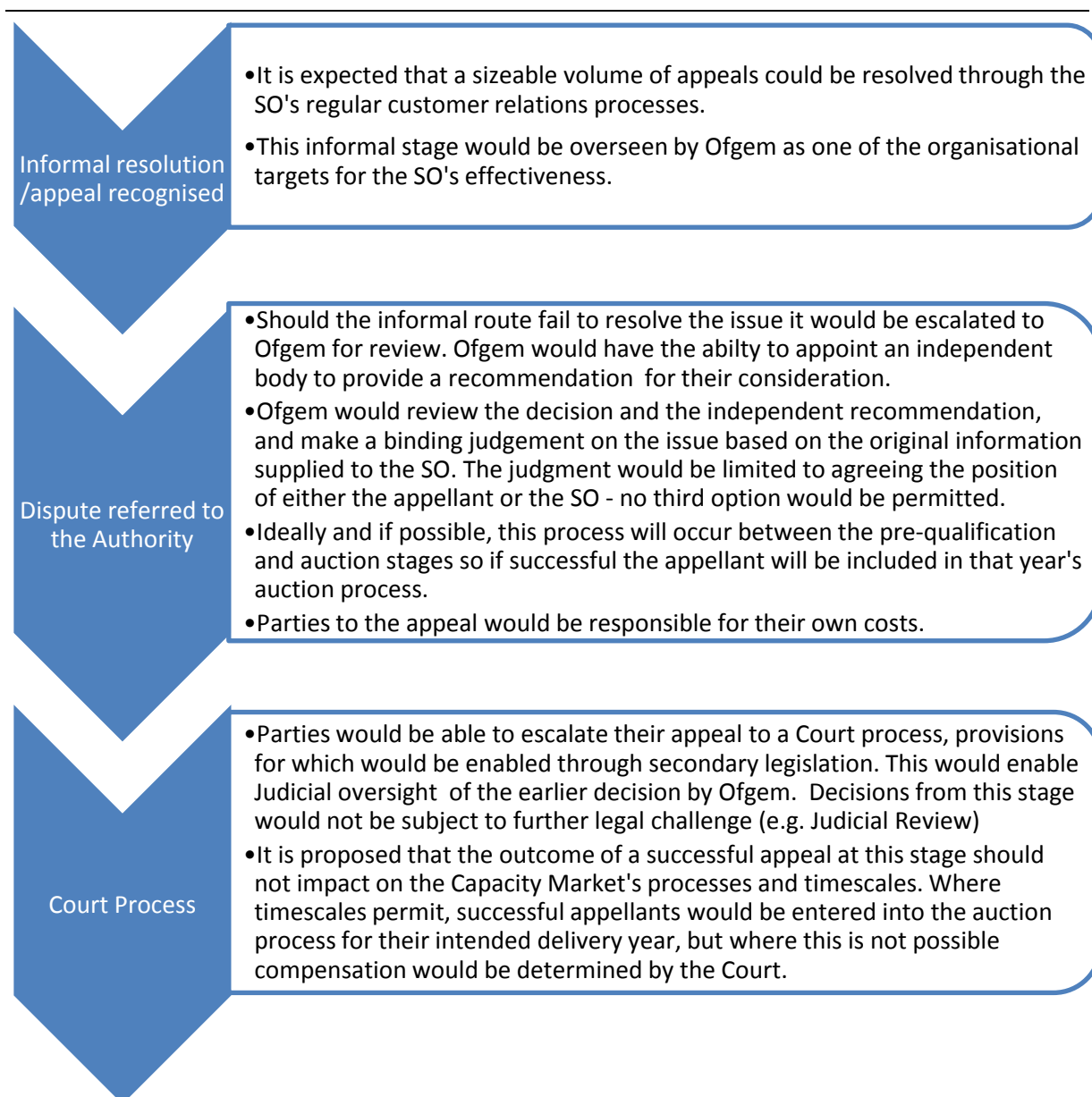
disputes within the Capacity Market, it is proposed that there are two fundamentally different categories of appeals which will require different processes to deal with them.

21. Appeals against an issue of rights and entitlements. This is viewed as primarily a decision taken regarding the pre-eligibility criteria and the application of a de-rating factor to a plant.
22. Appeals against matters of enforcement. For example the application of a penalty for failure to delivery during a stress event or to provide requested information.

Appeals against issues of rights and entitlements

23. Appeals in the first category will perhaps be the more difficult to resolve and are likely to be potentially contentious due to the potentially non-mechanistic elements upon which they are likely to be based. The implications of a successful appeal in these cases could be far reaching throughout the Capacity Market and the timescales associated with their resolution more critical.
24. It is therefore proposed to specify a new, tailored, fit for purpose process, detailed below, based around a three-tiered approach; tier one would involve an informal resolution stage with the System Operator, tier two a formal appeal to Ofgem, who could utilise independent resource to recommend a resolution, and tier three would involve determination by a Court.

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25. Question - Does the Expert Group agree in principle with the process as outlined above, accepting that precise details will only be possible when further design proposals are finalised?

26. The proposal for a tiered approach enables appropriate escalation over the course of the appeals process. It is also expected that the volume of live appeals would decrease through each stage, given the earlier justification of decisions by both the System Operator and Ofgem – the latter utilising independent technical expertise.

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27. The proposed third tier (Court stage) would satisfy the European Convention Human Rights (ECHR) requirement for recourse to a Judicial review process for a decision made by a public body. The principle rationale for specifying a Court based route, rather than enabling a Judicial Review, is that typically Judicial Reviews do not award compensation in cases but force a retaking of the original decision. While in some ways this would be desirable, the interaction with wider Capacity Market processes and timelines could cause significant upheaval and uncertainty should an auction either need to be postponed significantly or re-run.
28. It is expected that any resultant compensation payments would be recovered from suppliers' capacity payments, and ultimately consumers.
29. Under the current design there is a relatively short time window between the pre-qualification and auction stages to enable decisions made in the former to be challenged by the start of the latter. This window will be particularly narrow, by necessity, to enable the first auction to run in 2014 if so desired. This means that there is a risk that the determination of an appeal would not be made until after the auction for that delivery year has run.
30. In this case it would be unsatisfactory to re-run that auction, given the associated uncertainty for wider participants. Alternatively, purchasing extra capacity in the auction to cover volumes under appeal would have wider implications for the year-ahead auction and the expected revenues for the other Capacity Market participants. It is proposed that the first two tiers of appeals should be able to resolve any live appeals within these timescales, and it is recommended that financial compensation be provided for any live appeals still outstanding at the Tier three (Court) level which cannot be resolved within a short enough timescale to enable the appeal volume be included in the auction for that particular delivery year.
31. Question - Does the Expert Group agree that where it is not possible to resolve a pre-qualification appeal prior to the auction, that some form of compensation should be awarded as the implications of delaying the auction or overturning one already carried out are too detrimental to the running of the Capacity Market?
32. The intermediate (Tier two) step of Ofgem acting as an appeals body should allow for the timescales and costs of an appeal to the pre-eligibility process to be kept down for appellants. This will not only be beneficial for the smooth running of the Capacity Market but should also allow smaller players to access the appeals

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process given judicial processes can be significantly more time consuming and costly.

33. The cases where we feel this procedure would be appropriate are:

- Pre-eligibility disputes
- Application of a de-rating factor

34. Question - Does the Expert Group recognise any other areas which it feels would be best dealt with under this appeals regime?

Appeals against matters of enforcement

35. The second category of potential disputes relates to decisions regarding enforcement action and the resultant application of penalties. It is proposed that there are existing processes and legal vires to deal with appeals against such mechanistic decisions, although some may require modification to ensure their applicability to the Capacity Market.

36. The exact process to follow may depend upon whether the decision comes about through codes or regulations and which is the enforcement body for the decision. For example, Ofgem has enforcement powers over various obligations on licence holders introduced through the 'relevant requirements' provisions of the Electricity Act 1989 (e.g. chapter 29). While it is recognised that not all Capacity Market participants will necessarily be licence holders, it is likely that this remit could be expanded to incorporate them – as referenced in paragraph 13.

37. Subsection 27E of the aforementioned Electricity Act provides for an appeal to these decisions which would be heard through the courts (not via a Judicial Review). While this would not cover all potential Capacity Market participants or situations, we intend to 'hook' into this and other similar processes and potentially expand the definition to suit our needs without impacting on existing market practices.

38. In such cases, the consequence of appeal will normally be expected to be for the original decision to be undone; for example should a party be penalised for failure to provide capacity during stress conditions and this decision later be revoked, their fine would be cancelled and any monies already paid would be returned.

39. Question - Does the Expert Group agree with the principle suggested here, that existing processes will be used (with modification where required) to deal with these more mechanistic appeals / disputes?

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Consequences of Disputes

40. It is proposed that the lodging of an appeal, as confirmed by a receipt acknowledgement from the relevant appeals body, would suspend the enforcement action being appealed (e.g. payment of a financial penalty) with immediate effect, pending the appeals resolution. It is not proposed, however, to suspend the associated Capacity Market processes, for example the pre-qualification or auction processes. This would allow the Capacity Market to operate effectively (particularly for its first run) and avoid consequences from having effects on other market players.
41. As previously briefed, the only recourse to appeal secondary legislation itself will be through Judicial Review. Equally any decision made by the Secretary of State through provision in secondary legislation would only be subject to appeal through Judicial Review.

Section 4 - Capacity Market's information flows

42. This section presents the current thinking on how the Capacity Market's information flows will be treated, specifically:
- the rationale for information transparency;
 - what information is needed;
 - who should collect data;
 - how data should be collected and stored;
 - who should have access (in addition to the collector); and
 - whether it should be published.
43. It is proposed that the Capacity Market should be as transparent as possible, making as much information public as appropriate and/or useful for market participants. The basis for this is that it can help to create a competitive market environment by minimising asymmetry of information, and real or perceived conflicts of interest.
44. It is acknowledged, however, there may be certain circumstances where it would be prudent to withhold information, for example due to commercial sensitivities, duplication of existing data flows and enforcement issues. The interaction with the legal obligations of public bodies regarding data protection and freedom of information is under consideration.

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45. A high-level data mapping exercise has been undertaken to identify existing information systems, what information is needed for the efficient operation of the Capacity Market, who should collect the identified data, how it should be collected and stored, who should have access and whether it should be published. A brief summary is set out below:
46. **System Operator's existing arrangements** – National Grid publishes information on its website, for example, on generation connection information, balancing services (including reports on tenders), proposed amendments to codes, and has existing systems to manage the auctioning of gas transmission capacity. National Grid also capture data on metering, as a requirement of the Grid Code, and this is published on the Balancing Mechanism Reporting System (BMRS). Generators are also required by the Grid Code (Section OC2) to provide information to the SO on plant availability. A web based system, Transmission Outage, Generation Availability (TOGA), has been developed to enter and store this data.
47. **What information is needed?** – pre-auction information is needed *inter alia* on capacity forecasts, the condition of plants and the levels of plant reliability. Information will also be required to ensure providers meet pre-qualification standards, for example historic generation levels, TEC status, development timelines and business case justification data. Post auction the information needed primarily relates to the trading of agreements in advance of the delivery year, as well as the levels of capacity and incentive/penalty payments.
48. **Who should collect data?** – the SO already collects much of the data identified above and will need to continue to do so in order to advise Government e.g. on the volume of capacity to contract for. There are however some areas where processes/requirements for information, such as new plant milestones or financial data, could be strengthened through secondary legislation/codified requirements. The settlement agent will also play a key role in the delivery and payment of the Capacity Market and so there must be provision to allow it to collect specific information from participants.
49. **How data should be collected and stored?** – the SO has existing processes which may be appropriate for running the Capacity Market. There are also existing systems used for BSC settlement which may provide a framework on which to base the Capacity Market's settlement arrangements. Further work is needed to understand how synergies can be exploited and where modifications are need to existing systems. In general, it is proposed the collector of the data

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should also store the data, this is to avoid additional storage costs and unnecessary transfer of information and potential leakage, as some of the information will be commercially sensitive and should therefore be aggregated before publication.

50. **Who should have access** (in addition to the collector)? – this category has the largest spread of potential bodies through which information could be shared. In general terms, it is likely that Ofgem and Government will need access to data to ensure the Capacity Market operates in the most efficient way possible e.g. monitoring; taking decisions on the volume of capacity to contract. There are other specific cases where suppliers/industry, the possible settlement agent, the Panel of Technical Experts and the enforcement body (for appeals) may need access to information. Further work is required to examine the exact nature of data required and its form (aggregated/disaggregated) and how this can be done securely. However, the greater the number of bodies which have access to information, the greater the risk of errors when transferring information; of leakage where data needs to be kept confidential; and potential gaming.
51. **Whether it should be published** – using the principle of transparency as set out above, and given the existing arrangements where much of the information collected is already published by the SO (as part of the Grid Code and/or good practice), it is proposed that it would be sensible to continue publishing information, at least at aggregate level. There may be some circumstances where it is helpful, to encourage trading, to publish more detailed information on a plant by plant basis. Further assessment needs to be carried out as the detailed design develops.
52. The treatment of information is being considered in conjunction with the wider EMR workstreams to streamline and simplify requirements on participants across the programme, whilst managing any concerns reference potential SO conflicts of interest issues.
53. There is a wider question of the SO's current systems for collecting data and ensuring accurate and necessary information is used to deliver the Capacity Market. At present, much of the information provided by participants is on a goodwill basis as part of the Grid Code compliance. However, the SO has no way of testing the accuracy of this information. Whilst a generic provision for providing information in a timely and accurate manner, and the associated penalties for failure to do so, is discussed in paragraph 13, the details of what additional information obligations would be placed on providers, and the processes for

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delivering that information, is still under consideration and dependent on the final policy design. However the interaction with the Grid Code may mean that additional/formal requirements on suppliers to provide information are deemed unnecessary or limited.

Section 5 - Next steps

54. The finer details of the enforcement, appeals and information flows processes will be worked through between now and the end of March, when the details will be included in the final Strawman document and the Specification document which is handed over to the System Operator. The details will be considered in an integrated format, whereby providers' obligations will be mapped to the relevant enforcement regime, appeals process and information flows provision, enabling a line of sight linkage with the detailed Capacity Market process maps.

Annex – feedback from previous Expert Group/Project Board meetings

Previous Project Board feedback raised a number of points on the proposed enforcement regime:

- i. Obligations on Capacity Market participants should be clear, and there should be a hierarchy of actions to incentivise them to meet those obligations;
 - ii. Cases of material breach should be very limited and it should be clear where serious consequences (i.e. fines or termination of agreements) should apply;
 - iii. There is a distinction between ‘fraud’, which is legally defined, and the provision of inaccurate information. The latter may be a less serious problem and would justify different action;
 - iv. The distinctions between withholding and postponing payments and imposing fines under agreements should be made clearer;
 - v. It is important to separate issues and consequences in the pre-qualification period from those arising post-qualification.
1. We have responded to i, iv and v through our proposals on scheme penalties and enforcement below, which outline the principal obligations on Capacity Market participants pre- and post-qualification and the consequences arising from not meeting these.
 2. We have taken action in response to ii and iii by firstly reviewing current practices in the BSC, STOR and current legislation used to enforce the current market as part of a benchmarking exercise. Using this information and the details of the proposed penalty regime in the Capacity Market, we subsequently undertook a gap analysis to see where existing enforcement processes in the market, where suitable, could be mapped over to the mechanism and identify areas where further provision may need to be made to enforce obligations.

Previous Project Board (Dec 12) and Expert Group (Jan 13) feedback focused on a number of suggestions on the treatment of disputes, outlined below:

1. Consequences of successful appeals – It was highlighted how key the impact of a successful appeal would be to the on-going processes within the capacity market. It was agreed that further work should be undertaken to see how the suggested appeals processes could fit into the process map for the Capacity Market to attempt to determine what outcomes would be suitable and lead to an

efficient running of the Capacity Market. This work has been progressed with the outcomes outlined in the main body of this paper.

2. Whether there was an expectation that payments / penalties would still be made during the appeals process (i.e. should a company appeal a penalty, must they still pay this penalty before the appeal is finalised) – This was a more specific point related to number 1 above.
3. Transition vs. Steady State – It was highlighted that there may need to be differences in the appeals processes for the first run of the Capacity Market and its later steady state running. This would be primarily due to timescales between the first auction and the delivery year and not due to points of principle. This has been considered throughout this paper but not discretely discussed.
4. Links to cross EMR appeals processes – Work is now underway within other work streams regarding their appeals processes. The Capacity Market appeals work was initiated before some others so will feed in to their proposals. We have engaged with others, for example CfD, to discuss our approach and attempt to utilise similar processes where possible.