# EMR session

# Metering arrangements

# Baseline DSR within the delivery year to verify delivery

# 24th September 2013

**Attendees (as per sign-in sheet)**

Lesley Potts (Chair) – PwC
Stuart Cook – PwC
Mark Crowley – PwC

Iain Morrow- CEPA
Lisa Waters- Waters Wye
Deirdre Powers- SSE
Paul Jones – Eon
Eamonn Bell – Open Energi
Alaistair Lamond- Intergen
Bill Reid – Npower
Fergal McNamara – DECC
Jo Alexander – Smartest
Tom Slater – DECC

Steve Wilkin- Elexon
Roisin Quinn – National Grid
Simon Francis – DECC
Mark Duffield – DECC
Harish Mistry – EDF Energy
Elaine O'Connell – DECC
Jeremy Taylor – Green Frog Power
Gareth Davies – Statoil
Libby Glazeblock – GDF Suez
Marina Hod – KiWi Power
Justine Brown – EDF Energy
Arthur Probert – Energy Services Partnership
Alaistair Martin – Flexitricity
Andrew Corbey – SSE

## 1. Introduction- led by Fergal

**Introduction**

- The consultation document is due to go out week of the 7th
  - It is an omnibus consultation- currently it contains about 100 pages so far, and contains about 20 questions
    - It includes drafts of legal instruments, as well as drafts of regulation (there are three so far – concerning settlement, low carbon, and auctions)
    - Model capacity agreements are also included; some examples, and descriptions of the model contracts themselves
    - Customer journey- prelude to next stage of this collaborative development
  - The question logs developed over the course of these collaborative development workshops will also be included
  - Capacity market rules will also be published; currently this stands at 150 pages, and will eventually be owned by Ofgem
- DECC discussed the concept of revenue neutrality, and the change in policy with regard to this topic
  - The current belief is that supplier levy will be treated as a tax
    - Office for National Statistics (ONS) will confirm this over the coming months
    - It still requires parliamentary scrutiny
  - The concept of revenue neutrality means that penalties will need to match over-delivery payments; currently the theory is that these will match over time, but in time they will need to match over a delivery year
    - DECC have looked again at the formulas as a result of this to make sure that revenue neutrality is achieved over the delivery year
    - DECC recognises that there will be consequences as a result of this policy shift, including disruption of secondary market, but believe that the consequences will be relatively minor
- DECC stated that the consultation document will ask a number of questions related to the topics being discussed today:
  - Penalty caps and portfolios (including their reasonableness)

        - Do we think portfolio caps are the right policy to apply
        - Is a penalty cap still of such importance?
    - Settlement timeline
    - Quantum collateral and the terms
    - Institutional governance
    - Legal Architecture including the nature of the capacity agreement
    - DSR (a chapter in this is now being included in the document)- discussion around the nature of that resources, procedures for pre-qualification, launch of transitional arrangements
- Industry participants asked about timing of penalties and noted that this was an important point to consider

## 2. Setting a connection capacity for DSR- led by Jane Ellaway

**Maximum size of a capacity market unit**

- Original limit was 2MW for an aggregated CMU
- DECC has provisionally raised that to 50MW (aggregated units)
- Industry participants asked whether this implicitly implied that units up to 50MW are included
    - DECC agreed with this assessment
- Stakeholder feedback indicated that they welcomed this revised maximum
- DECC stated that it was unlikely they would be including a question on this topic in the consultation

**Defining DSR connection capacity**

- De-rating is there to reflect average availability of fleet
- Without central de-rating there is no guarantee that a DSR provider has backed off the resource. This is entirely down to individual risk appetite and increases the risk on other participants
- DECC have come up with proposals for:
    - Existing, proven resources
        - Maximum output from test undertaken for pre-qualification OR
        - Maximum output of the unit under existing balancing services
        - Industry participants queried what maximum output means
            - DECC responded it means maximum X or Y delivery
        - Industry participants raised a question around a portfolio with too many resources, but not too few)
            - DECC responded that a DSR provider is able to manage their risk down (with more resources), but not up
        - Industry participants raised the concern that in STOR there is no X of Y method
            - DECC responded that they need more data for STOR to come up with a conclusion for the methodology to be associated with STOR metering
        - Industry participants asked about the reasoning behind DSR being able to rate themselves lower, but conventional generators can't
            - DECC responded that that is the nature of a DSR resource- that you can keep aggregating upwards
            - DSRs are not reducing the capacity they are providing to the market
            - Industry participants noted that it would be reasonable for DECC to monitor whether DSR are withholding capacity from the market
    - For prospective, unproven resources
        - For auction: amount of capacity for which bid bond has been placed THEN
        - For obligation: maximum output from test (undertaken after the auction
- The intention is for DSR resources to be no more than X risky, and then it is up to DSR resources to manage their risk down
- Industry participants queried double hit of volume, and whether this had been considered
    - DECC responded that it wasn't specifically going to talk about it today, but it was a question included in the consultation

## 3. Governance- led by Tom

Following the discussions and points raised at the Governance workshop on the 18th of August, a number of changes were made to the process map associated with the Change to the Rules. The key changes highlighted and discussions points are as follows:

**Entry points to initiate change to regulations or rules**

- Propose that any member of public can propose a change to the Rules (step 1 and 35)
- Government itself can consider a change to regulations- can initiate on its own accord (step 3)
- Ofgem itself can consider that a change to the Rules is required (steps 9 and 41)

**Amending regulations and rules**

- The Secretary of State can propose that the Rules are changed at the same time as regulations, in order for the Rules to stay in line with any new regulations (step 29)
    - Can notify Ofgem of the proposal to change regulations so Ofgem can consider changing the rules
    - The Secretary of State will retain the power to change rules him/herself
- Industry participants queried as to what powers of veto DECC have?
    - Secretary of state won't have any power of veto over Rules changes, but he himself can make Rule changes
    - DECC stated that it is not expected that the Secretary of State would be getting involved in Rule changes in the normal course of business. Ofgem will oversee the Rules.
- Industry participants asked whether Secretary of State can create a Rule, and impose it?
    - The Secretary of State must consult on Rule change
    - Industry participants were worried he would be under political pressure to make certain Rule changes
        - Industry participants noted that they would like barriers for Secretary of State to make rule changes. DECC noted that it was very difficult to put this into legislation
        - The ability of the Secretary of State to change Rules stems from the idea that a complete change of Rules would run more smoothly under these circumstances
- PwC to send out crib sheet on which aspects of the capacity market will be in the Rules and which will be in regulation.

**Ofgem's role**

- DECC noted that they currently don't envisage setting out objectives for the rules; Industry participants noted that it would be very helpful if objectives were stated. A question on this is being included in the Consultation.
- The previous position was to not allow rule changes to be appealed; upon further consideration this is still DECC's position, and this is the position that will go out to consultation
- Industry participants had previously asked for greater clarity around detailed processes; the exact form proposals would have to be made in, whether Ofgem would notify industry participants (for both proposals considered and rejected and those it decides to take forward) , would Ofgem standardise rule changes?
    - DECC confirmed these issues will not be for consultation in October. Ofgem will consider what detailed processes it will put in place.
- Ofgem will be required to consider any proposals for rule changes
- Ofgem will need to consider if any licence changes or code changes need to be made upon the change of rules/regulations
- Industry participants made the point that in the circumstances licence change as a result of rule changes, generators have the right to appeal these licence changes
    - In this circumstance, generators are effectively appealing rule changes
    - DECC committed to looking further at this
- Industry participants were worried that the Secretary of State will come in and change the licence rules to make sure they are in line with rule changes, and that this could be done without any appeal
    - DECC will revert back with an answer to this question
- The concern was raised that if industry participants are able to appeal some parts of the rule changes but not others, there will not be able to be a coherent response to the appeal

- Concern was also raised with respect to investibility where there is no appeals process for changes to rules.

## 4. Capacity market scenarios- led by Simon Francis

**Scenario 1**

- DECC currently considering whether the CMW should be issued at the same time as the DCI
- Industry participants considered revenue neutrality in this circumstance, and noted that the payment rate for over-delivery will be calculated differently than for under-delivery penalties
    - DECC noted that Consultation document will talk about these rates
- DECC clarified that over-delivery "payments" are calculated based on total revenue for under-delivery penalties divided by your over-delivery
    - Industry participants felt that this situation implied that there was no incentive for over-delivery; if no one was to under deliver, then there is no revenue to share amongst participants who over-deliver
    - DECC pointed out that this was a Treasury condition of clearance- and that is was not up for negotiation – and that there is still an incentive, it is just less certain, plus additional incentives will exist outside the capacity market.
- Performance is relative to your stated delivery- if you initially had not planned to deliver, you are therefore not exposed to any penalties
- Following the first four hours, your obligation is based on your adjusted load following obligation
- If you failed to comply with BOA instructions you would be subject to penalties
- Industry participants asked if there is a blackout, do the load following obligations still apply?
    - At what point would you just suspend the market?

**Scenario 2**

- Period of load shedding has to be for at least 15 minutes continuously for an event to be classed as a stress event
- Duration of load shed doesn't meet condition of duration in this scenario, therefore the stress event does not materialise.
- In this scenario, the warning would be cancelled automatically at midnight
    - The methodology for cancelling CMW is still to be determined
- Industry participants made the point that there needs to be a rule clarifying which half hour it ends on
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**Scenario 3**

- Scenario 3 is effectively the same scenario as scenario 1
- In this scenario, suppliers outside capacity market under deliver
- Penalty revenue isn't sufficient, therefore no over-delivery payments are therefore made
- From a policy perspective, when a warning is issued, National Grid will provide forecasts of CM and non-CM capacity
- Losing link between different CMU's in your portfolio is of big concern to industry participants; if one generator fails to deliver, and another generator over-delivers, the over-delivery payments will not match the under-delivery penalties

**Scenario 4**

- Industry participants wanted greater clarification over the "holding back" process
    - Does this refer to constraint boundaries, or is it instructions from National Grid?
- Industry participants asked whether they would know up front it an event is a stress event?
- Industry participants stated they would like fewer stress events given new process with regard to over-delivery payments
- Industry participants would like a better definition of what constitutes a stress event; greater certainty required earlier as to whether it was a stress event or not-
    - It needs to be considered if this would have any consequences as to how people behaved
    - Industry participants noted that there needs to be some post event post mortem to determine what exactly happened

- Industry participants asked whether DECC could apply their methodology to events of last year, and determine which of those events would be classified them as stress events
- Implications for the supply side were considered; DECC responded that as a consequence of the shift in policy to revenue neutrality, suppliers will not be called on to provide money for over-delivery
  - Any penalty revenues collected will be used to fund over-delivery , any remaining funds will be returned to suppliers
- Industry participants believed that residual payments should be held over to the next stress event, rather than paid out to suppliers
  - Industry participants noted that, in an extreme scenario, if there is a big surplus from first stress event, then participants would be incentivised to want another stress event because of the potential over-delivery payments although other participants questioned whether this scenario was realistic.
- Industry participants queried what the cost implications were for suppliers
  - DECC's response was that suppliers have to fund regular monthly charges for regular supply obligations and to fund the cost of the settlement body
- Suggestion of a separate sub group to further discuss and work out what the 4 scenarios should be

## 5. Penalty Caps – Led by Simon Francis

**Introduction**

- Slight policy position change- the previous position was such that where liabilities were accrued, the cap would be charged at portfolio level. In this circumstance, individual units could wrack up greater penalties than their exposure
  - In this situation, in the case of a SPV or JV, these vehicles were concerned that unless the individual unit was to be ring-fenced, the situation would be un-investable
  - Under the new policy, there would be a cap imposed on an individual CMU's penalties; this would be a multiple of that unit's payments (between 100 and 150%). If that particular plant fails, and it incurs penalties up to and above that particular level, the difference between that individual cap across that portfolio and total portfolio liability would be borne by someone in that portfolio
  - The ultimate parent would be able to identify another affiliate to pay that disparity between the individual cap and the total portfolio liability
- Industry participants raised the concern that you were still creating a liability that is greater than the cap.
  - DECC responded that under the new policy, you are manager of the portfolio and therefore you have the flexibility to proportion it as you see fit; this flexibility did not exist before
  - Industry participants were concerned that this change in policy did not actually have any consequences for their companies- the situation is essentially the same from their point of view
    - Does it therefore create options that are useful in themselves?
  - Industry participants were concerned it exposes the rest of the portfolio to more risk
    - Banks are happier if it's the rule rather than the contract
  - Investors will not invest in a SPV if they are subject to the liabilities of a separate unit
  - Industry participants raised concerns that the investor in infrastructure doesn't want to be directly liable for the risks in the portfolio, but still have control
  - An applicant in respect to the CMU is the only party, but if dispatch control has been given to another participant, you can go to Ofgem and state that another party has control
- Industry participants concern that these policy changes are becoming more and more discriminatory
  - A question will be asked in the consultation document

**Penalty caps**

- Hard cap will be set at between 100 and 150% of an individual unit's annual revenue
  - Exposure by definition cannot exceed this hard cap
  - Settlement periods are irrelevant in terms of the hard cap
- Industry participants queried where over-delivery payments are taken into account when assessing how close you are to penalty cap
  - DECC confirmed that it does

- DECC stated that the formula was calculated as;
    - Actual settlement penalty/maximum penalty theoretical * (lower of max theoretical penalty and hard cap)
- Industry participants raised concern over the fact that the penalty caps are paid before over delivery payments are made, adding another disincentive to over-deliver
- There was also a worry that there would be serious cash flows issues for participants due to the settlement of caps and over-delivery payments at the end of the year
    - Industry participants are concerned that if you are DSR and you under-deliver, the penalty caps could potentially wipe you out in the absence of another/more stress events
- Industry participants stated that it is crucial that the cap is low for new participants
- It was asked that the slide be sent out again with indicators as to which formula kicks in and where

## 6. Payment timetable – Led by Mark Duffield

- Industry participants stated that they believed there wasn't enough notice
    - DECC noted this and stated they would take this into consideration
- Credit needs to be in place a few days before the start of the month
- Capacity payments made monthly, if your equipment breaks, you could potentially receive a 150% fine
    - Penalties are charged as they are accrued; they should be paid in the month that they are invoiced
    - Industry participants noted that this raises a potential financing problem; the situation could arise that you receive a 150% penalty in first month; the bank will ask for some sort of deposit to cover this eventuality, and they will also want insurance in the case that the equipment cannot be fixed
        - If settlement were to occur at the end of the year, then less equity would have to be committed
    - Some industry participants stated their belief that penalties and payments should be paid in the same month
        - Other participants suggested that statements be released every month of revenues and penalties, but are settled at the end of the year
        - Industry participants also queried as to why daily settlement was not considered?
            - DECC stated that the actual quantum of payments is largely determined on an annual basis, therefore billing that on that frequent a basis didn't seem like an efficient use of resources
- DECC clarified that future revenues will be withheld if you have debt outstanding in terms of penalties accrued
- DECC noted that they are asking a general question on payment timetables, and are asking a specific question on de-linking penalties from over deliveries on a monthly cycle

## 7. Credit

- The current charge for suppliers consists of a capacity charge and the settlement body charge, plus 10%
    - Industry participants feel that 100% would be sufficient, as opposed to 110%
- 2 months notice is given, and suppliers are expected to have credit lodged 9 working days prior to start of that month
    - If this requirement is not met, the credit default process is started
    - If credit is still not in place 3 working days prior to the start of the month, then the stage 2 credit default process will set in
- DECC asked an open question about the mutualisation of credit
    - Industry participants suggested that the cheapest option is that the counterparty can borrow (and recoup later) but DECC clarified that this is not possible.