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Dear Emma

Response to 'Consultation on draft guidance for the Capacity Market Rules change process'

Thank you for providing us with the opportunity to give feedback on the process for modifying the Capacity Market Rules ('CM Rules'). This submission is non-confidential and may be published on your website.

We are uncomfortable with the proposals contained in the consultation and believe that they will not result in a robust process. In particular, we think that:

- the timescale is unrealistically truncated for assessing what could be highly material changes;
- a process will be needed for prioritising workload rather than trying to assess – and consult on - all proposals to the same timetable;
- the proposed development process looks opaque, and may hamper stakeholders' ability to develop an understanding of proposals or to provide input at a time in the process when they are still in development.

We think that a better process would have the following features:

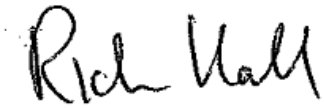
- An ability for proposals to be raised at any time of year;
- An open public forum, meeting at appropriate intervals, to discuss the development of 'live' proposals that have been submitted by interested parties, and also of those that Ofgem has initiated;
- A hard cut-off date within the year at which point any proposals approved by Ofgem will form part of the CM Rules for the next year (y+1) – but without the expectation that all proposals in the process will meet that deadline;
- Any proposals that are live at that point to be rolled forward into consideration for the following year (y+2);
- Any decisions to modify the Capacity Market rules should be made eligible for appeal to the CMA, if the Energy Act 2004 allows for this (and noting that this would require

the Secretary of State to make an order designating Capacity Market rules as an eligible document).

We explore these issues further in our answers to the three specific questions posed in your consultation document, which are included in the annex to this document.

We trust that this submission is clear, but would be happy to clarify or further discuss any points contained within it if you would find that useful.

Yours sincerely



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Annex – answers to consultation questions

"Do you think that an annual process of managing changes to the CM Rules is appropriate? If not, please outline your reasons and your preferred alternative approach."

We agree that it is appropriate that the CM Rules should be capable of annual modification. More frequent modification would be purposeless as the auctions will only run annually, while less frequent modification would delay the delivery of the benefits resulting from approved rule changes. But we do not support the process that you are proposing to deliver these changes.

A major problem is that the timings you propose appear highly unrealistic to us. On face value, it appears to us that there are significant similarities between the CM Rules and the existing industry codes – both are multilateral contracts that set out preconditions for participation in a common market, with an ability for signatories (or interested parties) to propose changes and the regulator having overall change control. Like the BSC or UNC, the CM Rules will influence security of supply signals and influence the shape of competition.

Experience from those codes suggests that a two month process, straddling the Christmas and New Year holiday period, to fully develop proposals is a timetable that is unlikely to be viable unless the number of proposals is very low, and all are characterised by being extremely simple and not contentious. Normally, only housekeeping or (some) proposals granted urgent status would make it through the industry code development process in those timescales. This problem is aggravated because it would appear that most, possibly all, proposals would be developed in parallel between December and February rather than being staggered across the year. This may be a particular problem in the early years of the CM Rules being in place as new codes tend to see a number of proposed changes that is far above the long-run average as teething problems are resolved. For example, there were 72 proposed modifications raised in the first 12 months after the BSC went live – compared to 8 in the last 12 months.

Some individual proposals to modify the CM Rules could be highly material and complex and need extensive development and assessment. This could result in occasions where the statutory requirement to conduct an impact assessment ('IA') is triggered[1].

To meet your timetable, you appear to envisage consulting on all changes in parallel as the final stage before making a decision on publishing final rule changes. But this appears to be the first and only formal public consultation on the rules – though we note that you 'may' organise stakeholder events in an earlier phase. Consulting so late in the process means that your ability to tweak proposals based on any feedback will be quite limited. Likewise, if responses suggest the need to further develop or assess aspects of the proposals it is hard to see how you could cater for that while still meeting your timetable. Finally, it means there may be limited opportunities for stakeholders to directly ask questions of you, or of the proposers, if they have questions around, for example, matters of interpretation. This rather opaque process runs the risk of reducing the quality of the input you receive as there is an increased risk that stakeholders do not fully understand what is being proposed or have not had an opportunity to full assess its impacts on their businesses if this is the first time they have seen fuller detail of the proposed change.

[1] As provided for in Section 6 of the Sustainable Energy Act 2003, legislation.gov.uk/ukpga/2003/30/section/6

We do support the implied approach of annually consulting on all proposals in parallel (where possible) however, as this could allow a better articulation of the trade-offs and interactions between proposals being considered than conventional one-at-a-time code assessment processes allow. This would be particularly beneficial where multiple proposals to tackle the same issue are being considered – current code processes largely frustrate side-by-side assessment and this is a real weakness in that regime.

For the reasons given above, we think you should consider:

- Allowing parties to raise proposals at any time, not simply in a short defined annual window – so that you can spread the burden of development work across the year;

- Tailoring the development time of proposals to their complexity and materiality – progressing them quickly when they are conducive to this, but taking the time you need to thoroughly assess them (which may include a statutory IA) rather than attempting a 'one-size-fits-all' timetable;

- Instituting some kind of public forum, meeting monthly or quarterly (dependent on number and complexity of live proposals) - so that stakeholders can ask questions and provide feedback during the development process, not simply at the end of it. Ofgem should use the forum to stress-test its assessments and to set out its expectations on how live proposals will be progressed;

- On an annual basis, conducting a single, combined consultation on all those proposals that are considered fully assessed by a defined cut-off date – those that are not should simply be 'rolled over' for consideration the following year, rather than trying to force a decision through on them now;

- Given the potentially high materiality / contentiousness of rule changes, we also think that the CM Rules should be designated by the Secretary of State as a document where appeals of Ofgem decisions to the CMA should be allowed[23].

"Does the draft CM Guidance cover the necessary issues?"

It would be useful to see detail on whether proposals can be combined or altered once submitted.

We would welcome a more precise commitment on the duration of the March consultation. This should be influenced by how much prior consultation has taken place. If this is the first opportunity that stakeholders have had to comment on proposals or to see Ofgem's analysis

[2] As provided for in Section 173 of the Energy Act 2004, legislation.gov.uk/ukpga/2004/20/part/3/chapter/4/crossheading/appeals-from-gema-decisions

[3] We recognise that the option of judicial review always exists for regulatory decisions. But the open-ended and potentially highly expensive nature of that approach means that is it an unrealistic option in all but the most extreme cases for large parties and is probably completely inaccessible for smaller parties. This deficiency was recognised in the decision to bring in a code modification appeal regime in the Energy Act 2004 and a subsequent licence change appeal regime in 2012. Given the conceptual similarities between the CM Rules and the existing codes we think that decisions to amend the former should also be subject to the right of appeal. We recognise that Ofgem is not in a position to deliver this right as the designation would need to be made by the Secretary of State (i.e. DECC), but highlight it here in order to ensure transparency on our position.

of the relative costs and benefits of particular changes, it may be that eight weeks or longer is required.

It would be useful if you could clarify whether you see the March consultation as discharging the statutory obligation to conduct an impact assessment in defined circumstances. If it does not, some detail on the timetable that would be followed in such circumstances would be useful as we cannot see how such proposals could hit the annual June cut-off date that you propose while meeting the previous timings.

"Do you have any other comments on the draft CM Guidance?"

Not at this time.