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CAPACITY MARKET RULES CHANGE PROPOSAL REPORT: CP374 AND CP375 ‘SPLITTING AND MERGING CMUS’

These Change Proposals (CPs) seek to allow CMUs to be split or merged after Prequalification, subject to De-rated Capacity remaining unchanged.

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About this Document

This is the CP374 and CP375 combined change proposal report that the CMAG is submitting to Ofgem for consideration in its Statutory Consultation.

In this document, capitalised terms used are defined in the Capacity Market Rules unless expressed otherwise.

This document is aimed at those with at least a moderate level of understanding of the Capacity Market Rules.

Not sure where to start? We suggest reading the following sections:

- Have 5 mins? Read the executive summary
- Have 15 mins? Read the issue, solution and impact and costs sections
- Have 30 mins? Read all sections
- Have longer? Read all sections and the annexes and attachments

Executive Summary

CP374 'Splitting Capacity Market Units' and CP375 'Merging Capacity Market Units' were raised on 8 November 2023. As the two CPs are similar and have been considered by the CMAG together, including its recommendations, a single CMAG report is being produced for both CPs for efficiency and simplicity.

The Proposal Forms, can be found on the [CMAG Website](#).

Issue

The CM Rules (Rule 4.4.4) prohibits a change in Capacity Market Unit (CMU) configuration after Prequalification. This prevents Capacity Providers from changing CMUs to reflect changes in project development and/or commercial structures. This can limit the commercial flexibility of Capacity Providers to address problems impacting the delivery of their Capacity Agreement following Prequalification; thus increasing the risk of project non-delivery, preventing more efficient commercial structures, and ultimately increasing Capacity Market costs.

Solution

CP374 and CP375 seek to amend the CM Rules to allow CMUs to be merged, or split, after Prequalification, subject to the total De-rated Capacity and Generating Technology Class of all components remaining unchanged.

Recommendation

The CMAG has agreed **not to continue development of CP374 and CP375**, on the basis that there was a significant risk they would be contradictory to Regulations and policy intent. They were deemed a low priority issue as the likely impacts of these issues would apply to a low number of sites.

The CM regulations likely to be impacted were identified as Regulation 31(3), which does not allow the description or capacity of a CMU to change for a Capacity Agreement. The CPs were thought to be contrary to the policy intent as they seek to move the CM from a physical-asset based mechanism to a financial one which is a considerable policy change and out of scope of CMAG.

The CMAG is submitting this report to Ofgem with the recommendation that Ofgem note the contents of this report that could feed into any wider review of Secondary Trading arrangements and Rule 4.4.4 (which Ofgem is considering initiating).

Background

CP374 and CP375 had initially been raised as surgery items at Meeting 12 for consideration. The Proposer highlighted two scenarios for CMAG consideration:

- A Capacity Provider wants to sell half of their CMU to another company prior to Significant Completion Milestone (SCM), splitting one asset into two, with two owners. Post-SCM, the Capacity Provider would be able to trade away part of the Capacity Obligation, add a new meter and trade it back into a “new CMU”. However there may not be a spare asset to trade to/from to make this work, despite the outcome being the same; and
- A Capacity Provider with two storage assets on the same site wants to merge them into one CMU. Over time as the assets degrade, they believe it will be easier to meet Extended Performance Test requirements as one CMU rather than two. The Capacity Provider in this scenario could trade the Capacity Agreements, re-register the asset as one CMU and trade back, but this is administratively burdensome.

Following CMAG feedback, the Proposer submitted both proposals and presented an initial overview at Meeting 14.

Issue

Rule 4.4.4 does not allow changes to the configuration of a CMU after Prequalification. This means Capacity Providers are unable to split their CMUs or merge into a singular CMU.

A Capacity Provider may Prequalify multiple CMUs (notably Battery Storage) and later wish to merge two or more of these into a single larger CMU to better manage assurance requirements such as Extended Performance Tests effectively, or to trade a CMU to mitigate against unforeseen delivery risks.

Capacity Providers may experience supply chain issues or connection delays that increase the risk of non-delivery against their Capacity Agreement. By allowing Capacity Providers to split or merge their CMUs, they can effectively manage these risks; for example merging CMUs to a single location with sufficient Connection Capacity to deliver the CM Agreement or splitting assets (and effectively its CM Agreement) to allow a Capacity Provider to sell a part of its original CMU as a new CMU, in order to deliver against the remaining part of its original CM Agreement.

Although there are mechanisms within the CM to trade CM Agreements, there are restrictions in place for when these can take place. Currently the CM Rules only allow for trades to occur after the T-1 Auction, and there is limited liquidity within the Secondary Trading market for this to be a reliable option. A Capacity Provider is also able to re-register multiple CMUs as one CMU in Prequalification for a later Delivery Year, once it has successfully traded away its CM Agreement; however the process to do this is administratively burdensome, lengthy and costly, therefore not an effective option for all Capacity Providers.

With increasing delays to connection dates (as noted in CM Rules Change Proposal CP371), Capacity Providers may wish to merge CMUs in order to share a connection agreement by moving their CMU to a location with capacity.

Solution

The solution is presented is based on the solution in the Proposal Form. As the CMAG decided not to progress CP374 and CP375 further, no further solution development was conducted.

The intention of the solution seeks to amend the CM Rules to allow CMUs to be merged or split after Prequalification, subject to the De-rated Capacity remaining unchanged.

Capacity providers have limited commercial flexibility, and the ability to split and merge CMUs would decrease the risk of non-delivery of CM Agreements by allowing efficient changes to commercial and asset structures within the CM. This would therefore increase capacity and support security of supply.

The Proposer noted along with an amendment to Rule 4.4.4, a new Rule may be required in order to include assurances for Capacity Providers who split or merge their CMUs to ensure effective delivery of CM Agreements. A process for how each CMU Connection Capacity would be modified (subject to the constraint that the total connection capacity is equal to the initial CMUs' aggregate connection capacity) would be required. The Capacity Provider would also be required to update its Metering Arrangements, notify CM Settlement Body it has done so and re-complete its Metering Assessment and Metering Test if necessary.

The Proposer provided two examples of how this solution may benefit Capacity Providers in delivering their CM Agreements. Both examples are based on a project developer that has been awarded a CM Agreement for a single CMU battery site with a connection capacity of 100MW.

- Scenario 1 - Due to financing issues, it wishes to sell half of the project to a third party. The current rules would not allow this to happen. Under the proposal, 2 CMUs of 50MW could be created and one could be transferred to the third party. Overall, total capacity obligation would be unchanged and the likelihood of project delivery would increase.
- Scenario 2 – Development has been delayed by a late running connection and will occur on a staged basis with 40MW available in line with 1st DY; 30MW by the Long Stop Date; and 30MW at a later date. Under the proposal, the developer could create three CMUs:
 - 40MW CMU could be operational from the 1st DY;
 - 30MW CMU could be operational from the Long Stop Date; and
 - 30MW CMU could be location changed to an alternate site.

In this case, the proposal would allow the operational batteries to actively participate in the CM from the earliest possible date, as they are developed.

Legal Text

The Proposer did not provide any proposed legal text, but noted an amendment to Rule 4.4.4 would be required to deliver the intention of their proposed solution.

CMAG did not proceed with developing legal text as there was a high likelihood that the CM regulations would also need to change, which is beyond the scope of the CMAG (and the Rule Book change process).

CMAG Development/Discussions

The CMAG discussed CP374 and CP375 at:

- [Meeting 12](#) (21 September 2023);
- [Meeting 14](#) (23 November 2023); and
- [Meeting 15](#) (13 December 2023).

A summary of discussion is noted below.

Alignment with CM policy objectives and intent

The Proposer presented CP374 and CP375 to CMAG at Meeting 14. A Member noted a potential issue where the solution could be gamed and used to terminate part of a Capacity Agreement the party cannot meet and avoid a larger Termination Fee. This could possibly be avoided through additional assurances included in the solution. The Proposer agreed that this is a potential risk, but for some Capacity Providers, if they are unable to split their CMU, they will not be able to deliver any of their Capacity Agreement at all.

A Member noted it may be better to incentivise those entering the CM to put forward for what they can realistically deliver from the outset. The Proposer notes that Capacity Providers do not often over-commit themselves but can be hit by unforeseen circumstances out of their control and these change proposals seek to allow for risk management techniques for these parties. The Proposer states that they are not aware of any CMUs in practice that are gaming the Rules and do not agree this should be considered high-risk in the CM unless it is clearly evidenced.

DESNZ commented that these Change Proposals could create lucrative opportunities for Capacity Providers to game the CM, which results in a risk to security of supply and undermines delivery assurance measures. For this reason these Change Proposals do not appear aligned to current policy intent as they seek to move the CM from a physical-asset based mechanism to a financial one which is a considerable policy change and out of scope of CMAG.

CMAG highlighted these change proposals could lead to Capacity Providers splitting a large CMU in to multiple CMUs, and then not delivering against a CMU resulting in a Termination; this could have significant policy

implications as it could impact security of supply in the CM. Ofgem also noted that Termination Notices are processed through the Secretary of State, and this could affect the complexity of that process if it seeks to introduce partial terminations.

The Electricity Market Reform EMR Delivery Body (DB) noted a solution could consider amending the Auction set-up rules, so the incentive to enter Auction as a single large CMU is changed and avoids the need to split this CMU at a later stage. The Proposer noted this has been discussed previously, where it had been considered to allow a BMU to enter auction and be linked after as a CMU, but the policy position was that this could lead to problems with Auction rules and trying to link together CMUs later down the line.

EMR DB further highlighted that these CPs could venture in to policy as Capacity Providers may make different choices at Prequalification to have better results at Auction. CMAG agreed with this, and noted that CP372 'Change to Rule 4.4.4' also highlighted this issue; noting that it could be addressed through additional assurance requirements.

CMAG noted at Meeting 15 that the principle behind splitting and merging CMUs is contrary to the current policy intent of Rule 4.4.4 and therefore appears incompatible with Regulation 31(3), which does not allow the description or capacity of a CMU to change for a Capacity Agreement. Therefore these change proposals cannot proceed as they are.

CMAG noted at Meeting 15, that although it is a valid issue, it is not a priority due to a minimal amount of incidences or impact of this change, it should be considered as part of the wider review of Secondary Trading arrangements and Rule 4.4.4 due to the wider policy interactions which require due consideration by DESNZ and Ofgem.

Assurance Requirements

A Member noted that it would be sensible to resolve the issues highlighted in CP374 and CP375, although recognised this was beyond the remit of CMAG. They suggested a clear structure and process on how this would be done is required; CMUs submit metering information at Prequalification for assurance purposes to ensure that they can deliver, any change would need to have the correct level of assurance to avoid any unintended consequence. The Proposer was supportive of ensuring appropriate assurance was in place.

A Member raised concern that allowing the splitting of CMUs could lead to part of a Capacity Agreement to be Terminated and potential risk to security of supply; there would need to be assurances in place, such as meeting the Financial Commitment Milestone, to discourage this. The Proposer also noted they have considered that the solution should require that a CMU has met its Minimum Completion Requirement (MCR) to avoid this risk, but a subsequent impact of this would be that Capacity Providers do not receive payments until they have passed their Long-Stop Date.

The Proposer noted a solution would need to consider whether there should be a limit on the number of CMUs a Capacity Provider can split a single large CMU in to, and whether deadlines for when a split/merge must be registered by would be beneficial in providing assurance for what CMUs will be delivery during the Delivery Year.

Impacts & Costs

Rules

As no legal text was developed, the only rule identified as impacted was rule 4.4.4 "Configuration of Generating Units."

Regulation and Other Code Impacts

CMAG noted the principle behind splitting and merging CMUs is contrary to the policy intent of Rule 4.4.4 and therefore appears incompatible with Regulation 31(3), which does not allow the description or capacity of a CMU to change for a Capacity Agreement. CMAG Members agreed with this view.

No impacts to other codes were identified. Further impact assessments were not conducted following CMAG's decision to halt development due to regulatory and policy implications.

Views against CM Rules Change Objectives and Ofgem's Principal Objective

Do CP374 and CP375 better facilitate the CM Rules Change Objectives and Ofgem's Principal Objective

Objective	Proposer's View
Ofgem's Principal Objective	Neutral
Promoting investment in capacity to ensure security of electricity supply	Neutral
facilitating the efficient operation and administration of the capacity market;	Positive CP374 and CP375 will provide Capacity Providers with the ability to flexibly manage their assets for more efficient operation in the CM.
Ensuring the compatibility of capacity market rules with other subordinate legislation under Part 2 of the Act.	Neutral

Recommendations

At [Meeting 15](#) on Wednesday 13 December 2023, the CMAG agreed to not continue with development of CP374 and CP375, on the basis that there was a significant risk they would be contradictory to Regulations and policy intent. They were deemed a low priority issue as the likely impacts of these issues would apply to a low number of sites.

The CMAG is submitting this report to Ofgem with the recommendation that **Ofgem note the contents** of this report that could feed into any wider review of Secondary Trading arrangements and Rule 4.4.4 (which Ofgem is considering initiating).

Appendix 1 – Summary of Issue and Government Policy Questions

Issue and Government Policy Questions	
Question	Comment
Is this a valid issue? Is the CM the right place to address this issue?	<p>The Proposer noted it is a valid issue, many Capacity Participants find themselves in the situation where they have Prequalified and then their commercial arrangements change due to circumstances outside of their control.</p> <p>Members noted that although it is a valid issue, it is not a priority due to a minimal amount of incidences or impact of this change. It should be considered as part of the wider review of Secondary Trading arrangements and Rule 4.4.4.</p>
<p>Is the solution to this CP going to be counter to the policy objectives of the CM? What is the impact on:</p> <ul style="list-style-type: none"> • Security of Supply • Cost (including cost to consumers) • Unintended consequences – if there are any, what is the impact? 	<p>A Member noted as there is no legal text, it is unclear whether they would align with policy objectives but they can see a number of unintended consequences that may not be in line with current policy intent.</p> <p>EMR DB noted these CPs could venture in to policy as Capacity Providers may make different choices at Prequalification to have better results at Auction.</p>
Are there any consequential impacts on the Regulations?	CMAG noted the principle behind splitting and merging CMUs is contrary to the policy intent of Rule 4.4.4 and therefore appears incompatible with Regulation 31(3), which does not allow the description or capacity of a CMU to change for a Capacity Agreement.
Does this explicitly affect any functions granted to the Secretary of State?	Ofgem noted Termination Notices are processed through the Secretary of State, and this could affect the complexity of that process if it seeks to introduce partial terminations.
Is there an impact on subsidy control?	Members noted it is not clear if there is an impact on the Subsidy Control Framework.