



Capacity Market 2023 Consultation

[BEIS Capacity Market 2023](#): Strengthening security of supply and alignment with net zero

Piclo Response

Piclo's involvement with the Capacity Market

In [2020](#), Piclo secured funding from BEIS to work on the FleX Exchange project, an ambitious energy flexibility market trial. In close collaboration with National Grid's EMR team, Piclo collaborated with the market to understand barriers and help shape improvements to secondary trading in the Capacity Market. In 2021, [Piclo Exchange](#) was launched which meant for the first time Capacity Market Providers could register to find, bid to buy and sell existing contracts with other qualified providers in a single marketplace.

Since launching in 2021, 33 Capacity Market providers have registered on Piclo Exchange, which has raised the visibility of those seeking to trade the 35 contracts that have been advertised. The platform has facilitated the first-ever competitive bidding for contracts on the secondary market with 3 contracts receiving a total of 5 bids and the marketplace successfully facilitated a secondary trade of 2.847MW between Vattenfall and Enel X.

Summary of Piclo's response & recommendations

1. **Begin the proposed review of secondary trading and establish an industry steering group:** the proposed changes within this consultation have the potential to increase reliance on secondary trading in the Capacity Market. Consequently, it is essential to begin identifying and removing barriers to trade through the proposed formal review and steering group.
2. **Establish a marketplace for secondary trading:** a marketplace for secondary trading is an essential and tested way to improve the Capacity Market's secondary market.
3. **Take learnings from the BEIS FleX Exchange trial:** facilitate improvements such as API integrations with National Grid ESO and a platform with the Capacity Market rules incorporated to further improve liquidity by streamlining the process for secondary trading.
4. **Prioritise changes that enable revenue stacking across all markets:** revenue stacking is critical for the future of competitive, decarbonised energy markets and so potential changes to the Capacity Market cannot be assessed in isolation. Consequently, improvements must be prioritised that advance the visibility, qualification, contract management, operations and settlement across all markets Flexibility Service Providers (FSPs) seek to participate in. This includes the consideration of the role of marketplaces and exchanges.

Response

Our response focuses broadly on the following questions:

Question 6: Do you agree with the proposed changes to the CM's penalty rate? Are any unintended consequences likely to result from this change?

Question 16: Could secondary trading provide a pathway to the decarbonisation of an existing CMU? Please provide an explanation to your answer.

Question 17: Could reactively procuring capacity provide a pathway for CMUs to decarbonise whilst ensuring security of supply? Please provide an explanation for your answer.

Question 18: Could over-procurement of replacement capacity via the CM enable CMUs to decarbonise whilst ensuring security of supply? Please provide an explanation to your answer.

It is encouraging to see the call for evidence focus on the importance of aligning the Capacity Market with net zero. Previously, secondary trading in the Capacity Market has been highlighted as an important area to improve through past reviews. In the secondary market, many barriers to liquidity remain and already there have been low-regret solutions in the rules or through innovative developments identified as possibilities to implement. Furthermore, this 2023 consultation considers several changes that if implemented have the potential to increase the reliance on secondary trading further, including changes to the penalty regime and implementing a decarbonisation route for CMUs. We urge DESNZ and National Grid ESO to implement low-regret improvements to secondary trading, such as initiating a review of secondary trading, establishing a steering group and introducing a marketplace.

Increasing the reliance on secondary trading

Firstly, the consultation highlights the need to decarbonise existing Capacity Market Units (CMUs). Currently, the only route available to the majority of Capacity Providers to exit their CM agreement early is to secondary trade their obligations, however, the consultation also proposes whether reactive procurement and over procurement could be facilitators. Whilst a mix of these routes could work, secondary trading should be prioritised due to being an already established route available and offering a least-cost route to consumers by mitigating the need for further procurement of Capacity. Only if secondary trading is not possible should alternative procurement be sought. As a result, changes that improve the competitiveness and participation of secondary trading should be implemented alongside these developments.

Secondly, the consultation proposes to strengthen the penalty regime of the CM by increasing the penalty rate that determines how much a CMU must pay if it does not deliver its contracted capacity. The consultation correctly identifies that this may lead to providers improving the reliability of their capacity, such as by seeking to find a secondary trade when their asset has an outage. The consultation further identifies that this depends on the ability of providers to improve their reliability and again the barriers to secondary trading could stifle this ability and potentially deter participation when combined with a strengthened penalty regime. We agree that participants should be incentivised to improve the reliability of their capacity and that a penalty regime that reflects the importance of this could be a solution to implement, however, it must be combined with improvements to secondary trading in the Capacity Market to have the desired outcome.

Furthermore, in 2021 [LCP analysed](#) the projection of secondary trades as part of the BEIS Flex Exchange project. Whilst these figures are not up to date, LCP highlighted that secondary trading was already expected to increase due to factors that remain relevant such as:

- Current commodity prices may lead to an increased risk of insolvency and termination of existing agreements, as well as Flexibility Service Providers (FSPs) running assets harder to avoid peak prices. This could lead to greater unavailability due to backup generators not being designed to run for such extended periods
- Tighter margins due to coal plant closures and nuclear and CCGT unavailability could make stress events more likely. Plus, due to newer, distributed technologies having smaller capacities than technologies such as coal plants, many more CMUs are needed to meet demand - leading to a higher probability that some of those will secondary trade

A marketplace solution: removing barriers to secondary trading

As part of the UK Government's FleX Exchange competition, Piclo Exchange was recently launched - a marketplace that simplifies the process of secondary trading. Piclo Exchange was developed in direct response to the challenges FSPs faced with secondary trading.

CM participants identified that secondary trading is currently a time-consuming and inefficient process, which has not been optimised to provide the best price for either party during a contract exchange. For instance, user research highlighted that an obstacle to secondary trading was a lack of visibility, which means there is no way for providers to exchange contracts easily. Currently, if a provider needs to sell a contract they will need to manually find a buyer themselves, relying on individual emails and phone calls to find and negotiate trades with other CM Providers. This can be both a time-consuming and an administrative burden.

The Piclo Exchange marketplace provides a single place to find, buy and sell contracts, reducing the time spent on administration and enabling FSPs to increase participation and optimise their assets' performance. At the same time, Piclo Exchange helps to de-risk participation for those who have won contracts that they can no longer deliver and increases the revenue streams available to those who may want to take more on.

The benefits of introducing a marketplace for secondary trading include

1. **Full visibility of opportunities:** For the first time, there is one simple place for FSPs to find and exchange contracts, providing full visibility to those seeking to take on or trade away their obligations.
2. **Improved trading experience:** In addition to making the process of finding contracts quicker and easier, the marketplace also streamlines the process of the exchange and facilitates partnerships by providing templates for contracts and delivering a user-focused service.
3. **Increased number of participants:** By supporting secondary market participants, the number and type of FSPs willing to participate in markets, such as the Capacity Market, could rise and widen due to the de-risking of participation and more opportunities to win contracts.
4. **Market information and insights:** By supporting secondary market participants, the number and type of FSPs willing to participate in markets, such as the Capacity Market, could rise and widen due to the de-risking of participation and more opportunities to win contracts.
5. **Whole system coordination:** Whole system efficiencies will be driven by empowering participants to act through streamlined processes, improved interactions and availability of information.

Since launching in 2021, 33 Capacity Market providers have registered on Piclo Exchange, which has raised the visibility of those seeking to trade the 35 contracts that have been advertised. The platform has facilitated the first-ever competitive bidding for contracts on the secondary market with 3 contracts receiving a total of 5 bids and finally, the marketplace has successfully facilitated a secondary trade of 2.847MW between Vattenfall and Enel X.

You can read more about the Piclo Exchange marketplace in the following resources:

- [Press release: first CM secondary trade facilitated through marketplace solution on Piclo Exchange](#)
- White paper: [Secondary trading in the Capacity Market: Introducing Piclo Exchange](#)
- Blog: [Introducing Piclo Exchange Part 1: Diving into Capacity Market secondary trading](#)
- Blog: [Introducing Piclo Exchange Part 2: A marketplace for Capacity Market secondary trading](#)

For the benefits of a marketplace to be maximised and secondary trading optimised:

1. DESNZ and National Grid ESO must formally adopt a marketplace solution for secondary trading
2. Further marketplace developments must be included within its scope such as

- a. National Grid ESO system integration to the marketplace to reduce the number of interfaces and steps providers have to take
 - b. The incorporation of CM secondary market rules onto the platform to prevent errors or mistakes from happening
 - c. Contract negotiation and signing are incorporated into the platform to minimise time and administrative costs
3. A review of the secondary trading rules must be started, alongside an industry steering group, to identify and remove further barriers to a competitive secondary market

Longer term vision: removing barriers to revenue stacking

Revenue stacking is critical for the future of competitive, decarbonised energy markets and so the longer term vision for energy and flexibility markets must include optimised and simple participation for FSPs across all markets. To achieve this vision, and to reward the true value of flexibility, every market and every stage of the flexibility service journey must be digitised and interoperable. Consequently, platforms (such as marketplaces or exchanges that Ofgem are currently exploring) will also be critical for the development of revenue stacking opportunities and have the potential to unlock elements that are key to its progress.

As a result, changes to the Capacity Market cannot be considered in isolation and improvements must be prioritised that advance the visibility, qualification, contract management, operations and settlement across all markets Flexibility Service Providers (FSPs) seek to participate in:

- **Value assessment:** all revenue streams must be brought into play and be visible and transparent to FSPs. This is a huge challenge considering the very different mandates, stakeholders and participants for each of the markets/revenue streams.
- **Qualification:** processes for accessing these value streams need to be similarly transparent and accessible. It should be possible for a marketplace to create something akin to a "digital passport", so FSPs can manage their access (and qualification status) to multiple services. This in turn requires a standardised approach to identify assets and FSPs that translate between all different kinds of services.
- **Contract management:** marketplaces can help streamline FSPs' management of contractual obligations across multiple long and short-term markets. One important element of this includes the ability of FSPs to secondary trade their obligations when needed
- **Operations and Settlement:** to provide FSPs with choice, standardised approaches to key operational aspects (such as availability declaration, and dispatch) and settlement (baselining, performance verification) are essential. Otherwise, the level of bespoke technical systems needed will make it almost impossible to practically align all these markets.

All of these elements are important for the consideration of widening and decarbonising Capacity Market participation, particularly due to the onerous qualification process currently in place and because the asset type, size and capabilities as well as companies participating are going to diversify moving forward.

It is critical that the Capacity Market is considered holistically within the ecosystem of market design. DESNZ, Ofgem and National Grid ESO must accelerate the deployment of solutions that can assist in this new decarbonised and complex era we are heading towards whilst removing the technical rules and barriers to areas such as qualification that remain.