

## **Defining CMUs and Portfolios**

### **Summary**

This paper defines a Capacity Market Unit and who can enter a CMU into a future Capacity Market. It also considers how portfolio structures are defined and who will ultimately be responsible for the penalties arising from the failure of CMUs to meet their obligations in the case of portfolio structures.

### **Detail**

A CMU is a unit of electricity generation capacity or electricity demand reduction that can then be put forward in a future Capacity Market auction. In this respect it is the product that forms the capacity to be purchased in the capacity market. It is therefore CMUs that will be accredited (subject to the result of the capacity market auction) and therefore owners or contractual operators of procured CMUs will have obligations assigned to them and the right to receive capacity payments.

There are two types of CMU:

- i) A Generating CMU – This can be existing or new plant or storage equipment capable of exporting electricity to the transmission system or distribution network via a single half-hourly meter capable of independent control. Participation in the pre-qualification stage of the Capacity Market auction will be mandatory for existing licensed electricity generators. However they may opt-out of the auction during pre-qualification. There will be six classes of Generating CMU: 1/ New build (plant not built at the time of the auction) 2/ Refurbishing (existing plant wishing to refurbish for emissions reduction purposes and access a longer-term agreement) 3/ existing operational opt in 4/ existing operational opt out (plant opting out but remaining fully operational for the delivery year 5/ existing non-operational opt out (plant opting out and which will not be operational in the relevant delivery year) and 6/ retiring plant. Baseload onsite generation may be eligible for a Generating CMU provided it is connected to the DNO network.
- ii) A Demand Side Response (DSR) CMU – DSR is the reduction of electricity demand below a pre-determined baseline (the normal level of electricity consumption in that period) by consumers through the curtailment or time-shifting of activity during the stress event. DSR CMU holders must be able to achieve this shifting of demand either as the owner or contractual operator of the relevant plant and machinery, or have a contractual relationship with the owner or operator. This will then convey a legal right for the DSR CMU holder to either turn down or turn off the relevant plant and machinery.

**CMU characteristics**

A CMU must have a minimum capacity of 2MW. Limited aggregation is permitted with sub-units (Components) aggregated behind a single (for Generating) or multiple (for DSR) half hourly meters. Separately metered units of over 2MW cannot be aggregated to form one CMU as the purpose of aggregation is to permit access to the capacity market of smaller Components. Similarly aggregation of different types of Generating CMU (New Build/ Refurbishing/ Operational) will not be permitted as this would create uncertainty around the status of the CMU and the monitoring and reporting required to determine delivery by the owner or contractual operator.

**Evolution of a CMU through the Capacity Market Process**

A CMU will have a different status at different points of the Capacity Market process.

- i) A Prequalified CMU – a CMU assessed by the Delivery Body and granted prequalification status in relation to a specific upcoming Capacity Auction.
- ii) A Capacity Committed CMU – A Prequalified CMU that has been entered into a specific auction and has not been withdrawn from the auction before the auction has cleared. The relevant Applicant (i.e. asset owner) is issued with a Capacity Agreement for that CMU making the Applicant a Capacity Provider. The CMU then becomes a Capacity Committed CMU. Each Capacity Committed CMU may only have one Capacity Agreement.

A Capacity Agreement will describe the rights and obligations of Capacity Providers in relation to a particular Capacity Committed CMU. This will include the right to receive capacity market payments and the responsibility to provide capacity. The rights and responsibilities are outlined in the Capacity Market Rules and the Electricity Capacity Regulations. Therefore there is no traditional contract between the parties. Instead, shortly after the Capacity Auction the Delivery Body will issue to each successful Bidder a Capacity Agreement Notice which will record the key terms of the Capacity Agreement for the relevant Capacity Committed CMU. Information in the Capacity Agreement Notice will reflect information recorded for that Capacity Committed CMU in the Capacity Market Register.

**Who can put forward a CMU in the Capacity Market?**

Owners or contractual operators of CMUs will be known as Applicants. It is necessary to define 'Applicant' so that only one person has sole responsibility for obligations assigned to the CMU (note an Applicant may have more than one CMU so the obligation is assigned to the CMU not the Applicant). This will avoid complex issues of shared liability and/or duplicate claims. In the case of a Generating CMU the Applicant will in most cases be the owner only as it is unlikely that any person operating generation plant on behalf of an owner would expect to receive capacity market payments or accept relevant liabilities.

The only case where the owner will not be the Applicant is where the legal owner has entered into an agreement that transfers the right to control whether the plant exports electricity in any particular Delivery Year (Despatch Control) because the capacity market requires the obligations and rights to fall on the person capable of responding to a stress event. In this case the Rules require the parties to approach the Department of Energy and Climate Change (via the Delivery Body) ahead of pre-qualification to determine who the Applicant should be. If in the future general characteristics are identified in these types of cases that can lead to the formulation of general guidance for dealing with these cases then the Rules will be updated to reflect this.

In the case of DSR the applicant may not be the owner. It is likely the DSR applicant will be a person who has secured the capability to provide the demand side response during a stress event, either via ownership of the plant or, more likely, via contractual rights to operate the plant.

It will be possible for the Applicant to nominate an Agent to submit one or more applications on their behalf provided the Application discloses the identity of the Applicant and the agency status.

Each application can only relate to one CMU.

The Rules have been designed for only UK limited companies as Applicants. However other forms of corporate organisations may own CMUs. In these circumstances the relevant persons may approach the Department of Energy and Climate Change (via the Delivery Body) before the pre-qualification phase for a decision on how the rules apply to them which will then be available to others.

### **The treatment of CMU's that are part of a portfolio**

The "portfolio" in which a CMU sits is relevant to the total cap set for the cumulative liability of penalties accrued by CMUs within that portfolio. The cumulative impact of penalties, though each penalty is incurred at a CMU level, cannot rise above a pre-determined "cap" for a given delivery year when the performance of all units within a portfolio is assessed across the whole year.

### **Defining the portfolio in which a Capacity Market Unit resides**

This section outlines how portfolios are defined for the purposes of applying Capacity Market penalty caps. It also defines a series of tests for establishing the identity of the 'portfolio holder' for each Capacity Market Unit (CMU). A series of worked examples are provided for further explanation.

Whilst an Applicant could have a complex ownership structure, a CMU can only belong to one portfolio at any one time. It is considered appropriate that any person who is to be held

responsible for the payment of penalties with respect to an asset (i.e. the 'Portfolio Holder'), should have a degree of control or decisive influence over it. Therefore it is necessary to establish a series of tests to determine the scope of the portfolio by tracking all CMUs under one common control or influence. The tests will also establish the priority of claims in respect of CMUs within a complex corporate framework.

The Portfolio Holder of a CMU is therefore the ultimate parent company of, in order of application:

- **Test one** - the person that has (direct or indirect) control<sup>1</sup> of the Applicant (in the traditional sense of majority control of the board through ownership of shares or through contract); or, if none
- **Test two** - the person that has decisive influence<sup>2</sup> over the Applicant **AND** control of the person that operates the CMU; or, if none
- **Test three** - the one person who has decisive influence over the Applicant, or
- **Test four** - if there are more than one such person meeting test three, any one of those persons, as nominated by the Applicant; or
- **Test five** - if there is no person with decisive influence over the Applicant, the Applicant.

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<sup>1</sup> Control shall be interpreted in accordance with the Companies Act

<sup>2</sup> Decisive influence shall be interpreted in accordance with the EU Merger Regulation. For illustrative purposes it has been assumed that a 30% direct or indirect shareholding would constitute a decisive influence because of the ability of a shareholder holding this proportion of shares to block special resolutions (which can be done with a shareholding over 25%).

**Appendix 1 - illustrative examples of CMU/Portfolio Holder relationships in basis corporate structures**

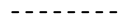
The following key applies to all the examples in this Appendix:



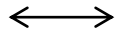
= *Applicant*



= *Portfolio Holder*



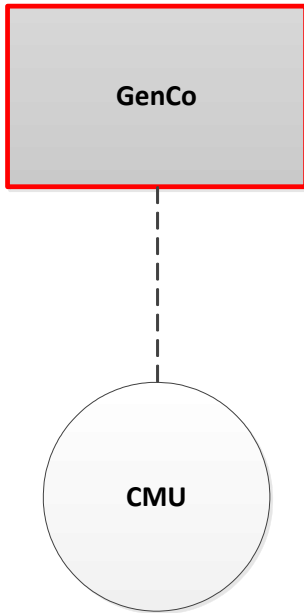
= *Shareholding*



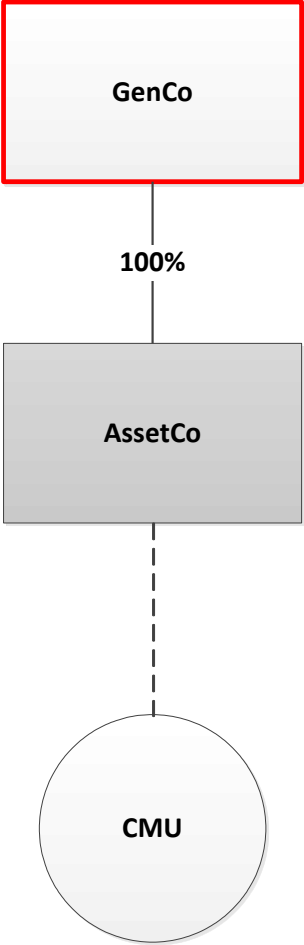
= *Asset ownership*

= *Contractual relationship*

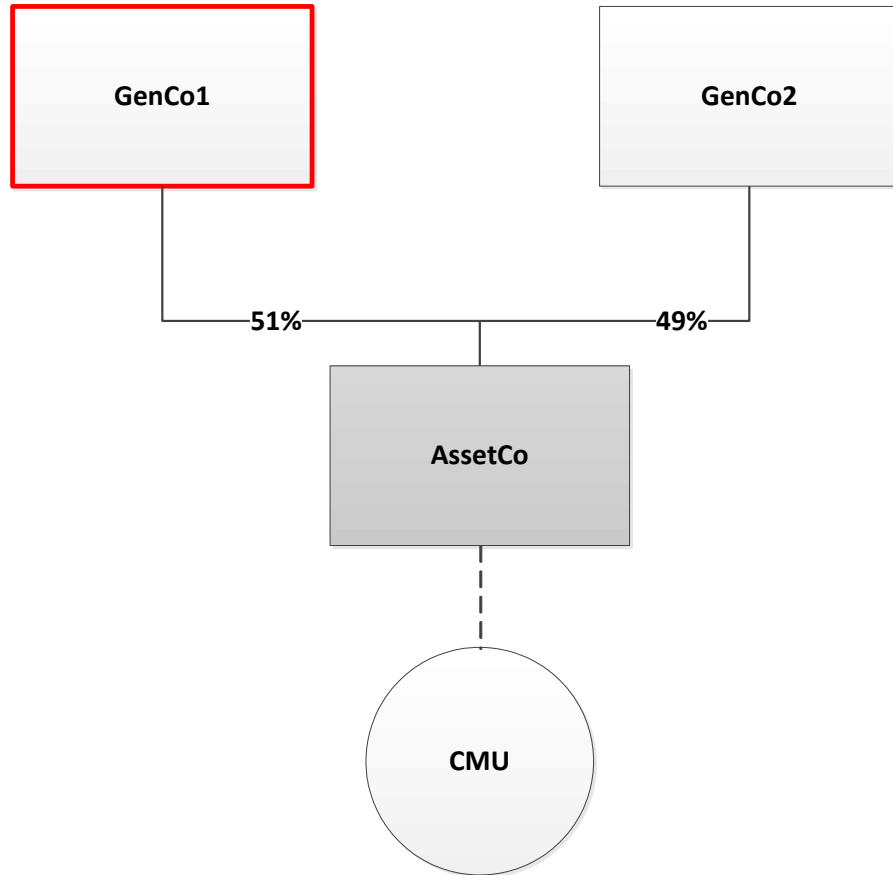
**1 Direct 100% ownership of a CMU by a generating company**



**2 Indirect 100% ownership of a CMU by a generating company**

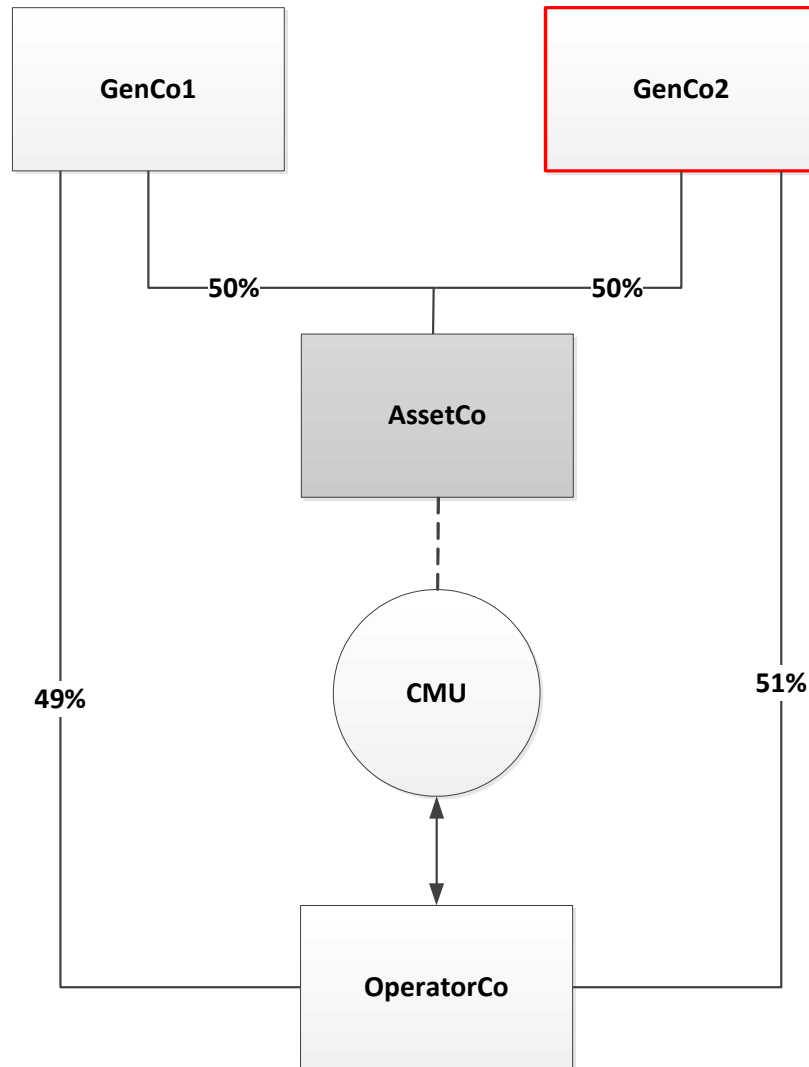


**3 Majority ownership of a CMU by a generating company**

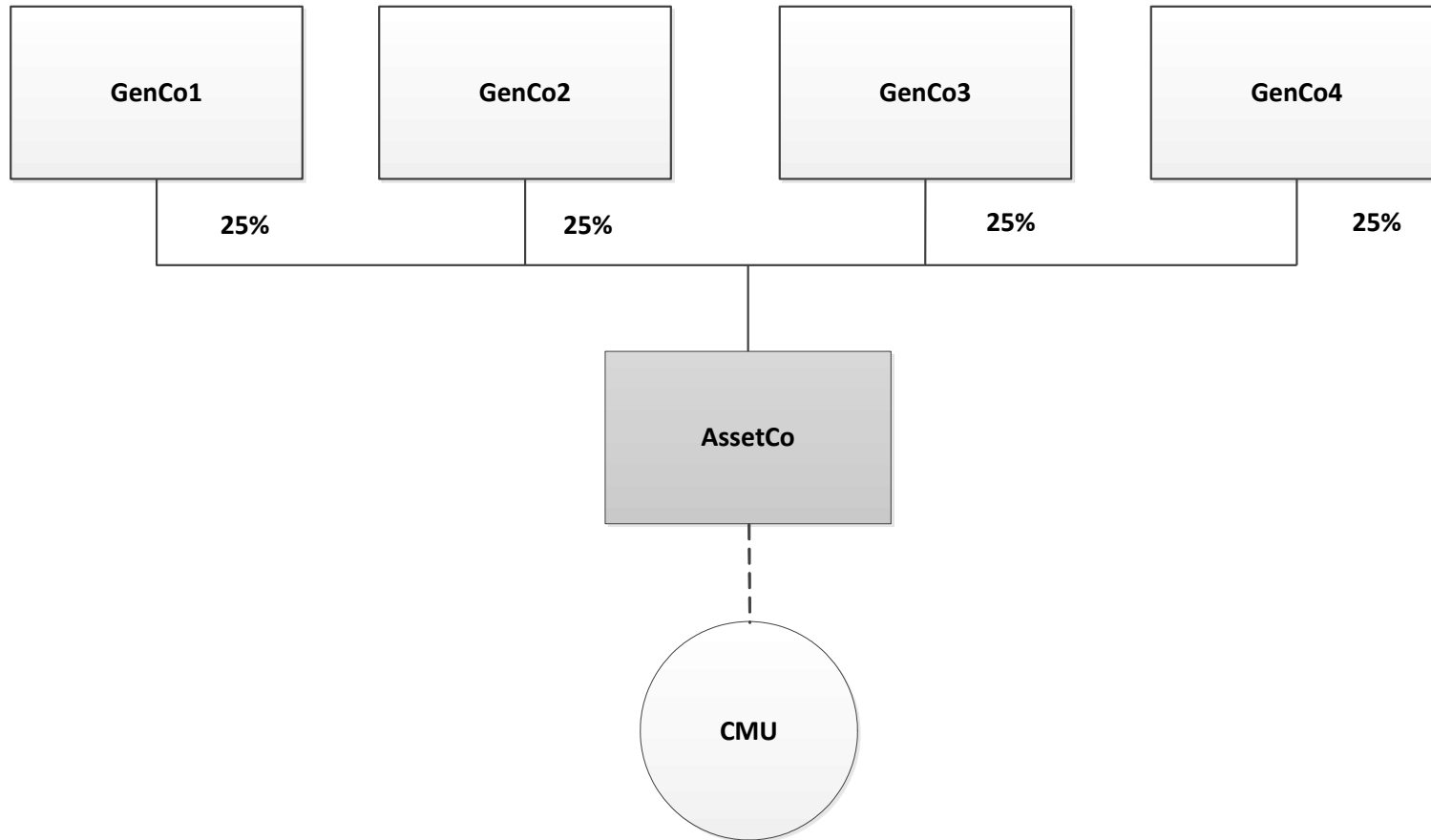




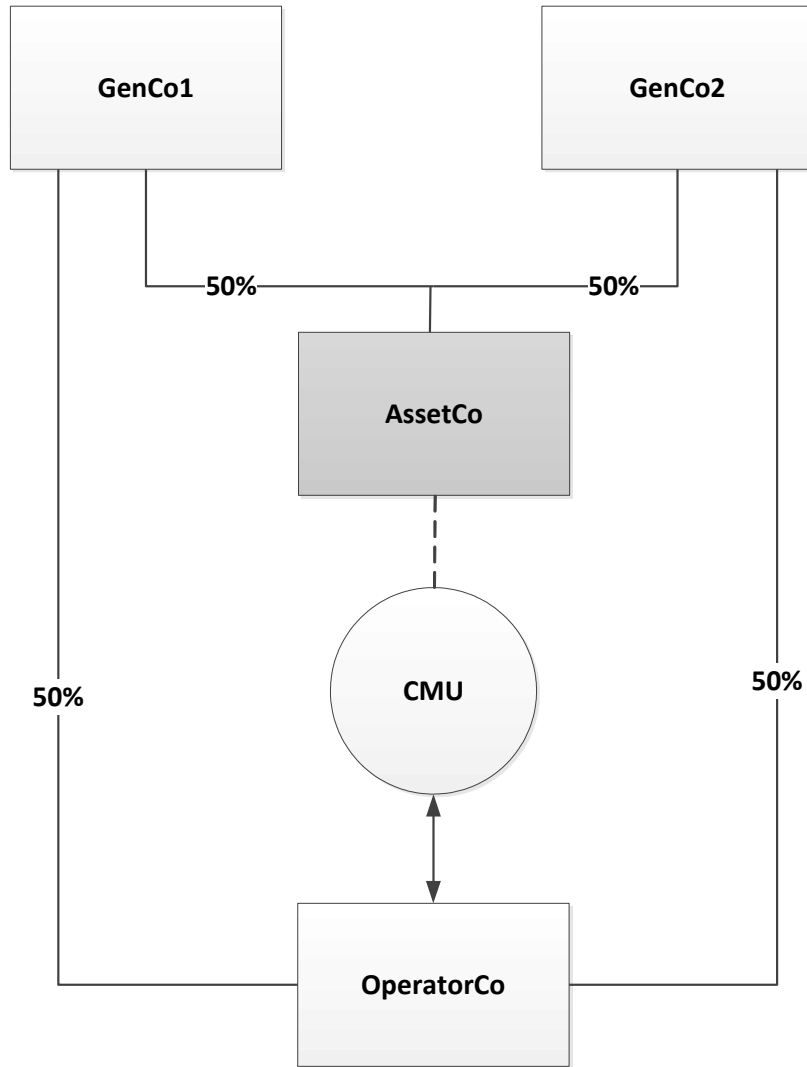
4 50/50 JV ownership of a CMU with majority ownership of the operator



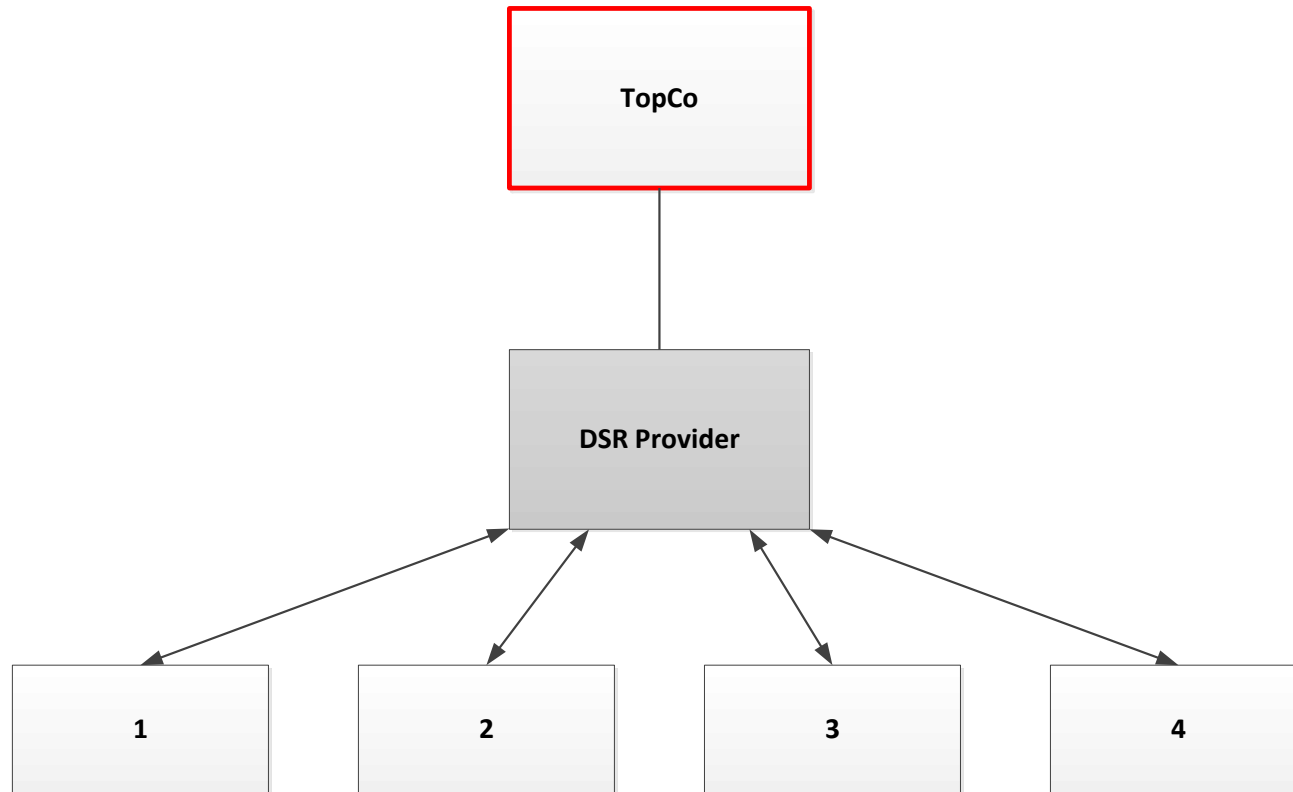
**5 Equal shared ownership of a CMU (no decisive influence = no portfolio)**



6 50/50 JV ownership of a CMU with 50/50 JV ownership of the Operator – full deadlock = no portfolio?



**7 DSR applicant**



### Appendix 2 Example group structure with multiple CMUs

Key:



= Portfolio Holder



= Agent



= Applicant / Capacity Provider



= CMU within portfolio



= CMU outside portfolio

OperatorCo

AssetCo

ManagementCo

100%

35%\*

25%

51%

49%

SPV1

SPV2

SPV3

SPV4

CMU

CMU

CMU

CMU

CMU

The Generating Company (GenCo) is split into three fully owned subsidiaries

- i) Operating Company (OperatorCo)
- ii) Asset Owner (AssetCo)
- iii) Management Company (ManagementCo)

Other party has majority control (test one)

Percentages refer to the proportion of the SPV owned by the Generating Company.

GenCo holds interests in 5 CMUs.

\* Assume no other company has a majority interest in the SPV

GenCo has a decisive influence (>30% shareholding) over the applicant (SPV1) AND

GenCo has majority

GenCo has majority

Other party has