



Department for
Business, Energy
& Industrial Strategy

Proposals for further amendments to the Capacity Market

Response to consultation



OGL

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Executive summary

The government believes the GB Capacity Market (“the CM”) remains the right mechanism to deliver secure electricity supplies at least cost. The government ran a consultation from 7 March 2019 to 4 April 2019, which covered proposals for:

- replacing the postponed T-4 auction from January 2019 with a T-3 auction to run in early 2020 for delivery in 2022/23;
- allowing certain renewable technologies to participate in the CM;
- changing the methodology for determining the de-rating factor of interconnectors participating in the CM; and
- making minor corrections and additions to the Rules.

In total, 42 responses were received from a range of stakeholders including CM providers, generators, interconnectors, suppliers, a local authority, NGOs and trade associations.

Following the consultation, we can now confirm that the government will proceed with making the necessary legislative changes to:

- replace the planned T-4 auction with a T-3 auction for delivery in 2022/23;
- allow certain renewable technologies to participate in the CM;
- remove the historical floor from the interconnector derating methodology; and
- make minor corrections and additions to the Rules to ensure they are clear and operate as intended.

1. Introduction

The CM aims to procure the capacity required to meet peak demand in a range of scenarios through competitive auctions normally held four-years and one-year ahead of delivery.

Since the CM was introduced in Great Britain (GB) in 2014, a series of auctions have been held securing capacity out until 2021/22. This includes four T-4 auctions, one T-1 auction, one 'Transitional Arrangements' auction for Demand Side Response (DSR) and small-scale distribution-connected capacity providers, one 'Transitional Arrangements' auction for turn-down DSR, and a one-year-ahead 'early auction'.

On 15 November 2018 the General Court of the Court of Justice of the European Union handed down its judgment in a case relating to the European Commission's decision-making process for giving State aid approval for the GB CM scheme¹ ("the State aid judgment"). The State aid judgment removed the European Commission's State aid approval for the GB CM scheme and introduced a standstill period until the scheme can be approved again, during which aid cannot be granted under the scheme. As a result, the government postponed the T-4 and T-1 auctions that were due to be held in early 2019.

On 21 February 2019 the European Commission launched an in-depth investigation, as required for the scheme to be approved again. As part of this they held a month-long stakeholder consultation, to seek industry views on the CM. Separately the European Commission has appealed the State aid judgment², and the UK government is has confirmed that it intends to support the Commission in this appeal³.

1.1 Summary of consultation proposals

The government has conducted a consultation on several changes to the CM, including a limited number of priority changes identified through the call for evidence issued during the summer of 2018 as part of the Capacity Market 5 Year Review.

The government proposed:

- A replacement T-3 auction to be held in early 2020, securing capacity for delivery year 2022/23 and replacing the T-4 auction previously scheduled for January 2019. This proposal included running a full new pre-qualification exercise and retaining existing requirements for auction participants to demonstrate Transmission Entry Capacity ("TEC").
- The addition of generating technology classes for certain renewable technologies and related changes to allow for the inclusion of these intermittent technologies in the CM. This followed the call for evidence from the summer of 2018 in which a strong majority of responses were in favour of allowing the participation of these technologies.

¹ <http://curia.europa.eu/juris/document/document.jsf?text=&docid=207792&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=1430154>

² http://europa.eu/rapid/press-release_IP-19-1348_en.htm

³ www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-02-21/HCWS1351/

- Changes to the methodology for determining interconnector de-rating factors. The government proposed removing the requirement for historical data to provide a ‘floor’ for interconnector de-rating factors (whilst leaving open options for an ongoing role for historical data).

1.2 Summary of responses to the consultation

In total, 42 responses were received from a range of stakeholders, including capacity providers, generators, interconnectors, suppliers, local authorities, NGOs and trade associations.

A clear majority of respondents were supportive of the proposals across each of the three key areas consulted on.

Most respondents agreed with the government’s proposal to run a T-3 auction for delivery year 2022/23. Some concerns were raised regarding the potential administrative and financial burden of running an additional auction alongside next year’s T-1 and T-4 auctions, and a number of respondents requested that pre-qualification applications which were submitted for last year’s postponed T-4 auction be ‘counted’ as applications for the new T-3 auction.

A large majority of respondents agreed that we should make the technical changes needed to allow further renewable technologies to participate, which would provide the opportunity for unsubsidised generators able to make a contribution to security of supply to receive fair and appropriate compensation. A small number of respondents disagreed arguing that the intermittent nature of renewables would not align with the purpose of the CM if renewables were unable to deliver capacity during a stress event.

The majority of respondents also supported the removal of the historical ‘floor’ for the interconnector de-rating methodology, and many respondents were supportive of the government’s proposal to introduce greater transparency into the de-rating process. A variety of suggestions were made for alternative ways in which historical data could be used in the de-rating methodology.

1.3 Next steps

This government response is divided into four chapters by subject area, each corresponding to one or more questions from the consultation. Each chapter contains an overview of the responses received in relation to the questions posed in the consultation (the ‘summary of responses’ sections) and explains the decisions that the government has taken and the legislative changes it will or intends to make to the CM legislation (the ‘Government response’ sections).

- Decisions in relation to the holding and implementation of a T-3 auction for 2022/23 are set out in Chapter 2.
- Decisions in relation to allowing certain renewable technologies to participate in the CM are set out in Chapter 3.
- Decisions in relation to the methodology for determining interconnector de-rating factors are set out in Chapter 4.

- Decisions in relation to miscellaneous additions and corrections to the Principal Regulations and Rules are set out in Chapter 5.

The government will lay draft regulations (the Electricity Capacity (No. 2) Regulations 2019) (“the draft regulations”) to make the necessary amendments and modifications to the Electricity Capacity Regulations 2014 (“the Principal Regulations”) and the Electricity Capacity (No. 1) Regulations 2019 shortly after this government response is published. The draft regulations must be debated and approved by both Houses of Parliament before they can come into force. The necessary amendments and modifications of the Capacity Market Rules 2014 (“the Rules”) have been organised into three separate instruments:

- The Capacity Market Amendment (No. 3) Rules 2019 came into force in late May 2019 and will be laid in Parliament in early June alongside the Electricity Capacity (No.2) Regulations 2019, making the amendments which are necessary to come into force ahead of the scheduled replacement T-1 auction and the opening of pre-qualification for the next auction round, including allowing the participation of further renewable technologies in the CM, updating the methodology for de-rating of interconnectors, and making miscellaneous corrections to the Rules to align the drafting with policy intent and current operation of the Capacity Market;
- The Capacity Market Amendment (No. 4) Rules 2019 will come into force alongside the draft regulations, to make the amendments which are necessary to require other low-carbon support received by the new build renewable technologies being introduced into the Capacity Market to be declared by Capacity Providers;
- The Capacity Market Amendment (No. 5) Rules 2019 will come into force alongside the draft regulations, putting into effect modifications relating to the T-3 auction for 2022/23.

2. 2022/23 delivery year

Consultation questions:

1. Do you agree with the proposal to run a T-3 auction for delivery year 2022/23?
2. Do you agree that the amendments to the usual T-4 auction design/process proposed above are appropriate for this T-3 auction?
3. Are there any further issues the government should consider in implementing the T-3 auction?

2.1 Summary of responses

41 respondents provided responses covering questions 1 to 3.

Holding a T-3 auction: A large majority of respondents considered holding a T-3 auction the best available option to secure capacity for delivery year 2022/23 following the suspension of the CM in November 2018. Two respondents noted that they would have preferred a conditional T-4 auction (along the lines of the arrangements for the conditional T-1 auction for 2019-20)⁴.

Auction timing: Although most respondents supported the proposal to hold the T-3 auction alongside the other auctions scheduled to be run in the next auction window, several respondents requested that the T-3 auction for 2022/23 be held as soon as possible.

Eligibility and prequalification: 14 consultees objected to the proposal not to carry forward successful prequalification applications from the postponed 2022/23 T-4 auction into the new T-3 prequalification process, arguing that this would result in an unnecessary repeated process. A number of respondents flagged concerns about the administrative burden associated with submitting several prequalification applications within a limited timeframe. In addition, some respondents thought there was a greater potential for errors in prequalification applications if more prequalification processes than usual were run in parallel, and requested changes to regulation 69 of the Principal Regulations to allow errors to be corrected at the appeal stage.

Respondents were supportive of the proposal to retain the usual requirements relating to Transmission Entry Capacity.

Target capacity: Several consultees highlighted their support for a short gap between the T-3 and T-4 auctions to allow the outcomes of the T-3 to be factored into the final T-4 parameters (when setting T-4 capacity levels). However, feedback from one trade body noted mixed views on this amongst their membership, with some members supporting the proposals and others suggesting that the parameter-setting process for the T-1 auction for 2023/24 would provide a more appropriate opportunity for revising capacity for delivery year 2023/24.

⁴ www.gov.uk/government/consultations/capacity-market-technical-amendments

Milestones: Respondents were mostly supportive of the proposed milestone changes, though there were more mixed views regarding the proposal to change the FCM to 12 months post-auction, with some respondents in favour and some against. Those against tended to feel that the change would disadvantage large plant. A couple of respondents suggested that bringing forward the requirement for increased credit cover was disproportionate and would increase costs in the auction. Several respondents noted more general concerns about the ability for new build projects to meet their construction milestones within shortened T-3 timescales.

Credit cover: Most respondents were in favour of the changes, though two respondents suggested that once the current standstill period ends, back-payments should be made to providers before credit cover is required to be posted. There were some concerns that the current proposals could require the duplication of credit cover where a prequalification application was made for both the 2022/23 T-3 and 2023/24 T-4 auctions.

Other T-3 issues: One respondent raised concerns that new build CMUs which successfully prequalified for the postponed 2022/23 T-4 auction would no longer be entitled to 15-year contracts in the T-3 auction if they had been commissioned since the previous prequalification. Another respondent suggested that changes to the opt-out and price taker rules covering the 2023/24 T-4 auction should be introduced to avoid any risk that existing capacity providers are obligated to offer assets that are unsuccessful in the T-3 into the T-4 at uneconomic prices.

Respondents also raised a variety of other **more general issues**, not specifically related to government's proposals for a T-3 auction:

- A number of respondents made general requests for the Rules and the Principal Regulations to be simplified.
- Several respondents requested a lighter touch prequalification process.
- Various comments highlighted respondents' concerns around the uncertainty created by ongoing State aid clearance and the potential impact on investment, and there were several requests for BEIS to set out a 'plan B' for the event that State aid clearance is not forthcoming.
- General concerns were raised about the functionality of the EMR Delivery Body Portal, which does not provide the option of carrying forward relevant information where it is unchanged from a previous year's application.

2.2 Government response

2.2.1 Rationale for a T-3 auction

The government intends to proceed with changes to allow a T-3 auction to be held for delivery year 2022/23, in line with the majority view in the consultation feedback that a T-3 auction is the best of the available options. This approach will provide greater certainty to investors than a delayed T-4 auction, enabling the auction to be run at a time when the Commission is likely to have made a decision about State aid approval. It will also allow capacity agreements to be awarded through the auction (as opposed to 'conditional capacity agreements', as per the approach which was adopted for the replacement 2019/20 T-1 auction).

2.2.2 Timing

Concerns were raised regarding the impact of a late auction on new build projects, which may find it harder to construct in a more compressed timeframe. The government recognises this concern, and is also of the view that an early auction would be preferable. Holding the auction as soon as possible will provide more certainty for industry and could increase competition in the auction, improving liquidity and reducing costs for consumers.

Accordingly, the government intends to hold a T-3 auction in early 2020 (subject to the timing of approval of the draft regulations by both Houses of Parliament), with the T-1 auction for 2020/21 to take place 1 week later, and the T-4 auction for 2023/24 to take place 6 weeks after the T-3 auction. An indicative auction timeline was recently published by the Delivery Body.⁵

As outlined in sections 2.2.3 to 2.2.7 below, we intend to make other changes to timeframes and processes to ensure these auctions can be run as soon as possible in 2020. We consider these changes strike an appropriate balance between ensuring the actions can proceed promptly, and avoiding placing additional burdens on CM participants and delivery partners.

2.2.3 Prequalification

The government intends to run a new prequalification exercise for the T-3 auction, during which each CMU wishing to participate in the auction would need to complete a new prequalification application. The government recognises concerns about the administrative burdens of running prequalification exercises for 3 separate auctions (2020/21 T-1, 2022/23 T-3 and 2023/24 T-4) within a restricted timeframe, but does not consider that it would be appropriate to 'carry across' the pre-qualification results for those who successfully prequalified for the 2022/23 T-4 auction before the suspension of the CM to the T-3 auction. This is because:

1. The T-3 is a new auction, which is not analogous in every respect to the postponed 2022/23 T-4 auction;
2. Information which was provided during prequalification for the postponed 2022/23 T-4 auction will need to be revisited due to the extended period of time which will have elapsed between pre-qualification for the T-4 auction and running of the T-3 auction;
3. The government believes that it is appropriate to run a prequalification exercise for the T-3 auction into which certain renewable technologies are able to enter (see Section 3 below).

Whilst the government understands concerns about potential mistakes made by applicants when submitting applications for up to three prequalification exercises, it is necessary to implement a firm deadline in order to allow the Delivery Body to conduct prequalification decisions and appeals in a timely manner to allow the auctions to be scheduled for early 2020. However, to help make the process as easy as possible for applicants the Delivery Body will continue to run a briefing event, provide one to one guidance by telephone via their front desk to support would-be-participants and produce an updated set of comprehensive guidance notes – measures which have been well received by many participants in previous years.

⁵ www.emrdeliverybody.com/Capacity%20Markets%20Document%20Library/Operational%20plan%20v1.0%202019.pdf

The government intends to modify regulation 69 to allow the Delivery Body up to 20 working days (instead of 15) to consider a request to review prequalification decisions in respect of the 2020/21 T-1 auction, the 2022/23 T-3 auction and the 2023/24 T-4 auction.

2.2.4 Eligibility

Consultation respondents were in agreement that it was appropriate to maintain the existing requirement relating to Transmission Entry Capacity (TEC), and the government will therefore be making no changes in this area.

However, in response to feedback received through the consultation and further scrutiny of the impact of necessary the modifications to the Rules to enable the T-3 auction, the government also intends to make the following changes in respect of eligibility. We consider that these changes are required to enable appropriate participation by prequalified CMUs in the 2022/23 T-4 auction:

- Following the auction results day for the T-3 auction, the Delivery Body will be able to change the status of CMUs prequalified for the T-4 auction so that they are no longer prequalified if a multi-year capacity agreement is awarded in respect of that CMU in the T-3 auction. This change is intended to avoid over-compensation in respect of a CMU which is participating in the CM for the 2023/24 delivery year.
- Following the auction results day for the T-3 auction, the Delivery Body will update the Maximum Obligation Period (“MOP”) for a prospective CMU entering the 2023/24 T-4 auction to one year if an agreement is awarded in respect of that CMU (or any of the Generating Units comprising that CMU) in the T-3 auction. Refurbishment CMUs will remain eligible for 3 year agreements in the T-4 auction if they have specified in the confirmation provided to the Delivery Body pursuant to Rule 5.5.14 that they also wish to participate in the T-3 auction with respect to the associated Pre-Refurbishment CMU, and are awarded a 1 year agreement for that Pre-Refurbishment CMU in the T-3 auction, after providing a duration bid amendment pursuant to Rule 5.6.6. This change is intended to prevent prospective CMUs specifying a capacity agreement duration of 1 year in the T-3 auction, and following the auction results of the T-3 auction specifying a multi-year duration for a capacity agreement in the subsequent T-4 auction.

One consultation respondent also queried whether new build CMUs which have fully commissioned their generation plant since prequalification for the postponed T-4 auction last year would be eligible for 15-year contracts in the new T-3 auction. Such plant would be an existing CMU under the Rules and would therefore be eligible to prequalify with a MOP of 1 year. The government will not be making any changes to this position, as a more flexible approach to eligibility for longer-term agreements would not be in line with our view that multi-year contracts are only justified where long-term financing is required to allow new entrants with high capital costs to compete in the auctions. Plant which has commissioned in the last year has demonstrated (by commissioning) that it does not need such an agreement in order to secure financing. Awarding multi-year agreements where they are not required risks undermining the government’s aim to maintain security of supply at least cost to the consumer.

2.2.5 Target Capacity

The draft regulations are expected to come into force after the Delivery Body’s annual deadline to submit their Electricity Capacity Report to the Secretary of State (1 June). Therefore to enable the target for the T-3 auction to be set as accurately as possible, the government intends to proceed with changes to Regulation 7 which will require the Delivery Body to provide

an updated assessment of the capacity that needs to be secured for 2022/23, via an annex to their 2019 Electricity Capacity Report. Regulation 12 will also be amended to require the Secretary of State to take this annex into account when determining the parameters for the T-3 auction.

The government also intends to allow sufficient time between running the 2022/23 T-3 and 2023/24 T-4 auctions to allow the results of the T-3 auction to be taken into account when confirming the final target capacity for the T-4 auction. The auction schedule outlined in section 2.2.2 is designed to accommodate a period of up to 8 working days for publication of the T-3 auction results after the auction has concluded (Rule 5.10.6), and a period of 15 working days before the T-4 auction date before which the final auction guidelines and final parameters must be published (Rule 2.2.2). Between the auction results day for the T-3 auction and the announcement of the final T-4 parameters we intend for there to be a short period in which the T-4 demand curve and target capacity could be amended (if necessary) to account for the total volume of multi-year contracts awarded through the T-3 auction.

Whilst a range of views were received on this proposal, the government's view is that it is appropriate that such an arrangement should be in place, allowing the parameter-setting process for the 2023/24 T-4 auction to align as closely as possible with the usual process for setting T-4 capacity levels. The alternative approach set out in the consultation (decreasing the capacity secured in the 2023/24 T-4 auction and increasing the capacity 'set-aside' for the 2023/24 T-1 auction so that any adjustments can be dealt with at that point) is sub-optimal. Although the latter option would allow the T-4 auction to be run a little earlier, it would also require government to make projections about the volume of multi-year agreements which were likely to result from the T-3 auction – an assessment which would be more likely to produce a less accurate result.

To allow the adjustment process described above, the government intends to modify how regulation 13 of the Principal Regulations applies to the T-3 auction and subsequent T-4 auction. These modifications will allow the Secretary of State to make additional adjustments to the demand curve and target capacity for the subsequent T-4 auction after being notified of the results of the T-3 auction by the Delivery Body under regulation 25(1).

Since any adjustments will be made shortly before the T-4 auction, the government did not consider it appropriate for these amendments to allow the late changes of any other auction parameters (such as the 15 year £/kW threshold, or price-taker threshold).

2.2.6 Milestones

The government intends to proceed with the changes proposed in the consultation with regards to delivery milestones for the T-3 auction, to enable similar levels of delivery assurance to be secured despite the condensed timeframe between the auction and the delivery year. These changes generally received support through the consultation, though some concerns were raised with regards to the proposed change to the financial commitment milestone (FCM, discussed below). Several respondents also raised more general concerns about the reduced ability for new build projects to meet their construction milestones within the three-year lead-in time associated with a T-3 auction. The government recognises that the State aid judgment and the resultant shift from a T-4 to a T-3 approach to secure capacity for 2022/23 will have impacted on the plans of some capacity providers, but remains of the view that it is not appropriate to move back the long stop date to artificially extend the construction period for the T-3 auction so that it is more in line with that of a normal T-4. This is because there remains a need for timely delivery of capacity, and that converging long stop dates for the T-3 and T-4 auctions would create risks for the security of supply.

The changes which government intends to make to the T-3 milestones by modifying the effect of the Rules are as follows:

- **Financial commitment milestone (FCM) (Rule 6.6):** The government notes that some consultation respondents would prefer to retain the usual FCM deadline (16 months after the Auction Results Day (ARD) for T-4 auctions), and recognises the challenges that the move to more compressed T-3 auction timelines may have for developers of new-build projects. However, we remain of the view that the proposal to bring forward the FCM to 12 months after ARD for the T-3 auction is appropriate and intend to modify the effect of Rule 6.6 to implement this change. Retaining the existing deadline would result in providers meeting the FCM just over a year ahead of the T-3 delivery year (in contrast to a T-4 auction, where the FCM needs to be met more than two years ahead of the delivery year). Moving the deadline to 12 months after ARD is a compromise that will result in providers meeting FCM around a year and a half ahead of the delivery year. We believe that this is appropriate to provide confidence that developers have committed to financing their projects, despite the shorter lead-in time between the auction and the delivery year.
- **ITE report/additional credit cover (Regulation 59(4) and Rule 6.6A):** To ensure appropriate sequencing of obligations the government intends to modify the effect of regulation 59(4) and Rule 6.6A to bring forward the requirement to post additional credit cover if an Independent Technical Expert (ITE) report has not been submitted 9 months after ARD for the T-3 auction (rather than the usual 12 months for T-4 auctions). Although two respondents considered that this change would raise the costs associated with providing credit cover through extending the period in which credit cover is required by 3 months, the government notes that the T-3 auction is taking place a year later than a normal T-4, reducing the overall period in which credit cover may be required to be held for most applicants.
- **Metering assessment (Rule 3.6.4, Rule 3.6A.3, and Rule 3.9.4):** We intend to extend the metering assessment deadline for existing generating CMUs, existing interconnector CMUs and proven DSR CMUs to two years ahead of the start of the 2022/23 delivery year. The usual T-4 deadline of 3 years ahead of the delivery year is clearly incompatible with the timescales of a T-3 auction, because it would require capacity providers to submit metering assessments immediately after, or potentially even before, the auction is held.

The deadlines for all other milestone obligations in respect of the T-3 auction will mirror the usual T-4 auction deadlines.

2.2.7 Credit Cover

In line with our consultation proposal, the government will suspend credit cover requirements for the 2022/23 T-3 auction, the 2023/24 T-4 auction, and the 2020/21 T-1 auction during the standstill period. This will be done by extending the provisions of the Electricity Capacity (No. 1) Regulations 2019 which suspend credit cover requirements for capacity agreements which existed on 15 November 2018 (i.e. regulations 20 to 22) to these auctions (with minor modifications).

Many consultation respondents commented on the importance of holding the upcoming auctions as soon as possible, and several consultation responses noted the importance of running the T-3 auction in particular as early as possible, due to the challenges that the T-3 timescale will pose to new build plant. The government is also keen to see these auctions run

to schedule to provide confidence to industry and to ensure the best levels of liquidity in the auctions to keep costs as low as possible for consumers. Having further considered the timeframes for these upcoming auctions, including the date by which it is desirable for them to conclude, it has become apparent that a 40 working day period for posting credit cover after being notified by the Delivery Body at the end of the standstill period that credit cover is required is likely to result in undesirable delays or deferral of prospective auction dates.

We do not intend to proceed with the 2022/23 T-3 and 2023/24 T-4 auctions prior to securing credit cover from relevant CMUs as the volume of new build plant is likely to be high, and there is a need for these projects to demonstrate that they are serious and viable to ensure security of supply. Failure to secure credit cover for these auctions could result in greater volumes of speculative projects successfully securing agreements, risking higher volumes of 'non-delivery' with knock-on implications for security of supply.

We therefore do not intend to implement our proposal that applicants for these auctions be provided with a 40 working day window to post credit cover. To minimise the risk of auction delays whilst retaining the delivery assurance provided by the credit cover provisions, we intend to require applicants to provide credit cover within 15 working days of the Delivery Body's notification, instead of the 40 working days originally proposed. We consider this provides an adequate amount of time for applicants to comply with their credit cover obligations, as this 15 working day period is in line with the ordinary deadline for posting applicant credit cover following receipt of a conditional prequalification notice.

In response to concerns raised by consultation respondents, we are also making changes to allow capacity providers who enter the same CMU into the 2022/23 T-3 and 2023/24 T-4 auctions to satisfy the credit cover requirements for both auctions together. Modifications to how regulations 59 and 60 apply in these circumstances will allow an applicant to post and maintain credit cover in respect of both auctions by providing or maintaining an amount equal to the higher of the two individual amounts required for these auctions. This means, for example, that where credit cover is no longer required in respect of the T-3 auction, an applicant will thereafter only be required to maintain credit cover at the amount required for the T-4 auction.

Applicants entering a demand-side response or interconnector CMU into a capacity auction are ordinarily able to apply to be exempt from the requirement to provide further credit cover if they are still maintaining credit cover for this CMU in relation to a prior auction. As the deadline for posting credit cover at the end of the standstill period for the upcoming auctions will be earlier than the deadline for posting credit cover for existing capacity agreements (15 working days, rather than 40 working days), we will be making adjustments to ensure the order in which credit cover is posted does not prevent applicants from accessing this exemption. We will modify how the Principal Regulations apply in these circumstances to allow applicants to request that credit cover provided for the upcoming auctions within the 15 working day deadline be treated as credit cover provided in respect of their existing capacity agreements at the 40 working day deadline for the purposes of the regulation 59(1B) exemption.

3. Allowing certain renewable technologies to participate in the CM

Consultation question:

4a. Do you agree with the addition of generating technology classes for these renewable technologies to Schedule 3 of the CM rules?

4b. Are you in agreement that the Equivalent Firm Capacity methodology should be applicable to wind and solar technologies, if and when it is deemed appropriate by the Delivery Body? If not, why not and what alternatives would you propose, if any?

4c. Are you aware of any additional low-carbon supports or funding programmes that need to be accounted for or monitored to ensure that wind and solar technologies participating in the CM are not receiving State aid from other sources?

4d. Do you agree that the existing approach of separately de-rating the component technologies included in a hybrid CMU containing renewable technologies is appropriate to use until reliable data on their observed performance is available? If not, what alternative methodology would you propose?

4e. Do you have any evidence of the impact the addition of technologies noted in 4a will have on your business, or are you aware of any impacts we have not considered above?

3.1 Summary of responses

Of 37 responses to question 4a, over 85% were supportive of the proposal, with a majority of those strongly supportive. Those in favour of the proposal felt that it was fair and appropriate for the CM to compensate technologies for their contribution to security of supply. Many noted that it was critical to ensure that de-rating factors are accurate and that mechanisms be put in place to ensure no double subsidy is received. Other reasons given in favour of the proposal were that the CM would likely provide an important route to market for certain renewables in future. A few responses noted the importance of facilitating secondary trading, including the removal of the 5-day notification period, since renewable participation would increase the need for secondary trading closer to real-time. Others noted the importance of an effective penalty regime in ensuring security of supply.

Those opposed to the proposal felt that allowing non-dispatchable technologies into the CM was counterintuitive and at odds with the goal of the mechanism. They felt there was no guarantee that non-dispatchable technologies would deliver at times of stress, and if non-delivery gave rise to security of supply issues it could undermine the legitimacy of the CM.

On the de-rating methodology (question 4b), all but 2 of the 31 responses received were in favour of the proposal to use the incremental Equivalent Firm Capacity (EFC) methodology to de-rate the wind and solar technology classes. A large number of responses noted that the de-rating factors needed to be reviewed regularly in order to ensure that they are reflective of technological changes, and appropriately reflect the performance of intermittent technologies during stress events. A number of respondents commented on three aspects of the proposal

to use the incremental EFC de-rating: some felt the use of an average incremental EFC would be more appropriate in general; some noted that using the average would be more appropriate for existing projects exiting the RO and other support mechanisms; and some noted a perceived inconsistency between using an incremental methodology for renewables and an average methodology for interconnectors. A couple of responses noted that, whilst they agreed that the EFC methodology was statistically accurate, it still did not guarantee delivery during times of system stress and so they remained opposed to the inclusion of renewables in the CM. A few responses noted that regional de-ratings could provide more accuracy in future.

In response to question 4c, one additional subsidy programme was noted.

All but one of the 26 responses responding to the question on the de-rating of hybrid CMUs (4d) felt that the existing methodology was appropriate at present (the further response was neutral). It was noted that de-rating factors for hybrid CMUs are likely to be complex, and that the existing methodology of separately de-rating the individual component technologies is satisfactory and should be used until there is data showing the contribution of hybrid CMUs to security of supply is greater than the sum of its parts.

18 respondents provided evidence about the potential impact of the changes on their business (4e). Most renewable generators indicated that they thought the proposals would not have an impact on their business or on their overall rates of deployment of renewable technologies, as the revenues from the CM would not be significant enough to influence investment decisions. A couple felt that there would be a minimal impact and would result in a very small acceleration of the deployment of subsidy-free renewables. A few non-renewable generators expressed concern that the continued deployment of non-dispatchable renewables would see further market impacts such as a decline in wholesale price that could impact their business, and that lower clearing prices in the auctions could push out dispatchable generation.

Overall, the responses to this consultation are in line with the 63 responses⁶ to the call for evidence that closed 1 October 2018. The large majority of these responses were also in favour of allowing the participation of these technologies.

3.2 Government response

3.2.1 Introduction of renewable technologies to the CM

The government welcomes the broad support for making the technical changes needed to allow the participation of further renewable technologies in the CM, and will adopt the proposal to add Generating Technology Classes for Non-Dispatchable Generation to Schedule 3 of the CM Rules. Mechanisms will be in place to ensure that de-rating factors are appropriate and are reviewed regularly (see 3.2.2) and that low-carbon support is accounted for to avoid duplication of State aid (see 3.2.3).

As noted in the consultation document and many of the consultation responses, wind and solar make a measurable contribution to security of supply despite their intermittency. This contribution is currently accounted for as part of the CM's auction target setting process. Accordingly, their participation in the CM does not increase security of supply risks, but rather alters where and how their contribution to security of supply is accounted for. Remunerating this contribution is a key principle of the technology neutral framework of the CM, and a

⁶ Many of which were from organizations that responded to the recent consultation.

de-rating methodology has been developed to accurately account for that contribution (more in 3.2.2 below). This methodology accounts for the risks of intermittency by further de-rating intermittent technologies as their deployment goes up, such that total reliance on intermittent technologies is not possible. Allowing these technologies into the CM further encourages delivery during stress events, through secondary trading when necessary.

It was always anticipated that the CM's framework would allow the participation of these technologies at some point. With the arrival of subsidy-free projects interested in bidding into the CM, and the Delivery Body ("DB")'s work to effectively de-rate intermittent renewables, the impetus for this change has become clear, reinforced by the widespread support of stakeholders. Given the intention from the inception of the CM to allow renewables to participate, and the arrival of subsidy-free projects sooner than anticipated, we believe that allowing these projects to pre-qualify for the T-3 auction in early 2020 is fair and necessary.

3.2.2 Use of the Equivalent Firm Capacity (EFC) de-rating methodology

The government intends to amend the Rules (at Rule 2.3) to allow an EFC methodology – which currently only applies to storage generating technology classes – to be applied to non-dispatchable generating technology classes.

In accordance with the process for review of de-rating factors (at Rule 2.3), the DB will undertake an annual review of the de-rating factors for non-dispatchable generating technology classes participating in the CM. De-rating factors will be included in the Electricity Capacity Report which the Delivery Body is required to submit to the Secretary of State.

Incremental de-rating is a method of measuring the contribution of additional capacity of a particular technology to the overall system, rather than the average performance of the existing fleet of that technology, and is used in the case of resources whose fleet performance varies depending on the total level of deployment of plant of that technology type. This is especially relevant for intermittent resources such as wind and solar, whose output is subject to the weather. Further description of the EFC methodology is available in the DB consultation response⁷. The BEIS consultation noted that future consideration will be given to the basis on which to calculate de-rating factors for ex-Renewables Obligation (RO) projects, in preparation for when significant amounts of projects exiting that program become eligible to bid into the CM. The DB has the discretion to use the incremental or average methodology, as appropriate. At this time, with the vast majority of the non-dispatchable renewable fleet outside of the CM, the incremental method has been recommended for use.

In respect of the comparison to the approach to de-rating interconnectors, it is appropriate to rely on a different approach given interconnectors are assessed and de-rated individually and on an annual basis (see Section 4.2.2). As noted, the rationale for the incremental methodology is detailed in the DB's consultation response, and the supporting statement of the Panel of Technical Experts quoted on page 10 of that consultation response provides additional explanation.

The government intends to correct the Rules (Rule 2.3) to clarify that the EFC methodology is based on the Expected Energy Unserved metric (the amount of total system demand for electricity in MWh that may not be served to consumers in a given capacity year), rather than Loss of Load Expectation, which is the basis for other de-rating factors.

⁷ www.emrdeliverybody.com/Prequalification/EMR%20DB%20Consultation%20response%20-%20De-rating%20Factor%20Methodology%20for%20Renewables%20Participation%20in%20the%20CM.pdf

3.2.3 Low-carbon supports and avoiding duplication of State aid

The Rules require, as part of the financial commitment milestone obligation (Rule 6.6), capacity providers for prospective CMUs in receipt of State aid under specified schemes⁸ (referred to as “relevant investment” in the Rules) to declare this support in a funding declaration where it is used to fund capital expenditure (described as “Relevant expenditure” in the Rules). Where Relevant expenditure is declared, regulation 49A of the Principal Regulations contains detailed requirements and the methodology for Relevant expenditure to be deducted from capacity payments by the Settlement Body. The requirement in the Rules for prospective CMUs to declare Relevant expenditure via funding declarations and the methodology in the Regulations for deducting it from capacity payments will remain unchanged, albeit we intend to amend Rule 6.6, Rule 8.3.8 and Regulation 49A to accommodate the declaration of other low-carbon support and the methodology for its deduction, as outlined below.

The government considers it appropriate for CMU applicants in receipt of funding via the Contract for Difference, Renewables Obligation, or Feed-in Tariff schemes to remain excluded from bidding for CM agreements as long as they are in receipt of subsidy under these schemes. However, as noted in the consultation, new build renewable technologies which will now be able to participate in the CM which do not receive support under these schemes, may still benefit from other low-carbon support which constitute State aid. In order to account for this additional support and prevent over-compensation with the aid granted by the CM scheme, the government intends to amend the Rules (Rule 6.6 and Rule 8.3.8) and the sample declaration in Exhibit J to require capacity providers for prospective CMUs in a non-dispatchable generating technology class to declare support received under such schemes (which will be called “relevant benefit” in the Rules) in the lead up to or during the delivery year for that CMU, where it is used on the costs of the CMU.

Regulation 49A of the Principal Regulations will be amended to require the Settlement Body to deduct “relevant benefit” from capacity payments in the same way as “relevant expenditure”. As relevant benefit may be declared late in the delivery year after most capacity payments have been paid, the Settlement Body will also be required to invoice capacity providers for outstanding relevant benefit and expenditure where there are no further capacity payments to make deductions from. This invoice will be capped to the total amount of capacity payments a capacity provider has been paid (and has not been required to repay).

In order to ensure that support received during the course of the delivery period for the relevant CMU is also declared and accounted for, the government intends to amend Rule 8.3.8 and to also enable capacity providers for prospective CMUs in a non-dispatchable generating technology class to submit updated funding declarations upon receipt of any undeclared support throughout the delivery period of their capacity agreement.

As described above, capacity providers for prospective CMUs in a non-dispatchable generating technology class will be required to declare support received that is State aid and constitutes “relevant benefit”, and if they fail to provide a funding declaration, their agreement may be terminated in accordance with the existing Rules (termination events at Rule 6.10.1).

In response to the consultation the government has only been made aware of one additional low-carbon support scheme available to new build renewable technologies which will now be able to participate in the CM. Guidance containing illustrative examples of support schemes

⁸ The Enterprise Investment Scheme established by Part 5 of the Income Tax Act 2007 (“EIS”) or the Venture Capital Trust established by Part 6 of the Income Tax Act 2007 (“VCT”)

that may or may not constitute relevant benefit for the purposes of the funding declaration will be published by the DB ahead of prequalification for the next round of auctions to be run in early 2020⁹, though it will remain the responsibility of agreement holders to seek legal advice on the law relating to State aid where necessary.

3.2.4 Impact of the proposed changes

As noted in the consultation document, we do not believe CM revenues in themselves will have a material impact on the amount of new renewable projects coming forward, as the CM is expected to be a relatively minor revenue source when compared to wholesale revenues. This view was supported by respondents. The cost of remunerating existing unsubsidised renewables participating in the CM (versus the counterfactual example where they are not allowed to participate) is expected to be in the area of 0.5% of total costs in 2030, recognising a degree of uncertainty in our analysis. It is unclear whether the potential benefits of lower clearing prices from new build renewables displacing more expensive generators will exceed the cost of allowing renewables who would have operated in the absence of CM payments, but the analysis suggests that any impact is likely to be small.

⁹Similar guidance has previously been produced for the Contracts for Difference scheme by the Low-Carbon Contracts Company: <https://lowcarboncontracts.uk/sites/default/files/publications/State Aid V7 22032018.pdf>

4. Interconnector de-rating factors

Consultation question:

Question 5

5a. Do you agree that the historical 'floor' should be removed from the legal interconnector de-rating methodology? What are your views on how historical data should be used in future to inform the setting of interconnector de-ratings?

5b. Do you have any further comments or suggestions on the proposed interconnector de-rating methodology?

4.1 Summary of responses

32 responses were received in relation to question 5.

There was strong support for increased transparency in the setting of de-rating factors for interconnector CMUs.

Most respondents also supported the removal of historical floor, although a few respondents did not want it removed until they were confident there was a better replacement. Whilst some companies noted a preference for interconnector de-rating factors to be based on actual recent performance rather than on generic assumptions about how interconnectors might operate in a system stress event, a number of respondents felt that historical data was of limited use due to the lack of an evidence base on interconnector performance during system stress events. Some respondents thought historical data would remain useful to a limited extent as an indicator when considering de-rating factors.

Mixed views were expressed on whether interconnectors were over-valued in the de-rating system. Some argued that interconnector de-rating factors are too high, whereas others noted that foreign countries' make-up of generation differs from the UK's and disagreed with arguments that the emergence of other capacity markets and renewables abroad would lead to correlated system stress events and less reliable interconnection.

Several respondents thought there was inconsistency between the government requiring renewable CMUs to have incremental de-rating factors and interconnectors retaining average de-ratings (see section 3.2.2).

A number of responses identified wider concerns, beyond the issues specifically consulted on, relating to the current system of interconnector participation in the CM:

- that the 'cap and floor' system is providing an unequal playing field and distorting the market;
- that interconnectors do not pay the same charges as British CM participants for transmission network access and usage; and

- that it would be better to allow foreign plants to participate directly in the CM (capped at interconnector volume) instead of allowing interconnectors to participate in their own right.

4.2 Government response

4.2.1 Historical data

The government considers that retaining the historical data ‘floor’ would risk artificially constraining the final interconnector de-rating factors to a higher level than would be justified by the wider evidence¹⁰, and we therefore intend to proceed with our proposal to remove this floor.

For future auctions, including the 2020/21 T-1, 2022/23 T-3 and 2023/24 T-4 auctions to be run in early 2020, the government intends to substitute a new Schedule 3A to the Rules setting out the methodology for determining the de-rating factors for interconnector CMUs. Schedule 3A will remove the use of the historical floor from the process of setting interconnector de-rating factors.

The government considers that there is an ongoing role for historical data, but has not yet formed any firm conclusions on how it should be used in the long-term. We intend to ask the Panel of Technical Experts (PTE), who already play a key role in helping the Secretary of State to set derating factors, to help examine whether a specific methodology can be established which includes an appropriate role for historic evidence, alongside future-focused stochastic / probabilistic modelling. Any such methodology could then be set out in the Rules for future years.

4.2.2 ‘Average’ de-rating factors

In line with advice from the Panel of Technical Experts, the government intends to maintain average de-rating factors for each country or territory in which a non-GB part of an interconnector CMU is located (“interconnected country”). We share the concerns of the PTE that ‘incremental’ de-rating factors would increasingly under-represent the overall physical capacity value of each additional interconnector, likely overstating the amount of GB generation capacity required from the CM to meet our reliability standard¹¹, adding unnecessary costs. The PTE have also noted that an average de-rating factor approach would not be material in practice, as capacity agreements for interconnectors are restricted to 1 year in duration. As interconnector de-rating factors are set for each auction separately, the de-rating factor for an interconnector in one delivery year is not carried forward to subsequent delivery years. In line with these recommendations we intend to retain the current ‘average’

¹⁰ This is based on advice in ‘National Grid Electricity Capacity Report 2018: independent report by the Panel of Technical Experts’. Pages 16 to 24 set out the Panel’s advice on de-rating factors. Paragraph 89 sets out the Panel’s view that the historical data floor ‘no longer remains relevant’ for 2022/23.

www.gov.uk/government/publications/national-grid-electricity-capacity-report-2018-findings-of-the-panel-of-technical-experts

¹¹ Each year, the Government sets the amount of capacity to secure through the auctions by targeting the GB reliability standard of 3 hours Loss of Load Expectation (LOLE). LOLE represents the number of hours per annum in which, over the long-term, it is statistically expected that supply will not meet demand. The level of loss of load is not equivalent to the expected amount of blackouts; in most cases, loss of load would be managed without significant impacts on consumers.

de-rating factor approach. We consider that it is appropriate for all interconnectors in a country to be affected equally by expected increases or decreases in future de-rating factors.

The new Schedule 3A will require the Delivery Body, each calendar year, to use stochastic modelling methodology to produce a range of de-rating factors for each interconnected country / territory (or each country which may be interconnected by the Delivery Year), and provide these ranges to the Secretary of State together with the scenarios on which they are based.

4.2.3 Transparency

The government notes strong industry support for greater transparency in the de-rating factor modelling process, and intends to continue working with the Delivery Body and PTE to consider additional opportunities for industry engagement in the process. The timelines associated with the modelling are tight and there are some necessary commercial sensitivities, but we are keen to ensure that the process is as transparent as possible within these constraints. We also consider that measures could be taken to encourage greater awareness of existing processes for industry to provide evidence, such as earlier publication of deadlines for the submitting of views and evidence into the modelling processes of the Delivery Body and the PTE.

Under the new Schedule 3A, the Secretary of State may choose to consult persons of proven technical expertise (this will usually be the PTE) before (i) selecting the Forecasted De-Rating Factor for each interconnected country for the relevant year within the range of De-Rating Factors provided by the Delivery Body and (ii) making an adjustment to the Forecasted De-Rating Factor for that interconnected country to account for the technical reliability of each interconnector to arrive at a final de-rating factor for each individual interconnector CMU.

4.2.4 Longer-term methodology

Examination of the longer-term methodology for interconnector de-rating factors will also need to take into account any outcomes of the Five Year Review of the Capacity Market, as well any future arrangements for foreign plant to participate directly.

5. Miscellaneous additions and corrections to the Principal Regulations and Rules

Consultation questions:

6. Do you agree with these proposed corrections and additions?

5.1 Summary of responses

16 respondents answered this question.

Four responses expressed concern about the proposed amendment to Rule 9.2.6, suggesting that it did not align with the views expressed in Ofgem's recent workshops with stakeholders on secondary trading, and that any changes to the secondary trading Rules would be better managed via a more holistic review as part of Ofgem's Five Year Review.

Several other responses proposed called for overall simplification of the Rules to be a priority going forwards.

5.2 Government response

We intend to amend the Principal Regulations and the Rules as follows:

- CMUs awarded agreements in the replacement T-1 auction who are terminated on the ground in Rule 6.10.1(ha) will be required to repay capacity payments received under that agreement for the repayment period "TP3" described in Regulation 43B of the Principal Regulations. This approach is in line with termination events for other milestone obligations that are being deferred to the delivery year readiness deadline¹².
- Regulation 43B(3) of the Principal Regulations will describe a new repayment period, "TP4", to run from the start of the relevant delivery year until 30 April. Rule 6.10.3A will include a new sub-paragraph which will require that capacity payments are repayable for the repayment period TP4 if a capacity agreement is terminated on either of the grounds in Rules 6.10.1(r) and Rule 6.10.1(s).
- The termination event in Rule 6.10.1(d) will be clarified so it applies as intended. It will be clear that the termination event will apply when any of the conditions of the General Eligibility Criteria are no longer met, or in the case of the third condition would not be met if an application for prequalification were submitted afresh.
- Rule 9.2.6 will be clarified so that sub-paragraphs (i) to (ix) are applicable to each of the Rules 9.2.6(a) to (d) respectively, to better reflect the existing policy intent and the current way in which this Rule is applied by the Delivery Body in assessing Acceptable Transferees. Ofgem have suggested in their recent Five Year Review consultation that

¹² The 'delivery year readiness deadline' is described in section 2.2.4 of the Government's response to its December 2018 consultation: www.gov.uk/government/consultations/capacity-market-technical-amendments.

further work is required to ensure that the Secondary Trading arrangements as a whole are fit for purpose, and that Rule 9.2.6 in particular merits more investigation.

We intend to make these changes to the Rules, and to correct one other minor error in Rule 16.4C.13 , via the Capacity Market Amendment (No.3) Rules 2019 and the Capacity Market Amendment (No. 4) Rules 2019. We have also identified some minor errors in the Electricity Capacity (No. 1) Regulations 2019 which we intend to correct via the draft regulations.

Annex A – list of respondents

ADE
Britned Development Ltd
Calon Energy
Centrica
C.Gen
Drax Group PLC
EDF Energy
E.On
Energy Intensive Users Group
Energy UK
EP UK Investments
ERG
ESB
Flexible Generation Group
Gloucestershire County Council
Green Frog Power Limited
Independent Renewable Energy Generators Group (IREGG)
Innogy Renewables UK Limited
Intergen
MakeUK
Meaford Energy Ltd
Mutual Energy Ltd (Moyle)
National Grid Ventures
Neuconnect
Renewable Energy Association
Renewable Energy Systems Ltd
RWE
Sandbag
Scottish Power
Simec (GFG Alliance)
SmartestEnergy
SSE
Stag Energy
Statnett
Triton Power
UKPR (Sembcorp)
Uniper
VPI Immingham

Four confidential responses were also received.

This publication is available from: www.gov.uk/government/consultations/capacity-market-technical-amendments

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