Department of Energy & Climate Change

CAPACITY MARKET

Consultation on Reforms to the Capacity Market
Government Response

URN 16D027 2016

The consultation response can be found on DECC's website:

https://www.gov.uk/government/collections/electricity-market-reform-capacity-market

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Contents

Executive Summary

1. This consultation sought views on proposed changes to the Electricity Capacity Regulations 2014 (“the Regulations”), the Electricity Capacity (Supplier Payment etc.) Regulations 2014 (“the Payment Regulations”) and the Capacity Market Rules 2014 (“the Rules”). In addition, this consultation posed questions on wider issues of interest to stakeholders, on the future of the Capacity Market (CM).

2. The Government also published illustrative drafting (unless indicated otherwise) for each of the proposals alongside the consultation to help explain the proposed changes, and sought comments on this drafting also.

Analysis of consultation responses

3. In total, forty-four responses were received from a wide range of stakeholders, including energy suppliers, generators, consultants, interconnectors, renewables companies, environmental groups, UK trade associations and others.

4. For every consultation question we have set out the question, along with a summary of responses received and details of the decisions taken. These summaries are intended to provide a representative overview of the feedback received and to explain why final decisions were taken.

5. All responses received as part of the consultation have been considered in developing final policy positions in the areas covered

6. We would like to thank all those who engaged with the consultation by submitting a response.

Next Steps

7. Following the consultation, the Government will be looking to amend the CM legislation in time for the opening of the prequalification period for the 2016 CM auction.

Introduction

Security of supply - the context

Delivering energy security is the number one priority for DECC. Maintaining the secure electricity supplies that hard-working families and businesses across the country can rely on is our key objective. We face a legacy of years of underinvestment which has left us more open to the risk of any quickening in the pace of plant closures. To address this we need to start building new capacity now, especially gas, to guarantee our energy security in the 2020s.

At the same time, the huge movement in global commodities prices during 2015 has lowered consumers' energy costs but has made generating power unprofitable for most non-renewable plant. Thermal generators are experiencing lower utilisation levels as a result of increasing renewable capacity and coal plant in particular, are facing large losses. In consequence, we have seen several closures announced and other plant may be at risk. We therefore need decisive action now to ensure energy security.

Our principal existing security of supply tool is the Capacity Market (CM). Two CM auctions have now been held, for delivery in 2018/19 and 2019/20 respectively. Whilst given the target levels that were set, the auctions procured relatively little new capacity, both auctions went smoothly and secured capacity at very low prices for consumers.

Capacity Market Review

As a result we have been reviewing the CM mechanism to ensure it remains fit for the purpose of bringing forward the new capacity we need, particularly gas plant, as older plant such as coal come off the system.

The clear message from industry and investors that we have heard as part of the review is that the mechanism retains their confidence; is the best available approach to our long-term security of supply; and that regulatory stability is of crucial importance. At the same time, we have heard clear concerns that we must do more to protect against delivery risks; that we need to tighten the incentives on those with agreements to honour those agreements; and ensure that the full range of delivery risks are accounted for in our procurement decisions; and that we must avoid the risk of under-buying, or buying too late - which would mean that new plant had

insufficient incentive to come forward. The overarching message has been that the volume of capacity procured needs to rise and the clearing price needs to increase as a result in order to provide the appropriate incentives for the market to bring forward new gas capacity.

We have reflected on these messages, and agree with them. We are therefore now proposing a plan of reform for the CM in three important respects:

- **Buying more capacity, and buying it earlier**. We will expect the next CM "T-4" auction in December 2016 to buy materially more capacity than might otherwise have been the case;
- **Tightening delivery incentives** on those who have agreements to deliver against them and to penalise those who renege more severely;
- Tackling how wholesale prices impact in the short term on energy security, **holding a new auction to bring forward the first CM delivery year to 2017/18.** We propose to hold a new one-year ahead auction this coming winter for delivery in winter 2017/18.

Buying more capacity, and buying it earlier

We need to buy more capacity, and buy it earlier, in order to manage the increased risks we face in the next decade as we transition away from coal and as older plant close. The precise target for the next (December 2016) four-year ahead CM auction will not be set until summer, once Government has had the chance to review detailed recommendations from National Grid. But we have been discussing with them, and with our own Panel of Technical Experts (PTE), the range of factors which it is appropriate to take into account. It is clear from these discussions that the incorporation of a new sensitivity to reflect these increased non-delivery risks will be recommended. We would expect this as a minimum to lead to an increase in the target volume of around 1GW, and we will be seeking expert advice on whether it should be higher. We will also consider whether it is appropriate to cover for a more extreme cold winter scenario.

We are also likely to bring forward much of the target procurement to the four year ahead auction, that we might otherwise leave until one year ahead. In previous auctions we have set aside 2.5GW for purchase at the one-year ahead "T-1" stage, but purchasing more of our estimated requirement earlier should help new plant such as gas participate to meet those requirements.

Of course, the *precise* target will be set in the light of all the evidence available at the time, including crucially an updated value for money analysis. There could for example be trade-offs in purchasing capacity early, which may hedge against risk and allow new resources to compete, but which brings with it some risk of over-procurement if demand subsequently shifts. **Nonetheless, taken together, we would expect the next auction to purchase significantly more capacity – perhaps over 3GW more - than would otherwise have been the case**. And, of course, if it becomes clear that plant which already have capacity agreements for the 2020/21 delivery year will fail to make good on their agreements, then we would expect to re-buy that capacity from other sources.

We are confident that a healthy pipeline of robust baseload and peaking gas projects stands ready to take advantage of the opportunities we are creating, and that the revised CM will deliver the new plant we need. Consultation suggests that, provided the CM is reformed in the way described, there are few if any other barriers to these projects coming through to fruition – but the Government will continue discussions with developers and investors to ensure that no unnecessary barriers exist to bringing forward an appropriate mix of plant.

Tightening delivery incentives

It is crucial for our security of supply that, when companies take on an obligation to deliver, they then make good on that commitment. If they do not, it creates shortfalls in capacity that need to filled, putting our security of supply unacceptably at risk. It is also potentially unfair to other bidders who would have been able to secure agreements. For this reason we need a robust system of checks both on new build projects, to ensure that they are on track to deliver by the delivery year, and on existing plant to ensure that they honour their agreements. At the same time, it is important that our requirements and sanctions regime are not so punitive that legitimate projects are dissuaded from participating in the first place.

We consulted in October on a range of potential new requirements to tighten the assurance regime around new build projects. In the light of responses, we are now implementing a number of these proposals – including a ban on failed projects from participating in future auctions, increased monitoring and reporting milestones, and potential increases in credit cover for projects who cannot demonstrate sufficient progress by the 11 month stage. Taken together, and on top of the existing requirements, these should materially increase the incentives on projects to have robust delivery plans in place from an early date

and, if they are to fail, encourage them to fail early, allowing more time for National Grid to seek alternative sources of supply.

However, we also heard evidence that one of our original proposals, for a system of pre-auction finance tests linked to auction bids, could act as a barrier to entry for robust independent projects. We take these concerns seriously, and are therefore not proposing to implement these proposals now as they stand. Instead, we are now inviting views on an alternative suggestion, that credit cover for all new projects should be increased at the pre-auction stage.

At the same time, we are taking the opportunity to consult on higher termination fees for existing plant who renege on agreements, to ensure that they fulfil their commitments.

Holding a new auction to bring forward the first CM delivery year to 2017/18

The reforms outlined above will mean that the CM can guarantee our security of supply now and in the future. But we also need to take decisive action in the shorter term.

National Grid has a firm plan in place to take the actions needed to maintain our margins this coming winter, and the Contingency Balancing Reserve (CBR) supports them in balancing the system in light of tightening margins. But the price of securing reserves of this sort has been increasing in recent years; and it has always been recognised that a reserve, if allowed to grow too large, can cause distortion in the market.

We therefore propose to bring forward the start of the CM delivery period by a year, by holding an auction this coming winter (likely to be in January 2017) for delivery one year ahead, in 2017/18. This auction would purchase 100 percent of the CM requirement for that year – in other words, while its structure and timings will be similar to the T-1 auction, it will procure our full capacity requirement, not just a top-up. This will provide assurance for the 2017/18 year and enable the CBR to be closed for that year as it is replaced by the CM. Ofgem have said that they expect the need for the CBR to disappear once the CM is in place.

This Government has promised to remove distortion and interventions from the market. We recognise that although the CBR has safeguarded our energy security, it increasingly risks doing so at the cost of distorting investment and plant closure decisions. By introducing the CM early, we allow the market to operate better earlier with less price volatility and uncertainty – a more efficient way of delivering energy security.

Diesel

Finally, we have heard a number of complaints that diesel engines have unfair advantages in the CM due to how they are treated in the main energy market. We think there may be merit in these concerns, and reasons why it could be hoped, but also expected, that diesel will play a smaller role in future.

There are concerns over the potential impact on local air quality. The CM is technology neutral, and as such any type of technology is allowed to participate provided it is otherwise in compliance with relevant legislation – so it would not be appropriate to set specific emission limits within the CM eligibility criteria. However, Government is not complacent, and plans to take swift and appropriate action to avoid any disproportionate impact on air quality from diesel engines via new environmental legislation introducing appropriate emission limit values for air pollutants for new generators, where these could significantly contribute to harmful levels of air pollutants and the exceeding of existing air quality limit values.

Defra will consult later this year on options which will include legislation that would set binding emission limit values on relevant air pollutants from diesel engines, with a view to having legislation in force no later than January 2019, and possibly sooner. These limits would apply to generators or groups of generators with a rated thermal input equal to or greater than 1 MW and less than 50 MW[1] - irrespective of their number of hours of operation during any given year**.**

Small distribution-connected generators are receiving increasing revenues from “embedded benefits” which include avoided transmission network charges. Some of this is justified because they offer system benefits such as avoided network reinforcement costs. However Ofgem has previously expressed concerns that these arrangements are not fully cost reflective; and hence “embedded benefits” may over-reward distribution-connected generators such as diesel reciprocating engines. Moreover, the proportion of generation connected at distribution level is increasing and so is the impact of flows from the distribution network on the transmission network.

Ofgem is therefore concerned that these charging arrangements could be having an increasing impact on the system, including distorting investment decisions and leading to inefficient outcomes in the CM. Ofgem is therefore reviewing whether it would be in consumers’ interests

[1] The existing Industrial Emissions Directive applies to 50MW+ generation

to change the charging arrangements for distribution-connected generators. Ofgem will set out their conclusions and a proposed way forward on this matter, potentially including initiating changes to the charging regime, in the summer. Ofgem will need to consider carefully how and when any changes should be implemented, including whether any transitional arrangements are required, and will aim to provide clarity on their direction of travel before prequalification for the next CM auction.

Consultation

Two documents are being published today: the outcome of a consultation which we ran from October to December 2015 (this document), and a new consultation following feedback from industry. These documents cover:

- Some changes we are now making to our delivery assurance regime which reflect the outcome of an October consultation. This consultation also discussed a number of other incremental improvements and simplifications to the design. The document to follow sets out the Government's full position on the outcome of this consultation exercise.

- Some further changes to the delivery assurance regime and other areas and, crucially, the ability for the Secretary of State to hold the proposed additional auction for delivery in 2017/18, are discussed in a consultation being published in parallel to this document – a formal public consultation. Responses are invited by April 1st by 5pm. See the chapter on general information for details of how to respond.

In addition, changes to auction parameters, including the amount to procure, do not require new regulations. Instead they will be determined as usual by the Secretary of State, in the light of expert advice, in summer, before prequalification starts for the next auction. Specific proposals for the parameters (e.g. precise volume targets) are therefore not discussed in these two documents, but the intention to purchase more capacity, and earlier, in that auction forms an important context when considering the documents as a whole.

Chapter 1 - Investment

1.1 - Supporting new build delivery

Consultation Question
Q1 - Do you have any suggestions for ways in which the Capacity Market requirements for evidence of planning consent can be better aligned with project development cycles?

Summary of Responses

1.1 There were nineteen responses to this question. Overall, stakeholders felt the current requirements for planning consent evidence should remain, with some additional suggestions received. Several argued the development consent order (DCO) process and CM auction pre-qualification requirements should be aligned, and that the derogation allowing planning consent seventeen days before auction should be extended indefinitely.

1.2 Other suggestions included:

- making earlier milestones more stringent than later ones to weed out unviable projects;
- tightening up assessment of CMUs' planning consents to rule out false information;
- shortening the DCO planning process to less than twelve months to allow latecomers to enter;
- allowing new build within Energy from Waste (EfW) to deliver district heating alongside the CM;
- concentrating as much volume as possible in the T-4 auction to give signals to new build;
- looking at planning consent; and
- relieving investors from delays in relation to Grid connection.

Decision taken since consultation

1.3 The Government has considered the responses. Overall, as stakeholders felt that the current requirements for planning consent evidence should remain, we do not propose to make any changes to the CM requirements for evidence of planning consent at this stage. The Government will, however, consider the wider suggestions received and consider whether improvements can be made. We will extend the derogation allowing planning consent seventeen days before auction indefinitely, and this will be in place before the next auction.

Consultation Question
Q2 - Do you have other suggestions for modifications or improvements which, within the overall framework, would help meet the legitimate needs of new build projects?

Summary of responses

1.4 There were nineteen responses to this question, covering a wide range of topics. A couple of stakeholders were concerned that the CM should not favour new build, as this could lead to existing plant closure. They argued that more new build would arrive once there were market signals, such as coal coming offline.

1.5 There were a few stakeholders in favour of increasing new build by either reserving some capacity in the auction or running a separate new build auction. Another suggestion was that the target capacity should be increased at T-4 or T-1 to improve liquidity.

1.6 Other responses to this question covered a range of areas including:

- allowing electricity storage to participate;
- restricting older plant through an emissions cap or mandating EU ETS permits;
- rewarding increased reliability of new build with a derating factor;
- providing better planning guidance;
- introducing flexibility triggers and efficiency premiums;
- T-1 allowing more Demand Side Response (DSR);
- differentiating nuclear in the auction (due to its function as baseload);
- a pre-qualification fee to discourage speculative bids;
- that owners and developers should have a choice of the CM or Triad but not both; and

- that secondary objectives should be achieved through the CM such as environmental standards/ favouring more efficient plant

Decision taken since consultation

1.7 The Government welcomes stakeholder feedback on this point and has considered the suggestions for modifications or improvements to the CM to help meet the legitimate needs of new build projects. Further discussion on the issue of ensuring the CM retains the confidence of investors and is fit for purpose in bringing forward new build capacity in a timely manner is considered in the consultation document being published alongside this response. .

1.2 - Securing new build delivery

Consultation Question
Q3 - Is 400MW an appropriate threshold for the new pre- and post-auction financeability tests? If not, please explain your reasoning.

Summary of Responses

1.8 There were twenty-two responses to this question. The majority of the stakeholders disagreed with the threshold of 400MW. There were concerns raised about promoting small-scale generation and concerns that the threshold could call into question the CM's State aid approval.

1.9 There was a suggestion from a stakeholder that a smaller threshold of 100 MW instead of the 400 MW could be more appropriate.

1.10 A number of stakeholders also thought the introduction of new tests would be bad for competition, discouraging new project financed non-balance sheet independent entrants, and that the costs, tests and resource associated with getting a project to prequalification was already onerous and adequate enough that such projects coming forward would be viable.

Decision taken since consultation

1.11 The concept of an applicability threshold was proposed in the context of the new pre and post-auction financing tests. This was to focus the new requirements, and the associated administrative implications, on capacity above a set quantum, whose potential default on their capacity agreement would be of material significance to our security of supply. After considering the views of stakeholders the Government has decided that were a threshold to be introduced, then 100MW, applied in respect of individual new build units or aggregated new build units within the same corporate portfolio, would be a more appropriate threshold.

1.12 We now propose, however, that the entire concept of a threshold is redundant given the decision not to progress the new pre and post-auction financing tests at this time. As detailed in the response to questions 10 and 11 later in this chapter, we propose to apply a targeted increase in credit cover requirements, and termination fee liability, to new build units which have not achieved their Financial Commitment Milestone by 11 months after the auction results day. This is effectively the earlier application of an existing milestone test, and as such should apply equally to both larger and smaller new build units (as it would do at the 16 month point anyway). The issue of a threshold is discussed in further detail in the consultation document being published alongside this response.

Consultation Question
Q4 - For the pre-auction financeability test, is the requirement for the directors to certify and evidence support for at least 50 percent of debt level appropriate? Would a higher percentage up to 100 percent be more appropriate, and if so, why?

Summary of Responses

1.13 There were eighteen responses to this question. The question had a wide mix of responses, ranging from suggesting that no certification should be required as it is not meaningful, and it would only be in principle; to suggesting that no firm commitment would be

available; to some respondents in agreement that 50 percent would be sufficient, including a lender.

1.14 There was a proposal for a generic Minimum Acceptable Auction Bid (MAAB) for different new build technologies, set annually as an auction parameter with evidence from industry and financial institutions feeding in to the setting of the MAAB. This would become the default minimum bid level for new entrants. Any new entrant wishing to bid below the MAAB would need to submit a specific, evidence based, justification to be assessed and approved by a panel of technical experts as to its feasibility. A similar proposal was supported by one stakeholder in relation to consultation question number six.

1.15 One stakeholder suggested that directors should be asked to provide evidence that the initial credit cover was lodged on the basis of the same MAAB as the in-principle finance agreement.

Consultation Question
Q5 - Are the pre-auction financeability test requirements for evidencing commitments from debt providers appropriate?

Summary of Responses

1.16 There were seventeen responses to this question. The majority of stakeholders who responded were not in favour of the proposals. There were concerns expressed that the evidence would be non-binding as no real commitment could be provided at this stage, and if a firm commitment was required this would be a clear barrier to entry.

1.17 Other stakeholders argued that the MAAB detracts from descending clock price discovery and that the new tests were directly counter to two of the CM's guiding principles of simplicity and facilitating investment. Another stakeholder commented that lenders would not be able to provide a "commitment" but may be able to provide an indication of interest for the project based on the information available at the time from the developers.

1.18 One stakeholder agreed with the proposal, but thought it needed to go further and that the MAAB needed to be defined (as a floor, and that it should not introduce a ceiling).

Consultation Question

Q6 - Do you agree with the proposal for the directors' certification in the pre-auction financeability test that equity is available for the balance of funding? If not, please suggest alternative/additional ways of evidencing the availability of equity funding pre-auction (for example letters confirming a willingness to provide equity on a first refusal basis from the third party equity provider). Views are especially welcomed (where equity is to be corporately funded) as to the potential inclusion of a net worth statement (for example to the effect that the equity requirement will not exceed a defined percentage of a metric such as the enterprise value of the applicant or Group) and the appropriate level of any such test in order to help mitigate a potential gaming risk of directors inaccurately certifying that equity is available.

Summary of Responses

1.19 There were eighteen responses to this question. Respondents were divided on the proposals regarding directors' certification.

1.20 Some stakeholders disagreed with the proposals, arguing that proving equity availability pre-auction does not mean the funding will be available following the auction; that equity providers are unlikely to give a commitment without the full details on the project, including debt; and that clearing prices and debt/equity split are likely to change post-prequalification. Furthermore, it was raised that directors' certificates would only be valid on the day they are signed, questioning the practical benefits of this proposal.

1.21 In addition, some stakeholders did not agree with the concept of the MAAB, arguing that providers will purposefully declare low MAABs, raising questions around its usefulness.

1.22 There were also concerns raised about portfolio players using individual Special Purpose Vehicles (SPVs) for a number of projects.

Consultation Question

Q7 - Do you agree that the pre-auction financeability test should be applied at the bidding confirmation point (ten to fifteen working days before the auction) rather than

as part of the prequalification application? If not, please explain your reasoning.

Summary of Responses

1.23 There were twenty-one responses to this question. The majority of stakeholders thought that confirmation closer to the auction was appropriate, to allow bidders the time to get such information together.

1.24 There were concerns raised, however, that failure to provide this information on time so close to the auction would not allow corrective measures to be implemented, and this could have serious consequences on auction liquidity and new build projects.

Consultation Question
Q8 - Should applicants/capacity providers have the flexibility to change the declared debt/equity ratio of their new build projects between their pre-auction declarations and their five month post-auction financing tests? Are there gaming risks associated with increased flexibility and how could these best be mitigated?

Summary of Responses

1.25 There were nineteen responses to this question. The policy intent was supported by all stakeholders who responded, who all argued that with a lack security of the CM clearing price, and a commitment to a construction contract, new build projects needed flexibility.

1.26 In relation to gaming risks, respondents argued that there would be no increased gaming risks with flexibility, and that gaming issues could be mitigated by increasing penalties for non-delivery.

Decisions taken since consultation – questions four to eight

1.27 The Government is keen to ensure that new build projects deliver to their agreements. However, we note the concerns raised by stakeholders, especially on the benefits of any such pre-auction commitments in this form being of limited value. The Government does not, therefore, intend to take forward these pre-auction financeability test and MAAB proposals in the form as consulted at this time.

1.28 The Government believes, however, there is merit in further considering whether delivery assurance can be reinforced by increasing pre-auction credit cover requirements and welcomes stakeholder views on what would be an appropriate increase to provide such assurance. This is considered further in the consultation document being published alongside this response.

1.29 Given the decision not to proceed with the implementation of the pre-auction financeability tests, the subsidiary issues of evidencing a minimum percentage of stated debt levels, timescales and flexibility requirements therefore become unnecessary points, and so the Government does not intend to take these further.

Consultation Question
Q9 - Should the financial commitment referenced in the five month post-auction financing tests refer to the project's financial closure?

Summary of Responses

1.30 There were seventeen responses to this question. The majority of stakeholders identified that whilst it is possible to achieve financial closure after five months, in some cases it may take longer than this. Others suggested that in most cases the five month mark would be appropriate for financial closure.

1.31 Some stakeholders did agree that the post-auction financing tests should refer to the project's financial closure.

1.32 A few stakeholders made the point that whilst five months may be too soon, financial closure should be well before delivery.

1.33 There were other suggestions in response to this question from stakeholders who stated that the Government should further explore the level of commitment of finance that is likely to be available ahead of the auction and test this with the finance community.

1.34 A continuing theme from stakeholders to this section of the consultation was that any milestones should be aligned with the overall CM process to aid procurement targeting for future auctions, e.g. the eleven month test.

Decision taken since consultation

1.35 Following consultation and further consideration, the Government has decided not to go ahead with the five month post-auction test, as we consider it produces no real benefit to HM Government while potentially cutting across some projects' finance cycle and increasing complexity and costs.

1.36 The Government notes the comments about testing the levels of commitment of finance with the finance community and that any milestones should be aligned with the overall CM process to aid procurement for future auctions.

Consultation Question
Q10 - Are the post-auction financing test requirements for evidencing commitments from debt providers appropriate? Would the submission of a summary term sheet (i.e. non-binding and subject to due diligence) with a prescribed set of headings, be preferable to the proposed debt-provider's declaration for the five month test?

Summary of Responses

1.37 There were eighteen responses to the question. The majority of the stakeholders agreed that the post-auction financing test requirements from debt providers at five months were appropriate. A few exceptions argued that post-auction financing tests were not appropriate, and that non-binding declarations would have little benefit.

1.38 One stakeholder said that as proposed, the post-auction tests may incentivise undue optimism bias by all the parties in issuing non-binding expressions of willingness to support the project. Instead there should be a ramp up in credit cover requirements and a potential termination penalty.

1.39 There was a mixed response to the proposal of a summary term sheet. Concerns were raised about commercial sensitivity, and that having one would not add significant further security but would add additional administration costs.

1.40 Some stakeholders also recommended that the Government engage further with financiers on this issue.

Consultation Question
Q11 - Do you have views on what post-auction financing test requirements for evidencing availability of equity should consist of for project financed and balance sheet funded projects? Should a form of net worth test (as outlined in Q6) be re-applied at these post-auction stages? Would the submission of a summary term sheet (i.e. non-binding and subject to due diligence) with a prescribed set of headings, be preferable to the proposed approach for third-party equity declarations for the five month test?

Summary of Responses

1.41 There were fifteen responses to this question. The majority of stakeholders said that equity should be confirmed in principle by all projects (no matter what financing type) via a directors' declaration or an indicative commitment declaration.

1.42 One stakeholder noted that post-auction financing should be consistent across both equity and debt-funded projects. The few stakeholders that mentioned a summary term sheet all disagreed with it.

1.43 Of the stakeholders that mentioned net worth, some felt that a net worth statement adds negligible value and that equity funders internationally may be put off.

Decision taken since consultation – questions 10 and 11

1.44 Following consultation and further consideration, the Government has decided not to take forward the post-auction financing tests linked to increased credit cover requirements in the form proposed in the consultation. The Government does propose, however, to utilise the existing concept of the Financial Commitment Milestone (FCM), slightly revised in scope (as detailed in the response to question 14), to focus an increase in post-auction credit cover to £15k/MW on those new build units not having achieved their FCM by the 11 month point after the auction results day.

1.45 Such providers not achieving their FCM by this 11 month point would be required to lodge and maintain the increased level of credit cover (£15k/MW) from the 12 month point onwards.

Those failing to comply with this requirement to lodge additional credit cover would have their capacity agreement terminated and a termination fee equal to their pre-auction credit cover requirement applied. Please see the consultation document being published alongside this response for further detail on the level of pre-auction credit cover.

1.46 The termination fee liability of such units where the provider fails to meet their FCM by the 16 month point, and therefore triggers a termination event, would be increased to £15k/MW.

1.47 This approach will enable a targeted increase in post-auction credit cover to reflect higher risk developments, with appropriate signals for those potentially failing to fail earlier in the process.

1.48 With regards to the proposal of a summary term sheet, the Government has decided not to implement this proposal, as stakeholder feedback suggests that it may be burdensome without bringing adequate assurance benefit to justify this.

Consultation Question
Q12 - Should the pass/fail status of a new build unit in the five and eleven month financing tests be published on the Capacity Market Register? Please explain your reasoning.

Summary of Responses

1.49 There were twenty-one responses to this question. The majority of stakeholders agreed with the question, believing that this information would add to the open and transparent nature of the CM Register and inform participants of non-delivery risks. These respondents noted that this would also help inform decisions on future developments, future bids etc.

1.50 A couple of stakeholders did raise some objections, arguing that the release would impact upon project confidence and that with credit cover already published, this may not add anything.

Decision taken since consultation

1.51 The amount of credit cover required to be maintained in respect of a unit is already published on the CM Register, as is the status of whether a new build unit is yet to achieve its Financial Commitment Milestone (FCM). The Government's decision to focus the 11 month test on achievement of the FCM would therefore mean these existing requirements would be

sufficient to indicate whether a unit had met their FCM by the 11 month point or otherwise triggered an increase in credit cover.

1.52 The Government does not therefore propose introducing any additional requirements to reference a pass/fail status of the 11 month test.

Consultation Question
Q13 - Do you agree with the proposal to focus increased credit cover, and an increased termination fee potential, on those new build projects unable to demonstrate committed finance in the post-auction financing tests? If not, please suggest alternatives.

Summary of Responses

1.53 There were twenty responses to this question. The majority of stakeholders agreed with the proposal to increase credit cover. Some stakeholders thought that increased credit cover itself was not enough, and that penalties for non-delivery should be increased further to greater than the cost of procuring alternative capacity (i.e. £18/kW).

1.54 Those stakeholders who were against the proposal said that the current credit cover regime provides sufficient assurance, and that increasing credit cover would serve as a further barrier to entry.

Decision taken since consultation

1.55 The Government will be going ahead with the modified proposal to increase credit cover to £15k/MW for those who have not achieved their FCM at the 11-month point after the auction results day. After considering consultation responses, we consider that increasing credit cover could be a simple and effective method of providing delivery assurance. In addition we will be consulting on whether pre-auction credit cover should be increased – as detailed in the consultation document being published alongside this response.

Consultation Question

Q14 - Should the requirements for new build CMU to meet their financial commitment milestones be strengthened in light of the proposed post-auction financing tests? Should the requirement to have achieved financial closure be explicitly introduced into the financial commitment milestones?

Summary of Responses

1.56 There were twenty responses to the question. The majority of the stakeholders agreed that the financial commitment milestones should be strengthened. The majority of stakeholders also said that an explicit financial closure milestone should be introduced, and should be clearly defined.

1.57 Other stakeholders also suggested financial completion should be brought forward from 18 months to 16 months after the auction results for all new build CMUs, to provide more time for any non-delivery of milestones to be addressed. Some highlighted that set requirements are important factors for new build CMUs to meet financial milestones.

1.58 One stakeholder stated that it was not necessary to strengthen the financial commitment milestones if strengthening of post-auction tests and the ramping up of credit and potential termination fees were in place.

1.59 It was noted by a few stakeholders that any financial closure milestone should be at a time that allows for the procurement of more capacity in the next auction.

Decision taken since consultation

1.60 The Government notes that the majority of stakeholders suggested that the FCM need to be strengthened. Rather than introducing a new milestone, we intend to expand the scope of the existing FCM to include an explicit test of financial close. We also intend to focus the milestone on achievement of 10 percent expenditure of the total project spend and exclude the option of 20 percent contractually committed expenditure (via a major or relevant contract).

1.61 Achievement of the FCM going forwards will therefore consist of two arms – i) achievement of financial close for the project and ii) that capital expenditure has been incurred for at least 10 percent of the total project spend for that unit.

1.62 In addition we intend to move the date of the FCM for all new build units from 18 months to 16 months after the auction results day. This will provide additional time to accommodate any termination events in the volume to procure decision for the capacity auctions that year.

1.63 The Government does not intend to implement the proposal to net off incurred capital expenditure from the level of credit cover required to be maintained.

Consultation Question
Q15 - Are there core milestones, additional to the existing four milestones, which are sufficiently generic to all new build projects which should be specified in the Rules to provide consistency between progress reports? If so, please provide details.

Summary of Responses

1.64 There were fifteen responses to this question. The majority of stakeholders were against any more milestones being added. There were a limited number of suggestions for additional milestones.

1.65 One respondent commented that there should be a balance between increasing reporting requirements and bureaucracy. Fifteen milestones was felt to be excessive.

1.66 Other suggestions from stakeholders for different milestones included a milestone for when progress reports were published; and when construction contracts for the power station and key ancillary items were signed.

Decision taken since consultation

1.67 The Government takes on board stakeholder views on avoiding bureaucracy and not creating too many milestones. We will strike a balance between flexibility and centrally imposed milestones by specifying an additional four milestones and a limited increase in the number of progress reports required (three and nine month post-auction). Broadly speaking, the additional milestones we intend to include are:

- Signing of EPC/equivalent major contract;
- Main foundations complete;
- Gas/steam turbine delivery (or any generator dependent on technology); and

- First firing.

1.68 The precise drafting of these milestones will be in the final legal drafting. These will be additional to the existing four milestones (Financial Commitment Milestone, commencement of construction works, achievement of back-feed milestone and Substantial Completion Milestone).

1.69 The Government also intends to progress the enhanced requirements to tighten up the consistency and standards of the progress reports submitted – as per our consultation proposals regarding a non-technical summary, most likely milestone achievement dates and details of the Independent Technical Expert's experience and technical expertise.

1.70 The Government intends to apply the enhanced reporting requirements to all new build units.

Consultation Question
Q16 - Are there any unintended consequences associated with the disqualification proposals?

Summary of Responses

1.71 There were twenty-two responses to the question. The majority of stakeholders were strongly opposed to director disqualifications (both for new build failing or existing stations getting rid of TEC). The proposals were regarded as 'overly draconian', would not drive the desired outcomes, and could disincentivise new build and deplete the small pool of project developers in the UK.

1.72 Some stakeholders also disagreed with proposals to disqualify new build projects from further auctions for two years, with some stating it would be hard to implement. One stakeholder noted that implementing this could lock out good projects that have failed due to specific market conditions or temporary conditions, where it might be better to allow them to participate again (possibly under new ownership).

1.73 Several stakeholders also commented that developers could find ways around the proposals (both on director disqualification and two-year disqualification of new build projects).

Decision taken since consultation

1.74 Responding to the overwhelming stakeholder feedback disagreeing with the proposals on director disqualification, the Government has decided not to go ahead with the proposals to disqualify nominated directors.

1.75 The Government will, however, take forward proposals to disqualify new build projects from further auctions for two years where these have failed to meet either their FCM or their Minimum Completion Requirement. We recognise that there were mixed views on these proposals, however the Government still considers that they are an important incentive for new build projects to deliver on their capacity agreements.

Consultation Question
Q17 - Should the disqualification proposals also apply in respect of new build agreements terminated for failing to provide increased credit cover?

Summary of Responses

1.76 There were seventeen responses to the question. The majority of stakeholders thought the proposals should apply to new build CMUs. However, many of these stakeholders disagreed with the disqualification proposals in the first place (see question 16) particularly for individuals.

Decision taken since consultation

1.77 As stated above the Government will not be taking forward proposals on disqualification of directors. We will, however, apply the two year unit disqualification where a provider triggers a termination event by failing to lodge the increased amount of credit cover in respect of a unit which has not achieved its Financial Commitment Milestone 11 months after the auction results day (the response to questions 10 and 11 refers).

Consultation Question

Q18 - Are the draft amendments pertaining to this chapter aligned with the policy proposals contained in this document? Are there any unintended consequences associated with the draft amendments?

Summary of Responses

1.78 There were ten responses to this question. There was mixed response, and the majority of stakeholders did not answer the specific question asked.

1.79 However, comments included:

- that the penalties associated with non-delivery under a contract are not consistent with termination of a contract – and there was a question over whether the termination fees would be fully recoverable;
- that the consequences of counterparty failure on the other counterparties, in terms of opportunity costs, need to be more appropriately considered;
- that new build agreements which are terminated for failing to provide increased credit cover should face disqualification, and credit cover requirements should be more stringent to discourage speculative bids; and
- the 400MW threshold is not useful and may simply incentivise new build projects below that threshold.

Consultation Question

Q19 - Do you think the package of amendments detailed in this chapter effectively balances greater delivery assurance and incentives against the risk of imposing unnecessary or disproportionate additional burdens?

Summary of Responses

1.80 There were twenty-one responses to this question. The majority of the stakeholders expressed concern with the package, particularly regarding the financeability tests and

disqualification proposals. These stakeholders thought that those proposals in particular would reduce competition and increase barriers to entry.

1.81 Some stakeholders believed that the Government should engage with the finance community, to discuss the impact of proposals on investment decisions.

1.82 Other comments included:

- that the Government should focus on increased credit cover requirements rather than other penalties/incentives;
- that the proposals should incentivise already constructed plant and not focus on new build;
- that the 400MW threshold is arbitrary;
- that the pre-auction financeability tests would not be useful; and
- that current requirements were adequate.

Decision taken since consultation – questions 18 and 19

1.83 The Government has noted the useful comments provided by the stakeholders who answered these questions and has considered these in our final package of new build proposals detailed within this document.

1.4- In-year delivery incentives

Consultation Question
Q20 - Are you aware of any class of participants for whom the Capacity Market incentives under the implemented design, when considered alongside their other incentives to deliver at times of system stress, could be considered insufficient to drive the desired behaviour? If so, please suggest how this could be addressed.

Summary of Responses

1.84 There were twenty-three responses to this question. The majority of stakeholders were unaware of any class of participants who would have insufficient incentives to drive behaviour.

1.85 Some further comments were:

- operators that have low exposure to balancing mechanism or wholesale markets did not have sufficient incentives to produce in system stress;
- operators are exposed by power purchase agreements;
- units with environmental constraints may be unable to deliver at times of system stress; and
- interconnectors are unable to provide the same certainty of responding in stress events, and de-rating factors do not adequately address this.

1.86 Other stakeholders indicated that the current wider (wholesale) market incentives discriminate against them, and that having to meet an infinite stress event was unfair on them.

1.87 We did not receive any suggestions on how to address these issues.

Decision taken since consultation

1.88 The Government has noted the responses to this question. However in the absence of any specific stakeholder proposals the Government does not intend taking forward any amendments in this area at this time.

1.5 - Secondary trading

Consultation Question
Q21 - Do you agree with the recommendations and proposed Regulation and Rule amendments?

Summary of Responses

1.89 There were eighteen responses to this question. The majority of stakeholders supported the aims of improving liquidity during the relevant delivery year.

1.90 Nonetheless concerns were raised, including:

- a general concern over whether secondary trading in the CM is going to become liquid to any meaningful degree;
- that the proposal that a participant holding an obligation for one day means exposure as though the obligation was held for much longer will ensure secondary-traded obligations are treated unfairly in the market, meaning that trading liquidity will be reduced;
- that the provision in the draft amendments to the Regulations which states “a termination of the related agreement also extinguishes the rights and obligations accruing in respect of any transferred part” could prevent obligation trading between companies, and removes the ability of obligation trading to deliver one of the duties for which it was designed; and
- there were two respondents that provided specific comments on the draft provisions.

1.91 Two stakeholders reiterated the importance of interconnectors being excluded from this expanded pool of participants due to flow direction not being known during this trading window (one to two weeks ahead of real time).

1.92 With regards to the proposed penalty cap calculations, most were in agreement that they were needed. However, it was highlighted that they are complex and one stakeholder stated it must be borne in mind that if these penalties/requirements are too onerous, then this is likely to discourage obligation trading, thereby increasing the risk of participation.

1.93 Security of supply concerns were raised regarding CMUs trading above their de-rated capacity. Procured capacity is based upon de-rating therefore if any generator has a higher obligation, statistically the obligation is less likely to be delivered and so overall the loss of load expectation will increase above the benchmark 3 hours per annum requirement.

Decision taken since consultation

1.94 The Government would like to clarify that the calculations for Monthly Penalty Caps and Annual Penalty Caps ensure that all CMUs are exposed to the same delivery penalties regardless of how long they hold the obligation for, assuming they have not had any previous penalties against the same obligations.

1.95 Further to this, transferors are only exposed to termination events and fees if they still hold part or all of the obligation within a delivery year.

1.96 Whilst we recognise that the calculations are complex they have been designed to ensure that gaming cannot occur through the transferring of obligations from one party to another to avoid penalties and to ensure that everyone is treated the same regardless of what obligations they hold.

1.97 Liquidity in the obligation trading market will be dependent on how many prequalified parties without agreements are available within the delivery year. Further to this, willingness to trade will be driven by price and each party's risk appetite. As availability to trade, and therefore liquidity is unknown, a package of options has been offered which includes reallocation trading and also financial trading.

1.94 Mixed views were received on whether trading above de-rated capacity will create a security of supply issue and we have concluded that more analysis is required and will therefore not be taking forward the proposal at this time.

1.98 All further proposals will be taken forward, however the Government has noted specific comments on drafting, and changes will be made where appropriate in the final legislation.

Consultation Question

Q22 - Do you agree that DSR CMUs should be able to nominate Satisfactory Performance Days ex-post (as with Generation)? If not, what other steps could be taken to ensure that providers are robustly demonstrating what they can realistically contribute during a system stress event.

Summary of Responses

1.99 There were sixteen responses to this question. The majority of stakeholders were in favour of the proposals (one stakeholder also stating "ex ante should be allowed"), citing reasons which included:

- they would ensure there are consistent demands of all CMU types participating in the CM (several stakeholders made this point); and

- currently DSR CMUs have to be dispatched for three satisfactory performance days in addition to dispatches in response to CM warnings. Since the short-run marginal costs of DSR CMUs tend to be amongst the highest on the system, this is wasteful, and the additional costs could mean DSR CMUs will exit capacity auctions at higher prices than necessary. Moving to an ex-post approach fixes the timing problem and is a significant improvement.

1.100 Some who were in favour also made the following points:

- one agreed with proposals as long as robust meter testing has already taken place, and that the values observed during meter testing represent a cap; and
- another respondent stated that thought should be given to allowing parties to generate their Adjusted Load Following Capacity Obligation (ALFCO) when demonstrating satisfactory performance, which would ameliorate the operational impact on the GB transmission of this incentive, or perhaps take the existing prequalification test whereby existing generating CMUs have to evidence historic output and repeat this just prior to the start of each Delivery Year across all CMUs with capacity obligations.

1.101 Some stakeholders disagreed with proposals, citing reasons which included:

- that the pre-nomination process ensures the delivery is deliberate;
- that the DSR testing regime is currently sufficient, and that having to demonstrate capacity in advance of delivery seems an essential requirement; and
- concern about the potential for gaming the system.

Decision taken since consultation

1.102 In light of the majority of stakeholders agreeing with the proposal of DSR CMUs nominating Satisfactory Performance Days ex-post, the Government will be going ahead with this proposal. Sufficient metering and testing requirements will be in place to support this change, and implementation will ensure that all CMUs are treated in the same manner whilst simplifying the process.

Consultation Question
Q23 - Are there are other areas of the Capacity Market regime that need amending to

deal with secondary trading?

Summary of Responses

1.103 There were twelve responses to this question. A few stakeholders thought there were no areas of the CM regime that need amending, however the majority of stakeholders suggested several areas that needed amending to deal with secondary trading. These included:

- enabling obligation trading to take place from immediately after the T-4 auction;
- a suggestion to either establish a central repository of, or flag on the CM register, those that are interested in secondary trading;
- allow parties to take on obligation trading above their de-rated capacity but restrict this to either the delivery year or only at the T-1 auction; and
- simplify obligation trading by only allowing it in annual blocks.

1.104 A further stakeholder thought that there was a possibility that New Build CMU termination events would need to be revised to reflect the ability to trade out partial obligations.

Decision taken since consultation

1.105 The Government recognises that some respondents were keen on simplification and timing changes, however we do not consider that the proposals received would enhance secondary trading, therefore the Government does not propose to make any further amendments to the CM in respect of secondary trading, but will continue to keep secondary trading under review and consider further changes if the need arises.

Consultation Question
Q24 - Are there alternative ways to encourage participation, liquidity and competition in secondary trading?

Summary of Responses

1.106 There were fifteen responses to this question. Stakeholders' responses were mixed, and many stakeholders raised the issues that they had raised in the previous question, particularly around enabling obligation trading to take place from immediately after the T-4 auction.

1.107 Other stakeholders raised issues around encouraging participation, suggesting that anyone active in the market that has registered with the Delivery Body should be available to take part in secondary trading, and suggested expanding the pool of acceptable transferees to those outside of currently eligible CM participants.

1.108 Another issue raised by stakeholders in response to this question was that the proposed notification period (five to ten days) of trading above de-rated capacity is unnecessarily long as trading appetite would probably be concentrated in the week-ahead and within-week market.

1.109 Another stakeholder believed that a more robust penalty regime would significantly increase the demand for secondary trading.

Decision taken since consultation

1.110 The timing of obligation trading is addressed in Q23. We will continue to keep secondary trading under review and consider further changes if the need arises.

Consultation Question
Q25 - Do you agree that no Government intervention is required to facilitate a secondary financial trading market?

Summary of Responses

1.111 There were seventeen responses to this question. There was only one stakeholder who disagreed with the proposition in the question.

1.112 Although the overwhelming majority did agree with the proposition in the question, some stakeholders suggested that:

- there may have to be some kind of central co-ordination to ensure that the details of those looking at trading obligations are readily available, especially in the case of bilateral negotiations;
- Government should have a mechanism to intervene if the secondary financial trading market fails to deliver necessary liquidity to cover obligations;
- the removal of artificial distortions, improved information flow, greater clarity on the System Operator's decision-making and more regular auctions are essential to creating a meaningful secondary market; and
- all transactions carried out should be notified to the market as this would encourage transparency and prevent any potential collusion or market manipulation.

1.113The one stakeholder that disagreed with the proposition in the question thought there was an opportunity for the Government to facilitate obligation trading and volume reallocation trading, to deliver a more liquid reallocation market. The result of Government intervention to deliver a more liquid secondary reallocation market would be to increase delivery rates by facilitating alternative capacity providers.

Decision taken since consultation

1.114 It is clear that the majority of stakeholders were in favour of no further intervention and that the option provides flexibility for market participants to optimise their own risks, therefore the Government will not be intervening in the financial trading market.

1.115 The Government will however review this again if secondary trading as a whole fails to provide the liquidity required to participate in the CM following the commencement of secondary trading in 2017.

Consultation Question
Q26 - Do you think the contents of the (publicly-visible) Capacity Market Register could be expanded to include other items of information which would be useful to those looking to undertake secondary trading? If so, what extra detail should be included?

Summary of Responses

1.116 There were twenty responses to this question. There were a wide range of suggestions from stakeholders. Suggestions as to what other items of information could be useful for stakeholders looking to undertake secondary trading included:

- details of obligation and vintage taken;
- contact details and indication of who wants to buy and sell capacity;
- a public register which mentions that a billing company or aggregator has “some capacity”;
- fuel type;
- parent company;
- TEC or Connection Capacity;
- status of penalties;
- status of a CMU where a potential termination event has occurred;
- prime mover technology for each CMU;
- energy efficiency; and
- emissions levels.

1.117 Some stakeholders thought that this was not a significant issue and there should be no expansion of the register. Another stakeholder also thought that a trading platform would facilitate secondary trading, which meant that further information on the register would not be needed.

1.118 One stakeholder also raised the issue that the Delivery Body needs to make sure that the public register is kept up to date on a regular basis.

Decision taken since consultation

1.119 There was a wide range of suggestions from stakeholders. The Government will not be pursuing a trading platform as the liquidity of the secondary market is not yet known and therefore developing and maintaining a platform is not an economical solution. If the liquidity does support a platform, providers will develop in response to the market.

1.120 The Government will be introducing three new requirements for information to be included on the CM Register: fuel type, contact details (telephone number and email) and parent company.

1.121 The Regulations already require the CM Register to be updated to show which CMUs have obligations, volume, clearing price, monthly and annual penalty rates and connection

capacity. Other factors, such as how much capacity is available for trading, can be calculated from the Register therefore the Goverment believes that no amendments are necessary at present.

1.122 Some stakeholders also requested updating the register to show penalties received and headroom available on caps, however such data changes on a half-hourly basis therefore it is not feasible or necessarily helpful to include these updates on the Register, which will be fairly static following the auction. Likewise introducing a CMU's desire to trade or status would require regular updates, and statuses can easily become redundant.

Chapter 2 - Regulatory Stability and Simplification

2.1 - Regulatory stability

Consultation Question
Q27 - Do you agree with the proposal for DECC to give notice to Ofgem on proposed changes to the Rules which would require approval by the Secretary of State?

Summary of Responses

2.1 There were twenty responses to this question. Stakeholders emphasised the need to ensure predictability, clarity and certainty in the Rules and Regulations, and the need to avoid any potential contradiction or ongoing confusion. However, views were divided over the necessity of the proposed 'call-in' power.

2.2 Stakeholders who welcomed the proposal cited the importance of ensuring that changes to the Rules are aligned and coordinated with the Regulations, and the importance of Government retaining discretion over changes that relate to policy issues as opposed to technical and operational matters. However, if adopted, stakeholders stressed the need to ensure that its use was extremely limited.

2.3 Many stakeholders felt that the current division of responsibility is appropriate and sufficient, with policy intent communicated via the Regulations and minimal political interference in rules agreed between industry and Ofgem. It was felt that the proposal could introduce a new risk of interference in the market, which may undermine investor confidence and increase auction cost.

Decision taken since consultation

2.4 In light of the mixed response from stakeholders to this proposal, the Government will not be taking forward this amendment to the Regulations at this time. The Government and Ofgem will however work together to ensure that the processes of regulation and rule change

are as co-ordinated, and as transparent for stakeholders, as possible. The Government will also continue to review how best to clarify regulatory roles and responsibilities over time to provide external reassurance that there is ultimately only one policy owner of the framework.

2.2 - Refurbishment agreements

Consultation Question
Q28 - Do you have views on whether there is a continuing need for three-year refurbishment agreements? If not, when would it be appropriate to withdraw this option? Please provide evidence, for example of any planned refurbishment programmes that would not take place without three year agreements (you may mark your reply as confidential if sensitive information is provided).

Summary of Responses

2.5 There were twenty-two responses to this question. There was a mixed response amongst stakeholders as to whether there was a continuing need for three-year refurbishment agreements.

2.6 Those that were not in favour of retaining three year refurbishment agreements cited the following reasons:

- all plants should be able to access different contract lengths as required for the viability of the plant;
- all existing plant should be treated equally;
- it is unclear whether it is necessary or in the best interests of consumers; and
- as these agreements were originally intended to support coal stations to stay operational, they were no longer needed given the Government's decision to close all coal-fired stations.

2.7 Those that were in favour of retaining three-year refurbishment agreements cited the following reasons:

- they should still be in place for Selective Catalytic Reduction/Open Cycle Gas Turbine (SCR/CCGT) modernisation;

- it would maintain the ability to ensure cost-efficient auction outcomes, allowing existing capacity to compete more equitably with new build;
- a refurbishing agreement can serve a practical purpose in seeing previously mothballed capacity brought back into service if a longer term agreement is available, and the auction can then be used to decide if this is a more economic option than building new capacity; and
- it could be needed in the future.

2.8 Other issues raised by stakeholders included:

- the expenditure threshold should be significantly reduced, as the expenditure threshold to secure a three-year refurbishment agreement is disproportionally high compared to the achievable Clearing Price and this is the primary reason why the uptake has been low;
- reviewing the eligibility criteria of three-year agreements to give welcome flexibility to DSR and existing generation participants would be a significant market improvement;
- there is a need for further review of the different contract lengths; and
- if retained, there needs to be clear guidance on the criteria for refurbishment to ensure that the option is viable.

Decision taken since consultation

2.9 It is clear that more respondents were in favour of keeping the three-year refurbishment category than withdrawing it, and although no evidence of future improvement plans were identified, there have only been two auctions to date and therefore it would be premature to remove it. The Government will therefore not be removing the refurbishing category.

Consultation Question
Q29 - How could the eligibility requirements and definitions be further defined? For example, could the Government outline specific qualifying improvement programmes for each technology or identify what is deemed routine maintenance and therefore should not qualify?

Summary of Responses

2.10 There were nineteen responses to this question, with mixed views expressed. Some stakeholders thought there should be no further action by Government, citing that changes introduced by the 2015 CM rules have not yet been tested and it would seem premature to change them. Others thought it would not be practical for the Government to outline specific qualifying improvement programmes in relation to each technology or in relation to deemed routine maintenance. A suggestion was also made that the modified definitions for the 2015 prequalification process, that specifically excluded routine maintenance and required an "as new" standard to be met for agreements in excess of three years, seems to have significantly lowered the numbers of CMUs coming forward in this category. This respondent suggested action is not required at this stage but that the issue should be kept under continuous review and action taken in future years if concerns arise then.

2.11 Other suggestions included:

- reviewing the eligibility criteria of three-year agreements to give flexibility to DSR and existing generation participants;
- that the conversion of a power plant to a combined heat and power plant should be specifically recognised as a qualifying improvement programme;
- clarification of what kinds of works do or (more importantly) do not qualify should be provided; and
- that evidence is provided of how the asset life would be extended and/or reliability improved.

Decision taken since consultation

2.12 On the basis of consultation responses the Government has not identified any clear and specific changes that should be made, and is not proposing regulatory change at this stage. However, the Government will continue to consider the feedback received.

2.3 - Unproven DSR – credit cover and termination fees

Consultation Question
Q30 - Do you agree that Unproven DSR providers should not incur the loss of their credit cover and also a termination fee prior to the start of the delivery year?

Summary of Responses

2.13 There were seventeen responses to this question. All those who responded to this question were in agreement with the Government's proposals, arguing for example that it would ensure consistency across technology types. One stakeholder noted that DSR providers should not incur the loss of their credit cover and also a termination fee prior to the start of the delivery year – and that this would constitute a double penalty for DSR which would be unfair. Another stakeholder stated that the termination fee for DSR is disproportionately high. A further stakeholder stated that DSR arrangements should deliver an equivalent incentive to those in the generation agreements.

2.14 There were a couple of additional suggestions, including that there should be improved credit terms for capacity providers repeatedly able to demonstrate their capability, reflecting they are a lesser risk.

Decision taken since consultation

2.15 The Government will amend the Regulations so that in calculating the termination fees for an unproven DSR CMU prior to the start of the delivery year, any previously drawn down collateral is subtracted from any termination fees. This amendment is also proposed for the TA auctions.

2.4 - Aggregation of prospective generating CMUs

Consultation Question
Q31 - Do you agree with the proposed approach to enable Prospective CMUs under 50MW with different legal owners to aggregate and that the individual CMU in the aggregated Prospective CMU can be sold, transferred or disposed of?

Summary of Responses

2.16 There were twenty responses to the question. The majority of stakeholders broadly agreed that CMUs under 50MW with different legal owners should be able to aggregate, and that the individual CMU in the aggregated prospective CMU should be able to be sold, transferred or disposed of. Around a quarter of stakeholders indicated that the government should go further and not restrict this just to those CMUs that are under 50MW.

2.17 One stakeholder advocated further flexibility by proposing an amendment to rules such that new build plant would be able to participate within an aggregated CMU without providing historical performance data.

2.18 Another stakeholder replied saying that the “Dispatch Controller” being the applicant for a Capacity Agreement may not be appropriate. They suggested a more general “lead party” approach.

2.19 One stakeholder noted that the amendment could increase the risk of non-delivery of new build projects due to different legal owners and developers.

Decision taken since consultation

2.20 The Government will amend rules 3.2.6 and 3.2.7 and the associated declarations at Exhibits F and G to include all Generating Unit types under 50MW. This will enable the aggregation of Prospective Generating CMU (under 50MW) with different legal owners. The ‘Dispatch Controller’ with respect to the generating CMU must be the applicant for a CM agreement. We do not propose to make any further changes in this area as there was not strong or consistent support for going beyond the changes proposed.

2.21 The Government will also extend Rule 9.2.10A and associated declarations in Exhibits H and I to include Prospective Generating CMU, to enable individual CMU within a Prospective CMU to be able to be transferred, sold or disposed, but only where the 'Dispatch Controller' for the CMU remains with the aggregator.

2.5 - Price Duration Equivalence

Consultation Question
Q32 - Do you agree that there is no robust basis for applying a price duration equivalence methodology not just for the next, but for any subsequent, auction? If not, please provide evidence.

Summary of Responses

2.22 There were twenty-four responses to this question. The majority agreed that price duration equivalence (PDE) should not be applied, as there is not sufficient evidence PDE would improve auction outcomes, but it would add complexity and associated uncertainty.

2.23 It was suggested by some that the Government should keep open the option of reconsidering the methodology in the future.

2.24 A few stakeholders expressed the view that PDE should not be disapplied as it allows comparing multi-year and one-year agreements, and that the current design favours long-term agreements and therefore increases costs to consumers. Furthermore, criticism was expressed that the current design, which does not differentiate between multi-year and one-year agreements, is a specific form of price duration equivalence, and the identified PDE complexities call the existence of long-term agreements into question.

Decision taken since consultation

2.25 The Government has investigated PDEs in two consultations and consulted externally to find an appropriate methodology. The research did not identify comparable methodologies being used in other jurisdictions or sectors. The findings indicate high complexity but no clear improvement of auction outcomes with respect to value for money or efficiency.

2.26 The fact that PDE methodologies are not found to improve the comparison of multi- and one-year agreements does not therefore imply that the rationale for long-term agreements, which aims at reducing uncertainty of investment decisions, is flawed or should be revisited.

2.27 The Government has thus decided not to apply PDE for the next or any future CM auction. The methodology will not be reviewed as keeping this option open is seen to introduce unnecessary uncertainty about future CM design.

2.6 - Payments and credit cover

Consultation Question
Q33 - Do you have any comments on any of the above payments and credit cover proposals?

Summary of responses

2.28 There were nine responses to this question, and none of these disagreed with the proposals. One respondent suggested a short window should be allowed for participants to amend Letters of Credit before these are drawn down.

Decision taken since consultation

2.29. The Government will proceed with the amendments proposed in the consultation, with the exception of the proposal to make changes in relation to invoices for late payment interest, which we have determined is not necessary. The requirements for maintaining Letters of Credit are clear, reasonable, and achievable. As such we do not propose to add any further window for amending these. We will therefore proceed with the amendments proposed.

2.7 - Appeals

Consultation Question

Q34 - Should the Government extend or make permanent the derogation which allowed appellants to provide additional information at a Tier 1 appeal?

Summary of Responses

2.30 There were twenty-one responses to this question. The majority of stakeholders wanted the derogation to be made permanent.

2.31 Stakeholders cited the perceived complexity and instability of the Regulations and the Rules with regards to numbers of amendments, stating that there was no perceived need to not allow additional information into the process, and also mentioned problems with the administrative systems.

2.32 Other stakeholders suggested the derogation should be retained for a further year or so, and then reviewed again as part of looking at the whole of the prequalification process. There was also a suggestion that there should be an extension of the Tier 1 dispute window so that applicants would have longer to submit their appeals.

2.33 Another suggestion was that the Tier 1 process be renamed to be called the 'verification process', making it more reflective of the fact that there have been challenges with prequalification, and that this does not in most cases suggest failure to prequalify which can be worrisome to investors.

Decision taken since consultation

2.34 The Government recognises there have been considerable operational problems with the prequalification process for the last two T-4 auctions which has resulted in a large number of appeals to the Delivery Body. In light of this, the Government will extend the derogation for another year for the 2016 T-4 auction.

2.35 The Government will also work with National Grid and Ofgem to look at the whole of the prequalification process in order to make it more user-friendly for stakeholders.

2.8 - Enforcement of penalties on companies with zero turnover

Consultation Question

Q35 - Do you believe there is an issue with companies who have breached the Rules and have zero or little turnover? If so, do you feel that it requires addressing in the context of the Capacity Market specifically?

Summary of Responses

2.36 There were twenty responses to this question. There was a mixed response, with some stakeholders believing that this was an issue but divided on whether it needed to be addressed specifically in the CM. Other stakeholders stated that they were unaware or did not think there was a specific issue around companies with zero turnover. It was raised that these companies are likely to be new entrants, and that there should be no barrier to encouraging innovative investments.

2.37 One stakeholder suggested that there should be an alternative regime for companies with zero turnover, where Ofgem should be able to impose a direct financial penalty, up to a cap (defined per MW). The parent company would then underwrite any penalties that are applied for breaking the CM rules.

2.38 One stakeholder thought that the issue was a major loophole and needed to be resolved as a matter of urgency. They recommended that there should be increased credit cover and tighter milestones on companies as a deterrent to speculative bidding.

Decision taken since consultation for questions thirty-five to thirty-seven

2.39 It is clear that there are mixed views on the issue of enforcement of penalties on companies with zero turnover. In light of these responses, the Government will continue to look at this alongside looking at the results of a recent consultation into Ofgem's enforcement powers, before any decisions are made.

Consultation Question

Q36 - If this were to be addressed, would the preference be for a new section on enforcement to be inserted into the Capacity Market Rules, allowing Ofgem to impose a financial penalty?

Summary of Responses

2.40 There were eighteen responses to this question. The majority of stakeholders were not in favour of a new section on enforcement being inserted into the Rules which would allow Ofgem to impose a financial penalty. Most stakeholders thought that Ofgem's powers were already sufficient and this proposal was unnecessary.

2.41 One stakeholder suggested that assurance could instead be provided by asking companies with a turnover of less than for example £100,000 to post £10,000 of credit or cash. This would however require applicants to supply audited accounts to establish turnover.

2.42 Another stakeholder thought if provision was put in the Rules, it would be necessary to ensure that the relevant rights of appeal (including the merits review of whether the penalty is appropriate in the circumstances of the case) are provided.

Decision taken since consultation

See above.

Consultation Question
Q37 - Do you think the disadvantages of a financial guarantee of a fixed figure to offset any penalty outweigh the advantages?

Summary of Responses

2.43 There were sixteen responses to this question, with mixed opinions regarding the advantages and disadvantages of a financial guarantee.

2.44 Some stakeholders thought that the disadvantages of a financial guarantee of a fixed figure to offset any penalty did outweigh the advantages but it depended on the level of penalties.

2.45 Another stakeholder suggested a threshold should be considered for the larger, and therefore what could be considered more risky, developments.

2.46 Other stakeholders thought it was unnecessary and would increase costs.

Decision taken since consultation

See above.

2.9 - Auction parameters adjustment

Consultation Question
Q38 - Do you agree with extending the period of time in which the Secretary of State can decide to adjust any of the auction parameters to ten working days?

Summary of Responses

2.47 There were twenty-two responses to this question. The majority of stakeholders agreed with the policy intent of extending the Secretary of State's decision to ten days.

2.48 However, some stakeholders thought that the Secretary of State should either have no role in determining auction parameters (they preferred a code), or that the evolution of the design of the CM over time should mean that the Secretary of State will have no role.

2.49 Other comments included:

- there is no reason to consider extending the window as it already causes uncertainty and risk to investors;
- the Secretary of State being given an additional week for amendments to the demand curve could result in a shorter time available for auction participants to see the demand curve and thus formulate their bidding strategies in the auction. This may not be desirable in terms of the liquidity or risks to participants; and
- the Government should review the process for amending the Transitional Arrangements auction Target Volume to formulate a coherent methodology and allow the alteration of the TA Target Volume following the results of the T-4 auction.

2.50 One stakeholder also expressed strong concerns about the Delivery Body's (National Grid) influence over the auction parameters, given that National Grid has a commercial arm as well, and wanted a review of this.

Decision taken since consultation

2.51 In light of the majority of stakeholders agreeing with the proposal of extending the auction parameters to ten working days, the Government will be going ahead with this in time for prequalification for the 2016 T-4 auction. In terms of the concern raised in relation to the Delivery Body's influence over the auction parameters, the Government has established a Panel of Technical Experts whose role is designed to provide an independent review of the auction parameters.

2.10 - Interactions with other support schemes

Consultation Question
Q39 - Do you have any evidence to suggest the current arrangements for eligibility as between the Capacity Market and other Government support schemes create any difficulties or uncertainty?

Summary of Responses

2.52 There were nineteen responses to this question. The majority of stakeholders did not comment on this question, indicating they do not have any evidence that interactions with any other support schemes create difficulties or uncertainty.

2.53 However of those that did comment, some stakeholders explicitly confirmed that they were content with current arrangements and felt them to be appropriate. Of the stakeholders who mentioned concerns or raised suggestions, these included that renewables projects such as those in Renewable Obligation (RO) or Contracts for Difference (CfD) support schemes should be eligible in the CM. Alternatively some stakeholders offered suggestions on the technical mechanism by which the exclusion of such supported schemes is affected.

2.54 The rationale for those who advocated including renewables in the CM included that this would incentivise low carbon investment and generation at times of system stress, but also because some stakeholders felt those receiving RO support have been unfairly disadvantaged since the introduction of the CM.

2.55 A couple of respondents also highlighted that biomass plant transferring from the RO to the CM would no longer be subject to any sustainability criteria – which they were whilst receiving RO support.

2.56 Further respondents mentioned Energy from Waste with Combined Heat and Power (CHP) stating it should be able to submit a ROO Conversion Notice in accordance with the other criteria. Others took the opportunity to mention concerns over more general equal treatment between different resource types (for example, suggesting that Ofgem's cap and floor regime for interconnectors could be viewed as a form of support scheme).

Decision taken since Consultation

2.57 In the light of the responses from the consultation the Government plans no material changes to the arrangements at this stage. The Government is separately proposing a small amendment to the Regulations to deal with the way the CM interacts with some additional schemes – see chapter 2.1 of the accompanying consultation document.

2.58 Government also acknowledges the feedback regarding sustainability criteria and will keep this under consideration.

2.11 - Capacity Market / Contract for Difference interaction

- Option one – delete the concept of a CfD transfer notice.
- Option two – enable units to terminate their capacity agreements to enter a CfD allocation round for unit or station biomass conversions.

Consultation Question
Q40 - Which option do you favour and why? Are there other options which should be considered?

Summary of Responses

2.59 There were thirteen responses to this question. Most stakeholders did not respond to this question, or stated they had no preference. Of the seven that responded with an explicit preference five preferred option two. Reasons given for option two included that it would retain some of the original policy intent, and would ensure clarity for this process and meet Government's policy intention of enabling certain types of unit to transition from the CM to CfD. However, many respondents raised concerns or suggestions, particularly focusing on the unsuitability, in their view, of either option.

2.60 Some stakeholders raised concerns including:

- that it is important to ensure a CfD transfer notice is not used to terminate a CM agreement where there is no real intention of securing a CfD, and that any opt-out from the CM carries all the costs and penalties consistent with any other non-delivery or termination;
- option one would prevent Carbon Capture & Storage retrofit and transfer from the CM to the CfD, and that option two would require a developer to forego a Capacity Agreement and enter into the CfD allocation process, the outcome of which is highly uncertain; and
- that the Rules, Regulations and the verification checks required to be carried out by the Delivery Body will need to be fully defined well in advance to enable CfD systems and processes to be developed ahead of the relevant CfD round, to support a seamless qualification process.

2.61 Other suggestions included:

- an incentive for low carbon energy - either in the CM or alongside it – would encourage small-scale generators in particular to make the change to a lower carbon fuel;
- extending the effective period of the transfer notice so that it can be activated within the term of a Capacity Agreement and not just prior to the delivery period; and
- enabling CfD participants to rescind their CfD contract and choose to participate in the CM instead or even better, reconsidering concurrent eligibility for the CM and CfD.

Decision taken since consultation

2.62 Government welcomes stakeholder feedback on this issue. In light of the mixed responses and the limited, qualified, support for option two, Government has decided, however, not to progress either option at this stage. It will reconsider the options and bring

forward amended proposals within the next 12 months. In the meantime parties will be bound by the existing Regulations.

Consultation Question
Q41 - Do you believe applicants that enter via a CfD transfer notice, as described in option two, would have an advantage over other applicants in the CfD allocation process?

Summary of Responses

2.63 The majority of stakeholders responding to the consultation did not answer this question. Of the eight who responded, all of them did not believe it would lead to an advantage for applicants able to enter via a CfD transfer notice.

2.64 A suggestion put forward by stakeholders was that the generator should be allowed to apply for a CfD whilst continuing to hold a capacity agreement, and then relinquish the capacity agreement if successful. Another stakeholder stated that any solution should not allow providers to speculatively bid into a CfD auction, so penalties and termination fees must be maintained for capacity providers with an obligation if they fail to deliver in the CfD mechanism.

Decision taken since Consultation

2.65 As stated above, Government has decided not to progress either option at this stage. We will reconsider the options and bring forward amended proposals within the next 12 months. In the meantime parties will be bound by the existing Regulations.

Consultation Question
Q42 - Which, if any, sanctions should be considered for applicants that enter the CfD allocation process via a CfD transfer notice and, for example, are awarded a CfD but

do not subsequently sign, or fail to deliver, the project as required under the CfD terms?

Summary of Responses

2.66 The majority of respondents to the consultation did not answer this question. Of those who responded (eight in total), a few felt sanctions were not required, with one stating sanctions for such a situation should be covered in the CfD scheme, and hence nothing is required in the CM Rules. Another stated Government policy was to allow capacity providers to transfer to a CfD contract without penalty.

2.67 Some neither agreed nor disagreed, but offered suggestions, including:

- that sanctions if applied must be in line with the CfD terms for other CfD allocation recipients and that the applicant should be excluded for a certain number of future Capacity Auctions for that CMU;
- that a unit that pursues a CfD Transfer Notice should have its existing capacity agreement terminated for that specific capacity – but that more thought needs to be given to situations in which a unit is split and only part of it is entered into a CfD auction (and where it may be reasonable that the generators exempt from the CfD continue to qualify for capacity agreements);
- that if a CMU withdraws from its CM agreement it should be excluded from all Delivery Years to which the agreement related to, otherwise a Capacity Provider might exit a Capacity agreement for commercial reasons by using the CfD/RO transfer procedure, then reapply in future auctions for the same delivery year; and
- any penalties applied should be the same as other CfD participants who do not subsequently sign, or fail to deliver the project as required under the CfD terms, and that those entering the CfD allocation process via a CfD transfer notice should not be treated differently.

Decision taken since Consultation

2.68 Again, as stated above, Government has decided not to progress either option at this stage. We will consider the responses we have received to the question above when we

reconsider the options and bring forward amended proposals within the next 12 months. In the meantime parties will be bound by the existing Regulations.

2.12 - New termination event

Consultation Question
Q43 - Do you agree that capacity providers found to have made false or misleading declarations should have their capacity agreements terminated, a termination fee of £25k/MW applied and be required to repay their capacity payments?

Summary of Responses

2.69 Twenty-one stakeholders answered this question. The majority (around two-thirds) supported the Government's proposals, but many had caveats or concerns.

2.70 Several respondents pointed out that 'false and misleading' information could be interpreted very widely, and that participants could be penalised for clerical errors, or misunderstandings. There was also concern that an immaterial error that subsequently came to light would automatically lead to the penalties. However, most felt there would be ways to mitigate these risks. For example one stakeholder suggested the wording should be changed to reflect that there must be real intent behind the provision of false or misleading information. Another said that the power to terminate should be subject to the Secretary of State's discretion under Regulation 33 of the Electricity Capacity Regulations.

2.71 Reasons given by those opposing the proposals included:

- that the termination of the Capacity Agreement should be sufficient penalty; and
- the CM Rules and Regulations are very complicated and it would be too easy to make statements which could be considered false or misleading.

Decision taken since consultation

2.72 The Government intends to take forward the proposals, as we believe that there should be a remedy post auction to terminate if it comes to light that untrue or incorrect information

was submitted with an application for prequalification, and that a capacity agreement has been won when it should not have been.

2.73 We have considered concerns expressed by stakeholders, including around the meaning of 'false and misleading' information, as well as concerns that immaterial errors that subsequently come to light would automatically lead to termination. The new termination event is linked to the requirement in rule 3.12.1 that information submitted with an application must be true and correct in all material respects, and that specific declarations must be true and correct. The Government considers that this would mitigate the risk of termination for minor errors.

2.74 Furthermore, in the event of a termination, it is important to note that in rule 6.10.2 there is also the possibility of making written representations to the Secretary of State including a cure plan as to how any issue may be addressed. Nonetheless, we will revisit the issue if operational difficulties arise in practice.

2.13 - Table of minor and technical changes

Consultation Question
Q44 - Do you have any comments on the table of minor and technical changes?

Summary of Responses

2.75 There were twelve responses to this question. The majority of those who responded supported the changes proposed in the table of minor and technical changes.

2.76 One stakeholder mentioned that termination (as a result of not meeting the SCM) of a new build interconnector could not be avoided by the use of secondary trading, but that the Rules do not fully reflect this.

2.77 Another stakeholder expressed concerns that the table does not contain proposed changes to enable battery energy storage to compete on an even playing field within the CM.

2.78 Some stakeholders raised that termination of capacity agreements in relation to CfDs and ROO conversions should be amended to include “Energy from Waste with CHP”, with respect to which ROCs the capacity provider intends to claim in respect of a CMU.

2.79 Another stakeholder argued that the proposed new paragraph 15A of Schedule 7 to the Rules should not be taking forward. The provision consulted on states that “a Main Meter and a Check Meter shall be supplied by the Capacity Provider for each circuit”, which the response argued is unclear.

2.80 One stakeholder agreed with the proposed changes subject to the following points:

- Regulation 60(2): Credit cover for TA auctions: suggest that Termination Fee TF1 as required under Regulation 32(2) should be amended to £500/MW in these circumstances;
- the requirement under Regulation 59(2)(a) to continue to post £5,000/MW under the enduring scheme is problematic for most DSR providers; and
- Rule 13.4.1(c) - the new drafting should state under which Rule/Regulation such penalty charges are paid.

Decision taken since consultation

2.81 The Government will be going ahead with the planned minor and technical changes in the table. The Government will also look at the other suggestions raised by stakeholders.

Chapter 3 - Looking Ahead

3.1 - T-1 auction

Consultation Question
Q45 - Is more clarity needed on the process and responsibility for determining the T-1 'set aside' amount at the point that T-4 auction parameters are announced? Do you have any views on the factors that should be considered to determine this in order to achieve the best balance of security of supply, market access, and value for money for bill payers?

Summary of Responses

3.1 There were twenty-three responses to this question received. Stakeholders supported the case for greater clarity over determination of the T-1 set aside. It was suggested this should be based on objective criteria, principally driven by security of supply considerations.

3.2 Several stakeholders stated that it was not appropriate for the set-aside to be related to expectations of DSR volume, on the grounds this is inherently uncertain, and creates a risk of relying on capacity that may not materialise. It was also argued that DSR can participate and compete fairly at T-4, particularly with the ability to bid Unproven DSR CMUs, and so suggesting there is no need for any 'link' between DSR and T-1.

3.3 Some stakeholders expressed a desire for an earlier forecast from National Grid regarding expectations of volume to be purchased at T-1 – although it was noted that this could subsequently change in response to revised data.

3.4 There was a clear view from several stakeholders that the volume set aside from T-4 should be lower than the 2.5GW set aside in the first two T-4 auctions, on the grounds that the set-aside distorts the T-4 price, and also leads to an increased security of supply risk due to the potential of insufficient liquidity at T-1. Conversely, a few stakeholders suggested that the T-1 volume should be 'guaranteed', or high enough to ensure that an auction goes ahead.

3.5 One stakeholder proposed changes to the CM to favour battery storage.

Decision taken since consultation

3.6 The Government will consider further how greater clarity can be given regarding the determination of the set-aside amount for the T-1 auction. The Government agrees with the view expressed by stakeholders that the security of supply implications of the set-aside amount should be paramount. The Government is clear that the overall CM framework needs to accommodate risks such as increases in demand estimates or non-delivery of other capacity, and ensure that sufficient capacity can be brought forward to protect against them. Decisions taken at T-4 stage on the amount of capacity to be held back for T-1 should therefore reflect those risks, in order to give confidence that the T-1 auction will be liquid and able to secure the amount of capacity that is ultimately needed in a given delivery year. This assessment will need to consider the extent to which some resources may be better placed to compete at the one-year ahead stage, and also that others (e.g. larger-scale new build generation) may only be able to compete four years ahead.

3.7 Some stakeholders have argued – here and previously - that set-aside amounts should be high enough to offer certainty to the DSR sector, on the grounds that, whilst able to participate four years ahead, DSR may be better placed to participate in T-1 auctions than the T-4. DECC recognises that T-1 auctions may particularly suit some DSR providers, but this must be balanced with the implications of setting aside an amount for T-1 that could lead to an unacceptable security of supply risk closer to the delivery year if insufficient capacity (whether DSR or otherwise) were to materialise to meet requirements. For the 2020/21 delivery year we are therefore likely to bring forward much of the target procurement that we might otherwise consider leaving until one year ahead in order to help mitigate delivery risks as discussed in the introductory section.

3.8 Both the Government and National Grid agree that an earlier indication of likely T-1 volumes would help the market to prepare. As such, National Grid's 2016 Electricity Capacity Report (ECR) will include information on potential requirements for the 2018/19 T-1 auction. However, this will not be a firm recommendation, so any information provided could be subject to change. A final T-1 volume recommendation for the 2018/19 delivery year will be provided in the 2017 Electricity Capacity Report as stipulated by the Regulations, in order to ensure that it reflects the most up-to-date analysis.

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However, this will not be a firm recommendation, so any information provided could be subject to change. A final T-1 volume recommendation for 2018/19 will be provided in the 2017 Electricity Capacity Report as stipulated by the Regulations, in order to ensure that it reflects the most up-to-date analysis. As previously stated, we also propose to bring forward the start of the CM delivery period by a year, by holding an action this coming winter (likely to be in January 2017) for delivery one year ahead, in winter 2017/18. This auction would purchase 100 percent of the capacity needed to meet the reliability standard that year – in other words, while its structure and timings will be similar to the T-1 auction, it will procure our full capacity requirement, not just a top-up. This will provide assurance for the 2017/18 year and Ofgem have said that they expect the need for the CBR to disappear once the CM is in place.

Consultation Question
Q46 - Does a T-1 auction held 12 months ahead of delivery represent an appropriate balance in terms of being able to access suitably accurate/up-to-date analysis of requirements whilst allowing a broad range of capacity to participate? Are there any arguments for allowing greater flexibility in the Regulations to run the T-1 auction earlier than this?

Summary of Responses

3.9 There were twenty responses to this question. The majority of stakeholders felt that a T-1 auction one year ahead is about right, and it was also noted that the knock-on impacts of a timing change on operational timetables and interactions with T-4 auctions would need further consideration. Some stakeholders felt that auction timing should be codified to remove discretion and offer greater certainty.

3.10 A few stakeholders thought an earlier auction would be beneficial as this would better suit the business timescales for certain participants – although one response stated that this should not be done ‘retrospectively’ in relation to delivery years for which T-4 auctions have already taken place, on the grounds that T-4 bidding strategies were based on current regulations and rules. Conversely, others felt that any more than 1 year ahead was less suitable for some participants. An auction closer to the delivery year was not advocated, although an ‘interim’ auction between T-4 and T-1 was suggested.

Decisions taken since Consultation

3.11 The Government has noted that most respondents support the current structure and timing of CM auctions, with no strong arguments made in favour of any changes. As such, with a view to maintaining regulatory stability, we do not propose to make any changes in this area, notwithstanding the proposals set out in the new consultation document published alongside this response. However, we will continue to monitor this over time to ensure that the current structure remains optimal.

3.2 - Cross border participation – other Member State interim solutions

Consultation Question
Q47 - Until an EU solution has been agreed, do you have any views on how Great Britain should approach cross-border participation with other Member States, in particular with Member States whose electricity grid is connected to GB?

Summary of Responses

3.12 There were twenty-one responses to this question. Almost half said they would like the Government to proactively work on tackling the barriers to a pan-EU solution and/or on regional approaches to cross border participation, to ensure consistency in the approach with other Member States, reciprocal arrangements, agreement of the rules at times of system stress and to avoid double counting of capacity in generation adequacy assessments.

3.13 Just over half also supported a generator-led or hybrid approach involving interconnectors and overseas generators rather than the current interconnector-led solution, although it was recognised by some that the current approach is administratively light and works well in the interim. These respondents commented that the interconnector-led approach tends to over-reward interconnectors and under-reward generators, that equivalent capacity should be taking part (generators, DSR) and that interconnectors operate significantly differently and cannot guarantee delivery.

3.14 Those who supported the current approach commented that it is efficient, in line with State aid guidelines and that, due to the nature of the interconnectors links (High Voltage Direct Current) and how market coupling works, it is difficult to see the influence of an

overseas generator on interconnector flows. There were differing views on whether the current assumed contribution for interconnection was ambitious or conservative.

3.15 Finally, some stakeholders raised concerns that interconnectors are not subject to the same taxation and charging regimes as generators, leading to what they believe is an unlevel playing field with impacts on their competitiveness in the CM auction.

Decisions taken since consultation

3.16 The Government will continue to work on the issue of cross-border participation at EU level, engaging as appropriate with the European Commission and other member states. Since the consultation was published, the Government has responded to the European Consultation on Electricity Market Design, which can be found here: https://www.gov.uk/government/publications/uks-response-to-european-commission-consultation-on-energy-market-design .

3.17 France and Ireland have also published consultations on cross-border participation in their respective capacity markets and we will continue to work with colleagues in those markets towards a solution for this complex issue as the proposals from them and the European Commission begin to firm up.

3.18 The Government has also commissioned analysis on the impacts of further Single Electricity Market reform and integration which we expect to conclude in the spring; we anticipate that this will help identify the potential benefit from sharing capacity resources and look qualitatively at possible policy measures to enable cross-border participation.

3.19 National Grid is working to further refine the process used to advise the Government on appropriate de-rating of interconnectors.

3.20 Level playing field issues raised are highly complex, lying as they do across different jurisdictions and driven by multiple factors including differing national tax regimes and renewable support mechanisms. The European Agency for Cooperation of Energy Regulators (ACER) has recently considered the specific issue of transmission tariff harmonisation, and has proposed further work to explore a common set of principles that could go some way to help avoid potential future investment inefficiencies.

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