Department of Energy & Climate Change

Electricity Market Reform: Capacity Market

Consultation on Capacity Market supplementary design proposals and changes to the Rules

Government Response

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Department of Energy and Climate Change
3 Whitehall Place
London
SW1A 2AW
Website: www.decc.gov.uk

For further information on this consultation, contact:
Security of Electricity Supply
Department of Energy and Climate Change
3 Whitehall Place
London
SW1A 2AW

Email: secondarylegislationemr@decc.gsi.gov.uk
The consultation can be found on DECC's website:
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Introduction

Consultation Overview

1. The Government's Electricity Market Reform programme is promoting investment in secure and low carbon electricity generation, while improving affordability for consumers. Integral to this is the introduction of the Capacity Market.

2. The Capacity Market is designed to provide incentives for investment in the overall level of reliable capacity (supply and demand side) and ultimately secure supply of electricity. The Capacity Market has also been designed to support the development of more active demand side management in the electricity market. It encourages investment by giving capacity providers certainty over part of the future revenues they will receive. It operates alongside the electricity market and the existing services National Grid contracts to ensure moment to moment balancing of the system.

3. The Capacity Market works by determining how much capacity is needed to ensure future security of supply. Competitive auctions are held four years and one year ahead of the year that capacity is expected to be in place. Successful bidders are assured of a steady payment in that year; however they face penalties if they fail to deliver energy when needed. In this way, we can have confidence that sufficient supply will be in place to meet demand.

4. Full details of how the Capacity Market operates are set out in the Electricity Capacity Regulations 2014[1] ("the Principal Regulations"), the Electricity Capacity (Supplier Payment etc.) Regulations 2014 and the Capacity Market Rules 2014[2] ("the Rules"). These statutory instruments and rules were developed based on responses to *Electricity Market Reform: Consultation on proposals for implementation,* published in October 2013 and the Government Response, which was published in June 2014[3].

5. The first Capacity Market 'T-4' auction began on 16 December 2014, and cleared on 18 December 2014, procuring 49.3GW of capacity at £19.40 per kW for delivery in 2018/19. Following completion of the first Capacity Market pre-qualification and auction, the Department undertook a lessons learnt process, including requesting views from industry stakeholders.

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[1] The Electricity Capacity Regulations 2014: http://www.legislation.gov.uk/uksi/2014/2043/contents/made
[2] Capacity Market Rules 2014: https://www.gov.uk/government/publications/capacity-market-rules
[3] The Government's response to the October 2013 EMR consultation can be found at https://www.gov.uk/government/consultations/proposals-for-implementation-of-electricity-market-reform

6. The Department is committed to establishing a stable and predictable cycle for running the Capacity Market auctions, reviewing and making incremental improvements. We aim to work with industry and interested parties to improve the process continuously whilst providing the certainty and clarity they require in advance of each auction. Due to the parliamentary process required to make changes to regulations and the lead time to implement systems changes, we envisage this will be a biennial cycle, so that regulatory amendments proposed following the 2014 auction will generally be in force prior to the opening of prequalification for the 2016 auction. We have already consulted on a set of amendments to the Principal Regulations, and associated amendments to the Rules, designed in particular to allow the participation of Electricity Interconnectors in the Capacity Market. The draft Electricity Capacity (Amendment) Regulations 2015 have now been approved by each House of Parliament, and will therefore now be made and come into force before the end of March 2015.

7. This document provides the response to a further consultation on Capacity Market supplementary design proposals and changes to the Rules. On the 12 February the Department of Energy and Climate Change ("the Department") launched the consultation seeking views on additional amendments to both the Electricity Capacity Regulations 2014 and the Capacity Market Rules 2014.

8. The Department specifically sought views on a range of supplementary design proposals for the Capacity Market. These covered proposals on:

- the definition of double subsidy in regulation 17 of the Regulations to remove the exclusion of organisations in receipt of certain research grants;
- the requirements to demonstrate eligibility for refurbishing status during pre-qualification;
- the appropriateness of the current tools for ensuring delivery;
- the participation of aggregated generation CMUs under 50MW;
- the timing of posting credit cover; and
- other technical amendments which seek to clarify the policy intent.

Analysis of consultation responses

9. In total 22 responses were received from a wide range of stakeholders, including energy suppliers, generators, Demand Side Response providers, UK trade associations and others.

10. For every consultation question we have set out the question in this document 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.

11. All responses received as part of the consultation have been considered in developing final policy positions in the areas covered, and we have sought, where relevant and appropriate, to ensure stakeholder concerns have been addressed in the final design.

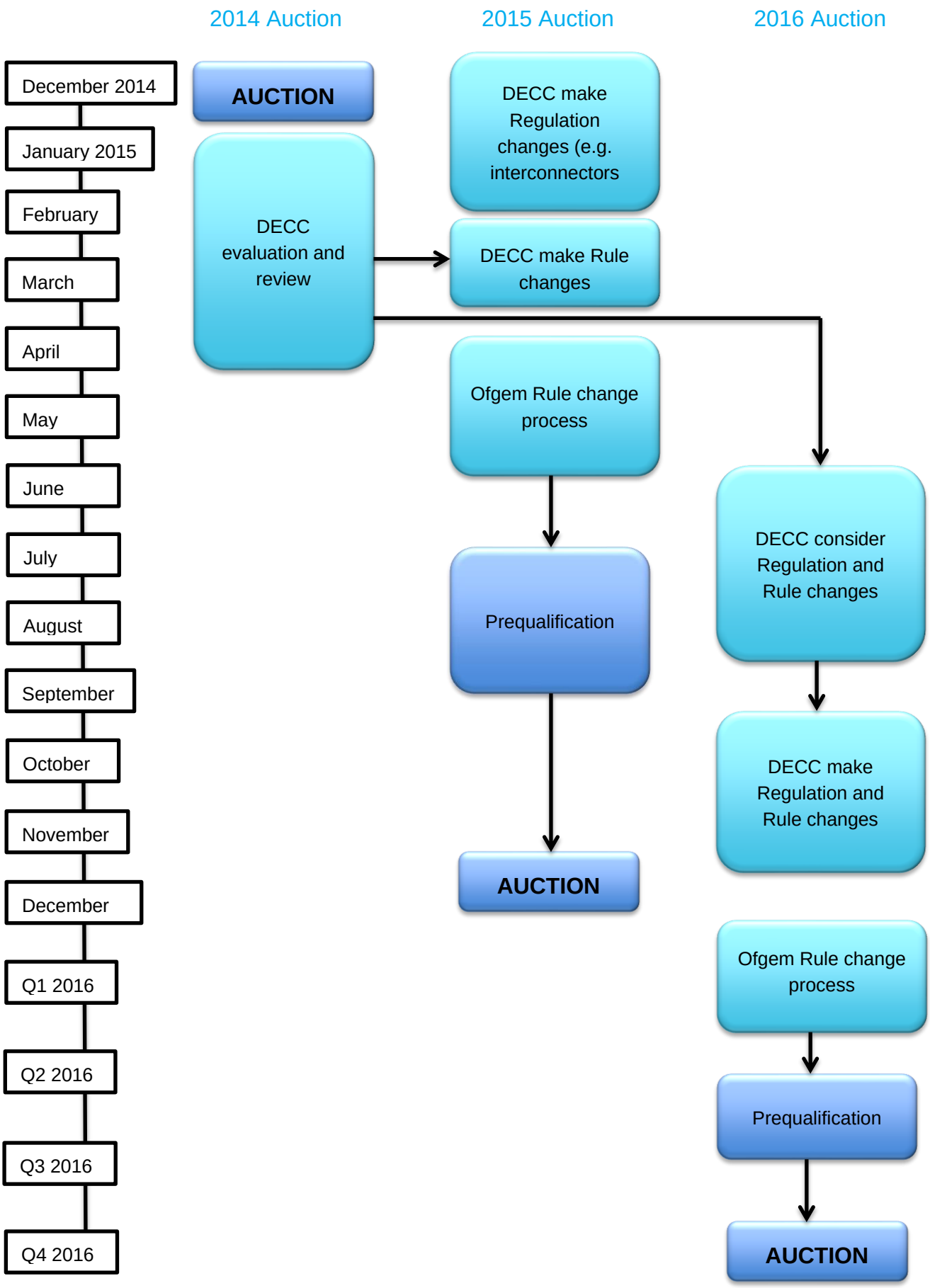
12. We would like to thank all those who engaged with the consultation by submitting a response. A full list of respondents to the consultation is included in Annex A.

Next steps

13. The decisions taken in light of the consultation are reflected in the Electricity Capacity (Amendment) (No.2) Regulations 2015, which have been laid before Parliament in draft alongside the publication of this document, and are, subject to securing the approval of both Houses, expected to be made and come into force in mid June 2015, before prequalification for the second capacity auction for delivery of capacity opens.

14. Amendments to the Capacity Market Rules 2014 are expected to come into force by the end of March, before Ofgem consult on further rule changes it proposes relating to the operation and administration of the capacity market. Ofgem are expected to consult on any proposed amendments in April this year in order to make such amendments before pre-qualification opens for the 2015 auction. Government will continue to work closely with delivery partners and capacity providers to implement these reforms in time for the second capacity auction for delivery of capacity in 2019/20.

Indicative timetable for 2015 and 2016 Auction



Chapter 1: Amending Regulation 17 of the Electricity Capacity Regulations 2014: excluded capacity – NER 300 and CCS grant scheme CMUs

Consultation Question	Amending Regulation 17 of the Electricity Capacity Regulations 2014: Excluded Capacity – NER 300 and CCS Grant Scheme CMUs
Question G1	• **DECC is seeking your views on the proposed amendment to limit the definition of "relevant grant" in Regulation 17. Do you agree with the proposal and the reason for it?**

Summary of responses

15. Twelve stakeholders responded to this question, all of whom supported the policy intent to amend Regulation 17. Stakeholders highlighted that the current Regulation has the potential to exclude plant on the basis on a FEED study.

Consultation Question	Amending Regulation 17 of the Electricity Capacity Regulations 2014: Excluded Capacity – NER 300 and CCS Grant Scheme CMUs
Question G2	• **Do you agree that receipt of non-capital funding should not exclude a CMU from applying for prequalification? Apart from funding for research how might "non-capital" be defined?**

Summary of responses

16. Twelve stakeholders responded to this question. Suggestions of how to define “non-capital” funding covered: to also include funding leading up to Financial Investment Decision for those capital projects where there is a significant early adopter cost/risk; any funding that is not intended to, nor which results in, direct financial benefit immediately or in the foreseeable future; funding that has no impact on the cost or value of the capacity offered by the CM; and funding that is not associated with delivering the Construction Plan or included in the Qualifying £/kW Capital Expenditure for the Prospective CMU.

17. Other suggestions were to not rely on a definition of “non-capital” but rather funding to aid the assessment of the feasibility of a substantial modification of the CMU in order to facilitate CCS, whether or not it will take place. It was noted that there needs to be a termination process to allow for a change from a non-capital to a capital grant.

18. Alternatively, it was also suggested that excluding “capital” grants may also not be clear cut and some forms of capital funding should not exclude a CMU.

Decisions taken since consultation

19. The Government will amend the regulations to ensure that grants to a CMU, whose purpose is feasibility studies or research and development in relation to CCS, will not preclude it from participation in the Capacity Market auction.

20. The essential feature is that the CCS support should not have provided effective material support for a CMU bidding in the Capacity Market which would put it at an advantage compared to units which have not so benefitted. This will not be the case for such early-stage grants for CCS purposes. As a result of these grants, units will either not proceed with CCS implementation – in which case, they may continue operation in unabated mode but will not have received support which is relevant to that operation – or they will proceed with CCS modifications with a view to CfD support – receipt of which will in itself preclude them from participation in the Capacity Market.

21. Given concerns from some stakeholders that the concept of “capital support” may not always be self-explanatory, with scope for varied accounting treatments within and outside Government, the amendment will not rest on the distinction between “capital” and “non-capital”.

22. The Government has noted other suggestions raised about potential interaction between the Capacity Market and the other funding regimes. No changes are currently planned, but the Government will consider further some of the issues raised in circumstances there may be arguments that no material advantage in relation to Capacity Market participation would have been gained, and may consult further with stakeholders in due course.

Chapter 2: Pre-qualification of Refurbishing CMU; Directors' Certification of requirement for capacity agreement exceeding one year

Consultation Question	Refurbishment CMU: Certification of requirement for capacity agreement exceeding one year
Question R1	• **Do you agree with the proposal in respect of applications for Refurbishing CMUs that applicants should state that a term greater than one year is required to undertake the proposed refurbishing work?**

Summary of responses

23. Eighteen stakeholders responded to this question. The policy intent was widely supported in terms of clear rules on eligibility regarding agreement length and to ensure that 'refurbishment' did not include 'business-as-usual improvements'.

24. However, several issues with the proposal were raised, such as the subjective nature of such a statement without guidance as to what constitutes eligible expenditure; the potential to include a wide range of works depending on a particular company's interpretation; and the inability to make such a statement without knowing the clearing prices for the next few auctions. If a statement was adopted, it would need to be caveated to be based on current economic and regulatory context. Furthermore, refurbishing CMU would not be able to switch to a one-year agreement as this would put the applicant in breach of the statement made at prequalification.

25. Several alternative solutions were suggested including: requiring Directors to sign a statement that the expenditure relates only to the improvements programme and is not being spent on activities that are part of the normal course of business; clarification on what constitutes refurbishment; definition of 'improvements programme'; remove "routine or statutory maintenance" from the definition of an "improvements programme" in the definition of a refurbishing CMU; or state that the capital expenditure that is eligible for 'refurbishing'

is the total expenditure for the post-refurbishment CMU over the term of agreement sought, less the expenditure that would have been made had the CMU been left in its pre-refurbishment state and maintained according to its original maintenance schedule over the same term.

26. Other points raised in relation to this proposal were that the timescale should relate to future expenditure from the Auction Results Day and not be backdated to 1st May 2012 or over a three year continuous period within the four years prior to commencement of the Delivery Year, thus limiting the extent to which business as usual activities could count towards the £125/kW threshold.

Decisions taken since consultation

27. Government welcomes the support of stakeholders for the principle that eligibility for up to three year agreements should reflect genuine refurbishment activity and not encompass business as usual expenditure. Government also acknowledges the range of views and alternative solutions on how to clarify this in the most effective manner.

28. Government does, however, reiterate the practical difficulty in accurately defining refurbishment without inadvertently changing the intended policy scope. Most of the alternative proffered solutions would require a more detailed definition to be drawn up, thereby presenting a risk of unintended consequences and potential gaming opportunities.

29. Government therefore maintains that a refurbishment statement, along the lines proposed would focus Directors' attention on the issue, internally, within a company, challenge the scope of the proposed improvements programme and ensure a corporate commitment to the applicant's justification for a greater than one year agreement. It is proposed, however, that the new refurbishment statement in the prequalification certificate is further clarified to remove any unhelpful ambiguity which might impact on Directors' ability to sign off on its terms with confidence. The statement will therefore require Directors to declare that a capacity agreement of greater than one year in duration is reasonably required to undertake the proposed refurbishment works under current economic conditions and regulatory and legislative framework, and that the associated total project spend will not include substantive routine or statutory maintenance.

30. As per the consultation proposal, the submission of a refurbishment statement would not restrict the ability to specify or amend the duration of the capacity agreement under rules 5.5.14 and 5.6 as relevant.

31. Government believes that the combination of the new refurbishment statement, the existing requirement to provide independent verification of incurred capital expenditure under rule 8.3.6, and the associated definition of capital expenditure in rule 1.2 (which references International Accounting Standard (IAS) 16), should help to ensure the scope of

refurbishments eligible for up to three year agreements is broadly aligned with the policy intent.

Consultation Question	Refurbishment CMU: Certification of requirement for capacity agreement exceeding one year
Question R2	• **Do you agree that where such a statement is not provided, the Maximum Obligation period available to that CMU should not exceed one year?**

Summary of responses

32. Seventeen stakeholders responded to this question, the majority were in broad agreement with the proposal if a statement were required, although most consultees pointed to responses under question R1 for alternative ways to implement the policy intent.

Decisions taken since consultation

33. Government intends to implement the proposal to restrict refurbishing CMUs to one year capacity agreements where the statement referenced in the previous question (R1) is not provided. This is a logical extension and consequence of the decision to implement the required refurbishment statement, and will apply even where the proposed capital expenditure is at, or above, the three year minimum £/kW threshold.

Consultation Question	Refurbishment CMU: Certification of requirement for capacity agreement exceeding one year
Question R3	• **Do you agree that the proposed statement should be extended such that, as well as stating that a capacity agreement exceeding one year is reasonably required to undertake the proposed refurbishing work, it also states such works could not otherwise be economically undertaken?**

Summary of responses

34. Sixteen stakeholders responded to this question. There were mixed views in relation to this question, with most stakeholders feeling that such an extension would not add any further assurance. Some felt that this question was too open and that the economic viability of an

overhaul cannot be accurately judged 4 years in advance in what is becoming an increasing volatile market. Such a statement could only hold true for the specific point in time it was made. It was felt that such a statement introduced a greater level of judgement that would depend on how an organisation assesses economic viability of a project.

35. Those in support of this extension felt that any plant seeking a Refurbishment status should be at, or very near, the end of its economic and/or technical life in the absence of capital injection; the capacity would only be available in the delivery year if Refurbishment status is granted.

Decisions taken since consultation

36. Government has decided not to progress this extension to the statement as proposed in question R3. Government acknowledges that such a reference to being economically undertaken would be open to interpretation and present significant challenges to defining 'economically undertaken', given the range of potential refurbishment projects and organisations' differing views on acceptable internal rates of return. It also accepts that such a declaration would provide only limited additional reassurance to the refurbishment statement in question R1. In addition it would create a tension with specifying the capacity agreement duration under rules 5.5.14 and 5.6 as noted in the consultation document.

Consultation Question	Refurbishment CMU: Certification of requirement for capacity agreement exceeding one year
Question R4	• **Do you have any evidence to suggest that it would be necessary to go further, e.g. to require submission of a "Refurbishing Memorandum"?**

Summary of responses

37. Seventeen stakeholders responded to this question. Most did not see the benefit in this requirement as it is unclear what additional value it would have or how it would be assessed by Ofgem. It was largely seen as an additional administrative burden.

Decisions taken since consultation

38. Government has decided not to progress the proposal for a 'Refurbishing Memorandum', primarily on the grounds of it being an unnecessary regulatory intervention, and administrative burden, at this stage. Government considers the combination of the new refurbishing statement and existing retention requirements for applications and supporting evidence (under rule 3.12.2) provide sufficient incentives for accurate and robust

declarations in respect of refurbishment support – although this will be kept under review going forwards.

Chapter 3: Ensuring delivery

Consultation Question	Ensuring delivery
Question D1	• **Do you think the current monitoring regime for new and refurbishing generating units, and associated milestone tests, are adequate? If you feel they should be strengthened, what should the key elements to focus on be?**

Summary of responses

39. Eighteen stakeholders responded to this question. The majority of respondents felt that the current monitoring regime for new and refurbishing plants, and the associated milestone tests, were appropriate. A small minority felt that the current monitoring regime was excessive and that monitoring of construction progress reports should be sufficient, while other respondents felt it was too early to judge the effectiveness of the monitoring regime and that this should be kept under review.

40. Some respondents, who otherwise felt that the monitoring regime was appropriate, suggested that monitoring in relation to refurbishing plant should be strengthened. Suggestions included placing an additional requirement on refurbishing plant, in the form of an additional report by the Independent Technical Expert, stating that the stated capital expenditure had actually been incurred and that this was additional to capital expenditure that would have been incurred in the normal course of business. It was also suggested that refurbishing plant that fails to meet the Financial Commitment Milestone should revert to a one-year capacity agreement.

41. A number of respondents suggested that monitoring information on the progress of new build and refurbishing plant should be more transparent, so that Government, the market and the system operator could take account of any capacity that was at risk of not being ready in time. It was proposed that reducing the Financial Commitment Milestone from 18 to 12 months would assist by giving earlier information, so that any capacity shortfall could be addressed. It was felt that a 12-month Financial Commitment Milestone represented a reasonable period for a project to reach financial close and would be aligned with equivalent provisions in the Contracts for Difference regime.

42. There was some concern that the current monitoring regime was excessively prescriptive and burdensome, and that it had been designed around the requirements of large-scale new build projects, and presented a barrier to entry for other types of capacity. To lessen this burden, it was proposed that the amount of detail and frequency of reporting should be reduced. It was also suggested that Independent Technical Expert reports should be made to adhere to more structured requirements to ensure consistency of standard and approach. These reports could be aligned with reports that are required as a condition of bank lending, to reduce administrative burdens on applicants.

Consultation Question	Ensuring delivery
Question D2	• **Do you consider the current levels of both termination fees for new generating units to be sufficient to incentivise timely delivery without presenting barriers to entry?**

Summary of responses

43. Seventeen stakeholders responded to this question. There was a divergence of views on whether the current level of termination fees is sufficient to incentivise timely delivery without presenting barriers to entry. Around half of respondents felt that termination fees need to be strengthened in some way to ensure timely delivery, particularly in respect of new plant – it was suggested that the current level of termination fees may encourage a new build CMU to treat a capacity agreement as an "option" rather than a firm commitment to deliver capacity. Of the remainder, some felt that the current level of termination fees was set at an appropriate level, some felt that the termination fees were already too high and presented a barrier to entry, particularly for smaller developers, and the remainder felt that it was too early to judge the effectiveness of the termination fees.

44. Specific suggestions included requiring new build CMUs to certify as part of the prequalification process that they had, or would have, sufficient financial resources to meet the total project spend, and to face a higher termination fee if they failed to deliver. It was suggested that the termination fee for failing to meet the Financial Commitment Milestone should be raised to £25/kW, and that credit cover requirements should be increased as it may not be possible to recover the full termination fee where a development project is structured as a separate limited company. There was also a suggestion that the penalty cap for failure to deliver in a Delivery Year should be lifted and that this would provide a stronger incentive for secondary trading.

45. Those who felt that the termination fees were already too high suggested that this would present a barrier to entry and would favour incumbent market players. One suggestion to reduce barriers to entry was to remove the requirement on new build CMUs to have

planning consent in place at the prequalification stage. It was also suggested that, where a new build CMU influences the clearing price in an auction but subsequently fails to materialise, that the auction clearing price should be retrospectively adjusted, so as to remove incentives for market manipulation.

Consultation Question	Ensuring delivery
Question D3	• **Do you consider the current arrangements for terminating generating units which mothball or decommission are sufficiently wide ranging and the termination fees of a level to disincentivise speculative applications into the auction?**

Summary of responses

46. Seventeen stakeholders responded to this question. Most respondents felt that the current arrangements for terminating generating units which mothball or decommission are sufficiently wide-ranging and represent a sufficient disincentive. A minority of respondents felt that disincentives were too weak and should be strengthened. Two respondents felt that it was too early to make a judgement about whether the scope and level of disincentives was appropriate.

47. A specific concern was raised that incentives were too weak on plant that faces low costs for maintaining its Transmission Entry Capacity (TEC), and that the penalty for not maintaining TEC should be replaced by a penalty for failing to demonstrate the ability to deliver capacity in the Delivery Year. Another respondent suggested that alternatives to TEC, if deemed acceptable by the Delivery Body, should be sufficient to allow a CMU to prequalify and avoid termination fees.

48. One respondent suggested that Government should increase the penalties for failure to deliver capacity when called upon in the Delivery Year. It was also suggested that existing plant which decommissions before the Delivery Year should be subject to the same termination fees as would apply to a new-build CMU, recognising the cost to society of failing to deliver the promised capacity.

49. Some respondents who felt that the current arrangements were appropriate suggested that to impose higher termination fees was likely to result in the imposition of additional costs on consumers.

Decisions taken since consultation

50. Stakeholder responses were mixed as to the efficacy of the current new build monitoring regime and delivery incentives, especially given a lack of evidence at this stage. However there is obviously a degree of stakeholder concern as to the impact of speculative/delayed new build plant, and existing plant surrendering their Transmission Entry Capacity (TEC), on the exposure of the wider capacity market.

51. As such Government intends to consider further policy options for reinforcing monitoring requirements and delivery incentives on new build plant and existing plant surrendering TEC, with an aim to bring forward policy proposals for consultation in the autumn 2015.

Chapter 4: Aggregated generation CMUs under 50MW

Consultation Question	Aggregated generation CMUs under 50MW
Question A1	• **Do you agree with the proposal to establish a similar mechanism to Rule 3.2 and Exhibit D to enable the aggregation of generating units with multiple legal owners to comprise an Existing Generating CMU?**

Summary of responses

52. Fourteen stakeholders responded to this question. There was a broad consensus in favour of this proposal, with only one respondent not expressing active support for the proposal. It was felt that this proposal would support aggregation and would increase participation in the Capacity Market, which would drive down costs ultimately to the benefit of consumers. It was suggested that this treatment should be extended to other types of CMU, such as new build and interconnector CMUs.

53. Other suggestions were that the Rules should be amended to allow parties to be agents for more than one Generating CMU in the Capacity Market, to reduce regulatory barriers for small generators, and that the Minimum Capacity Threshold should be reduced to 1MW.

Decisions taken since consultation

54. Government has decided that Rule 3.2.4 will be amended to enable Existing Generating CMUs comprising a number of generating units (up to a total of 50MW) with different Legal Owners to aggregate. Each Legal Owner of a generating unit within the CMU will be required to sign separate declaration confirming they are the Legal Owner of the generating unit, the identity of the Despatch Controller of that unit (i.e. the aggregator) and consenting to the Despatch Controller submitting an Application in respect of an Existing Generating CMU which includes that unit.

55. The Despatch Controller (aggregator) will also be required to sign a declaration setting out details of the relevant generating units comprised in the CMU, the legal ownership of each

unit and will confirm that it is the Despatch Controller. The declaration will also confirm that the aggregator as Despatch Controller is also the Applicant, Bidder and Capacity Provider in respect of that CMU.

56. The minimum capacity threshold for the Capacity Market was not a subject to review in this consultation and therefore will presently remain at 2MW, however, following evaluation of the Transitional Arrangements and the one year a head auction there may be potential to review this position.

Consultation Question	Aggregated generation CMUs under 50MW
Question A2	• **Do you agree with the proposal to allow individual generating units within an aggregated CMU to transferred, sold or disposed of, whilst maintaining that no capacity is lost from an agreement and that the despatch control remains within the CMU?**

Summary of responses

57. Fourteen stakeholders responded to this question. There was strong support from the majority of respondents to this proposal, as there were many real-world situations in which it might be necessary to remove individual generating units from an aggregated CMU. It was generally felt to be important in such circumstances, that the aggregator be required to maintain capacity at the level required by the capacity agreement, and that the CMU as a whole remains under single despatch control.

58. One respondent suggested that the restrictions on the unit should be clearly set-out in the legal owners' signed declaration submitted at the prequalification stage and that it may be appropriate to restrict any disposal, transfer or sale of the individual generating unit for a period of time.

Decisions taken since consultation

59. Government has decided that a new Rule in Chapter 9 will be added to enable the legal owners of individual generating units comprised in an aggregated Existing Generating CMU (up to 50MW) to sell/transfer/dispose of legal ownership in a generating unit only where the generating unit's despatch control remains part of the existing CMU aggregation arrangements, and the unit cannot form part of another CMU for the duration of the CMU's contract. Additional declarations confirming the despatch control arrangements for the generating unit remains within the CMU will need to be completed.

60. The suggestion of introducing a time bounded restriction on any sale/transfer/disposal of a generating unit fits with the proposed approach. Government is therefore happy to clarify that there will be no sale/transfer/disposal restrictions post the end of the relevant capacity agreement.

Consultation Question	Aggregated generation CMUs under 50MW
Question A3	• **Do you have a view as to how aggregated Prospective CMUs with multiple legal owners could participate in the Capacity Market?**

Summary of responses

61. Nine stakeholders responded to this question. A number of potential approaches were suggested to enable aggregated Prospective CMUs with multiple legal owners to participate in the Capacity Market. A number of respondents suggested that the aggregator, or other lead party, should take on the legal obligations, and that it would be up to this lead party or aggregator to decide how best to manage the associated risks – for example, through contractual arrangements with the legal owners.

62. Another suggestion was that multiple legal owners could demonstrate that they have commercial arrangements in place that would apportion the risk between them, so that each would be appropriately financially liable were a termination event to occur.

63. Others suggested a reduction in the Minimum Capacity Threshold to 500kW or 1MW to reduce the need for participation by Prospective CMUs with multiple legal owners.

Decisions taken since consultation

64. A number of suggestions were put forward by respondents and whilst there is merit in the concept, further work is needed to develop the proposal. As we also understand that a related proposal has been put forward to Ofgem (as part of their rule change process), we do not propose to take this forward as part of the current changes and we will review the position again following the conclusion of Ofgem's rule change process.

Chapter 5: Credit cover

Consultation Question	Credit Cover
Question C1	• **Do you have any comments on the proposal to extend the deadline for posting credit cover from 5 working days to 15 working days?**

Summary of responses

65. Sixteen stakeholders responded to this question. All but one respondent agreed with the proposal. One respondent suggested that the proposal should go further and allow 17 days for credit cover to be posted. The respondent who did not support the change suggested that credit cover requirements should be dropped altogether, or at least postponed until the award of a capacity agreement, as it was felt to place a significant additional cost burden on developers of smaller projects.

Decisions taken since consultation

66. Government has decided that Regulation 59 will be amended so that applicants are required to provide credit cover within 15 working days after receiving the conditional prequalification notice. Credit cover is required to be posted in advance of the auction in order to ensure that auction participants are credible, and are committed to achieving the capacity they are putting forward – as such this requirement will not be dropped.

Consultation Question	Credit Cover
Question C2	• **Can you see any unintended consequences of extending this deadline?**

Summary of responses

67. Sixteen stakeholders responded to this question. The majority of respondents did not identify any unintended consequences of extending the deadline for posting credit cover.

68. The only unintended consequence that was identified was that extending the credit deadline would mean that any applicants using the full fifteen-day period who needed to repost credit cover would have a shorter time-frame to do so. It was suggested that either the administrative period granted to the Settlement Body to process credit cover be shortened, or the overall duration of the credit cover posting period be extended to give applicants more time to repost credit cover in such circumstances.

Decisions taken since consultation

69. Government has decided that as set out in the consultation document, it will remain the responsibility of the applicants to ensure they post credit cover in sufficient time to get this approved; as such the applicant carries the risk if they opt to post credit cover towards the end of the period permitted by regulations. Further guidance will make clear the relevant timelines, and the potential implications of posting credit cover towards the end of the 15 working day period.

Consultation Question	Credit Cover
Question C3	• **Do you have any comments on the proposal to amend the Rules to require applicants of Unproven DSR CMUs to inform the Delivery Body if no credit cover is required as the DSR components of their CMU are the same as in a previous auction and the proposal to amend the Rules to reflect that applicants are not required to provide credit cover for these CMUs?**

Summary of responses

70. Ten stakeholders responded to this question. The majority of respondents supported the proposal to amend the Rules to implement the policy that where an applicant for an Unproven DSR CMU has provided credit cover for a capacity auction it is not required to lodge credit cover for any subsequent capacity auction if it intends to consist of the same components. These respondents supported the proposal to amend the Rules to require applicants of Unproven DSR CMUs to inform the Delivery Body if no credit cover is required as the DSR components of their CMU are the same as in a previous auction. A minority of

respondents felt that collateral should be posted, or that if the obligation were to be removed, the same should apply to new build and refurbishing Generating CMUs.

71. Some respondents suggested that the proposal should go further, and that no credit cover should be required for any portion of a CMU that has previously formed part of a Proven DSR CMU.

72. One respondent suggested that it would be difficult in practice to track the actual physical components that comprise an Unproven DSR CMU between prequalification applications in different years. Another expressed concern that the initial termination fee may not be enough to deter speculative projects.

Decisions taken since consultation

73. Government has decided that an applicant for an Unproven DSR CMU which has provided credit cover for a capacity auction will not be required to lodge credit cover for any subsequent capacity auction where its DSR components are the same. It is acknowledged that tracking the resources to ensure they are the same is a challenge and the applicant will be asked to confirm to the Delivery Body that the components are the same as in their previous application in a new Rule to be included in Chapter 3.

74. In response to queries raised for this amendment to be extended to Prospective CMUs, the amendment to Regulation 59 was made for Interconnectors and Unproven DSR as these are the only CMUs that would be required to lodge repeat collateral for the same resource. Prospective CMUs are able to access longer term agreements, which would make this requirement unnecessary.

75. The requirement for collateral provides an essential safeguard that the CMU is able to deliver its obligation and therefore the amount of collateral will continue to be set for the whole CMU output irrespective of whether the CMU contains some units that have previously formed part of a Proven CMU.

76. In the event of a termination, the CMU will have its credit cover drawn down and will be required to re-lodge collateral for the subsequent agreement it has already secured. This will continue to incentivise delivery and in the event of a further termination, the collateral will again be drawn down with the CMU again re-lodging collateral for any subsequent agreement already secured.

Chapter 6: Other changes

Consultation Question	Enforcement
Question E1	• **Bearing in mind Ofgem's existing enforcement powers described above, what are the advantages and disadvantages for making specific provision in the Rules for Ofgem to, for example, remove applicants from the auction where an applicant has engaged in Prohibited Activity?**

Summary of responses

77. Fourteen stakeholders responded to this question. The majority of respondents were supportive of the principle that Ofgem should be able to take action to remove a participant prior to the auction should there be clear evidence that the applicant has engaged in Prohibited Activity. A number of respondents felt that it was advantageous to remove an applicant prior to the auction taking place as it removed their ability to influence the outcome of the auction.

78. There was broad agreement that there needs to be clear guidance on the process for enforcing the Rules where a participant has engaged in Prohibited Activity.

79. There was no consensus on whether it was preferable or necessary to make specific provision in the Rules allowing Ofgem to remove applicants from the auction where an applicant has engaged in a Prohibited Activity. Some respondents supported making specific provision as this would clarify how the Rules operated in such circumstances, while others felt that further provisions were unnecessary, given the existing enforcement powers already available to Ofgem. It was suggested that, if a specific provision were put in place to remove applicants prior to the auction, this should be accompanied by a right of appeal against the decision or an opportunity for the applicant to review Ofgem's case before a final decision was reached.

Decisions taken since consultation

80. There was no consensus on the need to make specific provision for Ofgem to remove applicants from the auction where an applicant has engaged in a Prohibited Activity. The Government will keep the position under review but does not intend to bring forward a change to the Rules at this point in time, as it considers Ofgem's existing enforcement powers under the Electricity Act 1989 to be sufficient. Government notes the desire for greater clarity on the process for enforcing the Rules where a participant has engaged in Prohibited Activity, and has asked Ofgem to consider how guidance can be improved.

Table of proposed amendments to the Rules

Proposed change	Explanation
Rule 6.10.1(d) - Delete "ab initio" from the rule	Removal of potential ambiguity between Rule 6.10.1(d) and Regulation 35(1). Rule 6.10.1(d) provides for the termination of a capacity agreement where a capacity committed CMU no longer meets the General Eligibility Criteria, without prejudice to Regulations that render the agreement "null and void ab initio", whilst Regulation 35(1) provides that any agreement which, at the date on which the capacity agreement was issued, did not meet the General Eligibility Criteria is "null and void".
Replacement Capacity Agreement Notice - Amend Rule 7.8 to reflect Rule 6.3.3-6.3.7	To clarify that where a replacement Capacity Agreement Notice is issued, the provisions under Rules 6.3.3 to 6.3.7 only apply in respect of the amended information or data contained in the replacement notice.
BM unit metered volume data – Amend Rule 14.3.1(b) / Rule 14.3.3 and insert new rule 14.3.4 to align	Add provision for BM Unit Metered Volume data to be given for electricity suppliers. This data is required in order to calculate each supplier's share of capacity market charges.
Rule 6.10.1(f) / Rule 8.3.1(b)(i) - Amend so that these Rules are aligned	Alignment of wording to avoid any potential ambiguity between these cross-referenced rules. Rule 6.10.1(f) refers to the Capacity Provider

Proposed change	Explanation
	providing a copy of its Grid Connection Agreement evidencing that it has secured Transmission Entry Capacity (TEC) at least equal to the de-rated capacity of each CMU to which the Grid Connection Agreement applies. Rule 8.3.1(b)(i) refers to the Capacity Provider providing a copy of its Grid Connection Agreement evidencing that it has secured TEC for all relevant Delivery Years for the generating units comprised in the CMU at least equal, in aggregate, to the de-rated capacity of that CMU.
Disclosure of confidential information - sale of asset – Amendment to Rule 3.4.9(e)(x) to extend this to cover the professional advisers of the Applicant or the Applicants' Group, of any shareholder of the Applicant and its Group and of any potential purchaser of the CMU". Amend Exhibit C to align.	This is to allow wider disclosure of information, if required, to professional advisers of shareholders or those of a potential purchaser.
Rule 6.8.1(a) - Clarify that the reference within 6.8.1(a) to “and Rule 6.10.1 (b) shall apply” only applies to New Build CMUs	To ensure that under Rule 6.8.1(a) (which applies to all Prospective Generating CMU’s), the application of the termination provisions under Rule 6.10.1(b) only applies to New Build CMU’s.
Rule 7.5.1(r) - Add a reference to “Prospective” Generating Units	To clarify that the reference to a change of location for a Generating Unit is applicable to New Build CMUs (as the location is already fixed for existing plants).
Rule 11.3.2(b) – Delete ‘in any previous year’	This change clarifies existing eligibility policy for CMUs that wish to participate in the Transitional Arrangements. CMUs (including their components) that have a Capacity Agreement are not eligible to participate in the Transitional Arrangements regardless of the year in which the Capacity Agreement was awarded.
Rule 2.2.2 – Delete “and the associated update of affected Auction Parameters”	To avoid potential confusion as DECC does not have regulatory power to change the parameters at these later stages without re-opening pre-qualification.

Proposed change	Explanation
Rules Schedule 3, 1.2 – Add definition of CHP “a turbine or engine which generates heat and power, including electricity, simultaneously in a single process”	A definition is proposed to avoid potential confusion or ambiguity regarding the classification of Generating Technology Classes.
Rules 1.2.- Add definition of core winter period ““Core Winter Period” means the period from and including the 1st of December in any year to and including the last day of February in the following year.”	A definition is proposed to avoid potential ambiguity regarding the calculation methodology for de-rating factors
Rule 9.4.5(b) - Delete	To address an inconsistency with Regulation 52(3).
Rules 1.2 – Add definition for high demand settlement period	A definition of high demand settlement periods is proposed to avoid potential ambiguity regarding the calculation methodology for de-rating factors.

Summary of responses

81. In regards to Rules Schedule 3, 1.2, stakeholders supported the proposed definition of CHP.

82. In regards to Rule 7.5.1(r), it was suggested that Refurbishing CMUs should be excluded from the change to the clause allowing only New Build CMUs to amend their location; and that all transfers of a Capacity Obligation to a new site should follow the provisions of Chapter 9.

83. In regards to Rule 11.3.2 (b), it was suggested that the exclusion of DSR CMUs from simultaneously participating in both the Transitional Arrangements and the enduring arrangements should be removed.

84. In regards to Rule 3.4.9(e)(x), it was suggested that extending the exemption would impact on the ability for the Applicant/Legal Owner to disclose information to its interconnector partner due to the manner in which interconnector projects are structured.

85. Other points raised include: it was suggested that the current penalty cap at 100% of capacity income did not provide a sufficient incentive to deliver capacity in a delivery year (either directly or through the secondary market); unproven DSR is currently exposed to a double forfeit; there should be improved visibility of the status of new build projects through regular publication of construction progress reports and that the current combination of

milestones, termination fees and credit cover should be reviewed to ensure it adequately incentivises delivery of prospective CMUs; all CMUs, including prospective CMUs, should be exposed to penalty and testing events during the delivery year even if they deliver late; and that changes to the monitoring processes for new build, or increasing the termination fees would be premature.

86. It was also noted that the governance arrangements for making Rule changes needs to be more clearly set out and that a 'baseline' version of the Rules needs to be published against which changes can be assessed. Stakeholders also cautioned against making premature changes to the Rules before effects of issues have become fully apparent

Decisions taken since consultation

87. Government intends to implement these Rule changes as set out in the table with the following amendments:

- In response to stakeholder comments, we intend to widen the information disclosure in Rule 3.4.9(e)(x) to also include an interconnector joint owner.
- In response to stakeholder comments, we will further investigate the implications of the amendment to rule 7.5.1(r) on the provisions of Chapter 9.

88. In regards to Rule 11.3.2 (b), the aim of the Transitional Arrangements is to help develop and grow the DSR sector so that it is able to participate in the first year-ahead auction in 2017 (and subsequent auctions thereafter). This will give consumers reassurance that sufficient DSR capacity will be available to compete in the year-ahead auction if needed, thereby helping ensure security of supply. Allowing CMUs that have already secured capacity agreements to compete in Transitional Arrangements would fail to meet this aim. The Transitional Arrangements have less restrictive terms in comparison to the enduring regime and to better support new resources coming forward and to prevent existing DSR with capacity agreements from crowding out emerging resources, the Government is excluding the participation of applicants that have already secured an agreement from a four year ahead auction.

Chapter 7: Definition of “New Build”

89. Separate to the consultation exercise which is the main subject of this response document, Government consulted in late 2014 on whether the policy objective of restricting fifteen-year agreements to new generation capacity could best be achieved by clarifying that only New Build CMUs can access fifteen-year agreements, or whether (as it proposed) more complex eligibility criteria were required which would allow for some re-use of existing assets and infrastructure where appropriate.

90. In its response document of 19 January 2015, Government set out that it would be taking forward the latter option, which should provide greater flexibility for appropriate utilisation of existing assets and infrastructure and should help ensure the most economic new build plant is brought forward. There were however a number of detailed technical issue that needed to be worked through, with stakeholder input, before finalising specific changes to the rules.

91. The Government is grateful for the detailed and constructive input from industry over the course of recent weeks, which has allowed it to finalise the policy.

92. The essential principles which will now be adopted are that, for each generating unit in the CMU, some or all of the core generating equipment must be new or, where this is not the case, the used core generating equipment must be installed at a new site with new connections to the grid (and to prevent simple location-flipping of apparatus, there will also be a provision that re-used apparatus must not have been used (or have been available for use) for generation in GB within the previous three years). In addition, every generating unit must have a plant life expectancy that exceeds the duration of the capacity agreement; and the CMU must, when completed meet “new plant standards” for efficiency and emissions.

93. These new plant standards will differ by size of plant. For combustion plant 50MWth or above, compliance with new plant standards will be evidenced by an express statement in the CMU’s Environmental Permit that the applicant has demonstrated that it will comply with the relevant standards for a new Large Combustion Plant as defined in the BREF published at the time of application for the permit.

94. For those below the 50MWth threshold, one option was to reflect the standards likely to be required by the MCPD directive, which will come into force in coming years. However, stakeholders provided evidence that new equipment currently on the market may not yet

meet these standards, or not without additional expenditure over and above that needed to comply with the directive, making the use of MCPD standards an inappropriate proxy for “as new” standards. Given this uncertainty, Government has concluded that an Independent Technical Expert (ITE) should certify that each generating unit meets equivalent emissions and efficiency levels achievable by new generating equipment of the same type, fuel source and size currently supplied for operation in the GB market. While this introduces an element of technical judgement, and may not be a perfect solution for the long term, it maintains the principle that the Capacity Market should ensure that all units able to bid for 15 year agreements should be new or genuinely equivalent to new, without creating new environmental standards of its own.

95. The requirement for hydro and storage plant will be the same as for small combustion plant, namely an ITE statement.

Annex A – Respondents to the Consultation

Association for Decentralised Energy
C. GEN Killingholme Ltd
The Canterbury Club
Drax Power Ltd
E.On
EDF Energy
Eggborough Power Ltd
Energy UK
FGI Consulting Ltd
Green Frog Power Ltd
GDF SUEZ
National Grid Electricity Transmission
RWE
Sahaviriya Steel Industries UK
Scottish Power
Sembcorp
SSE
Tata Chemicals Europe
VPI Immingham LLP
UK Capacity Reserve Ltd
UK Demand Response Association
UK Power Reserve

15D/120

Department of Energy & Climate Change
3 Whitehall Place
London SW1A 2HD
www.decc.gov.uk