



Our ref: Capacity Market consultation letter – improving the framework

28 October 2016

To whom it may concern,

Capacity Market: proposals to simplify and improve accessibility in future capacity auctions

We are writing to you as you may be interested in issues we are considering around Capacity Market (“CM”) auctions. If you would like to know more, please see below for a short summary of the proposals and how to respond. This letter is also published on our website, where you can find more detail of the proposals and some indicative legal drafting: <https://www.gov.uk/government/consultations/capacity-market-proposals-to-simplify-and-improve-accessibility-in-future-capacity-auctions>.

Background to the issue

The CM is designed to promote fair competition in order to discover the lowest sustainable price at which the necessary capacity can be brought forward to ensure security of electricity supply in Great Britain.

In light of learning from previous auctions, we are proposing a number of essentially technical changes to the CM Rules and Regulations to simplify and improve certain areas.

The Government’s proposals

One important proposed change would be to calculate the CM **supplier charge** - the method by which CM costs are recouped from suppliers - on the basis of gross rather than net demand. Many stakeholders have suggested that **the current arrangements may favour small embedded generation, including diesel. The proposed change would remove a possible advantage**, potentially affecting the bids of such embedded generators in the forthcoming auction(s).

We are also seeking views on a number of other changes, as follows:

- amending deadlines relating to metering assessments and metering tests to help providers to navigate the **metering regime** and simplifying some of the current Demand Side Response (“DSR”) Test and Metering Test processes;



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- adjusting certain delivery milestones for the **T1 auction** to ensure they work in the context of a one year-ahead (rather than four- year-ahead) auction;
- minor changes on **credit cover** to clarify the Regulations and ensure they reflect the policy intention;
- clarifying the duration of previous CM agreements which are relevant for the purposes of the **total spend declaration** made in respect of new build plant;
- ensuring that figures for **de-rated capacity for DSR** are used consistently across the CM framework;
- applying **termination fees** in all circumstances where a Capacity Market Unit (CMU) no longer complies with the general eligibility criteria;
- introducing a new termination event with an associated termination fee to ensure all CMUs undertake a **metering assessment** by the relevant deadlines;
- enhancing the **transparency of information that is published about the CM**;
- amending the name - but not the substance - of the current **capacity market warning** to avoid any possible confusion.

Indicative drafting

Indicative drafting for our proposed amendments to the CM Regulations and Rules is available on our website (see below for details), as follows:

- Part 1 sets out draft amendments to the Electricity Capacity (Supplier Payment etc) Regulations 2014 to illustrate the proposals concerning changes to the calculation of the supplier charge;
- Part 2 sets out draft amendments to the Electricity Capacity Regulations 2014 to illustrate the proposals concerning the requirement to maintain credit cover, definition of de-rated capacity and amending the name of the current capacity market warning; and
- Part 3 sets out draft amendments to the Capacity Market Rules to illustrate the proposals concerning:
 - Section A – delivery milestones for the T-1 auctions;
 - Section B – total spend declaration;
 - Section C - metering requirements;
 - Section D – definition of de-rated capacity;
 - Section E – termination;
 - Section F – transparency publications; and
 - Section G – capacity market notices.

The indicative drafting is intended to illustrate the policy proposals that are described in the detailed proposals document on our website (see below for details), but should not be taken to be conclusive. If, following the outcome of this consultation, we decide to take forward the proposals then further amendments may be required to the legal drafting in order to give full effect to the proposals, including any changes to take account of consultation responses received.



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Further detail

The annex to this letter sets out the areas for consultation in a little more detail, and the full detail can be found on our website <https://www.gov.uk/government/consultations/capacity-market-proposals-to-simplify-and-improve-accessibility-in-future-capacity-auctions> as well as some indicative legal drafting and information on how to respond.

Yours faithfully,

Energy Security Team

BEIS

Information on this consultation:

Proposals and indicative drafting: <https://www.gov.uk/government/consultations/capacity-market-proposals-to-simplify-and-improve-accessibility-in-future-capacity-auctions>



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Annex

Supplier charge

The method by which Capacity Market (“CM”) costs are recouped has the potential to give an unfair advantage to small embedded generation.

We propose calculating the supplier charge based on gross rather than net demand, so that suppliers get charged according to their total share of electricity use irrespective of its source. This will address any potential distortion, and bring the CM in line with the Contract for Difference supplier charge.

T-1 Changes

We propose adjusting a number of the delivery milestones currently set out in the CM Rules, to ensure that they work in the context of a year-ahead auction.

The CM Rules also currently include derogations from the requirement to have connection agreements in place at the time of prequalification for (a) transmission connected capacity in the first two T-4 auctions, (b) new distribution connected capacity in the T-4 auctions and (c) both distribution and transmission connected capacity in the early Capacity Auction. These derogations were included principally in recognition of the fact that participants would have already set their connection positions for the related delivery years and would not be able to change this ahead of the prequalification period for these auctions.

However, the rationale behind these derogations does not apply for future T-1 auctions, and therefore it is proposed that there should not be any continuation of the derogations for either distribution, or transmission-connected generators, in order to reduce the risk that capacity procured at T-1 is subsequently unable to deliver on its obligation.

Total spend declaration

An applicant for a prospective CMU is required to declare the requisite capital expenditure incurred, or expected to be incurred, in respect of the CMU prior to the commencement of their first CM delivery year; their ‘Total Project Spend’ (“TPS”). This is subject to two caveats regarding the time window for such expenditure and whether the capital expenditure had previously been considered in an earlier prospective CMU application which resulted in the award of a capacity agreement.

We propose clarifying the drafting of this second caveat and putting it beyond doubt that a **new build CMU** which had been awarded a previous new build capacity agreement would not be eligible for a subsequent multi-year agreement, irrespective of their declared capital expenditure and of the duration of their previous agreement.

We will also clarify that the restriction of declared TPS will apply in respect of subsequent applications for a **refurbishing CMU** with three exceptions; i) where the capital expenditure has not previously been declared in respect of an application for a CMU which subsequently gained a capacity agreement of any duration ii) where an Independent Technical Expert’s certificate confirms that TPS of a lower figure than that declared has been incurred in respect of the CMU under rule 8.3.6(aa) or iii) the capacity agreement for which the TPS was originally declared in the prequalification application has been terminated.

Requirement to maintain credit cover

It has been brought to our attention that the circumstances as currently detailed in Regulations do not fully cater for all scenarios in which applicant credit cover has been or must be lodged. We therefore propose introducing amendments to clarify the drafting and put beyond doubt the requirement to maintain credit cover until a CMU has achieved all of the Financial Commitment Milestone and TEC/connection agreement requirements against which they lodged applicant credit cover and for which a failure to meet would otherwise trigger a termination event.

In addition it has emerged that circumstances may align to place an unintended double liability on a party; whereby they become liable for their applicant credit cover being drawn down against a date based trigger, whilst also being liable for a termination fee liability for the same event. We therefore propose to remove

the date based triggers and instead rely on an unpaid termination fee liability to trigger the applicant credit cover draw down.

Metering Changes

Capacity providers must verify their output to ensure capacity is genuine and avoid customers paying for failed delivery. The CM's metering requirements are aligned to existing industry standards, however, Government is aware that some providers have struggled with the DSR Test and Metering Test processes and invites industry views on how requirements could be simplified, whilst maintaining confidence in output readings.

The 2015 Transitional Arrangements (TA) auction year provided the first experience for CMUs and delivery partners in undertaking both the Metering Assessments and Metering Tests processes. Following lessons learnt, Government proposes to amend metering process timelines; extend Metering Test Sampling to the early Capacity Auction and the enduring regime; and enable providers using Balancing Services and Bespoke Metering Configuration Solutions in the early Capacity Auction to submit their own meter data.

Pre-auction credit cover requirements

In its response to the March 2016 consultation, Government confirmed its intention to increase the pre-auction credit cover requirement for new build CMUs to £10k/MW but not for unproven DSR at that time. We now wish to review this position in respect of unproven DSR.

Government would welcome views on whether credit cover for unproven DSR should be (a) increased to £10k/MW, (b) maintained at £5k/MW, or (c) reduced to a lower level (please specify). Please provide evidence to support your position.

Definition of de-rated capacity

DSR providers are able to reduce their de-rated prequalification capacity prior to the auction ensuring that capacity procured at the auction can be relied upon when the system is tight. Whilst the prequalification capacity is de-rated, the DSR CMU's nominated lower bid volume is not, creating an inconsistency with other CMUs and subsequently reducing the volume of reliable capacity that has been procured.

We propose that the lower volume nominated by a DSR CMU prior to the auction should be de-rated and to integrate the definitions of DSR Bid and DSR Bidding Capacity into the definition of De-rated Capacity.

Termination

Many termination events in the CM Rules have an associated termination fee to ensure CMUs honour their commitments to make available the capacity procured in an auction. However, the termination event relating to meeting the general eligibility criteria does not have a fee associated with it and we propose for consistency and to prevent loss of capacity to apply a termination fee of £10k/MW to this event. We also propose to introduce a termination event for all CMUs (with the exception of Prospective CMUs) who have failed to complete Metering Assessments by the relevant deadline and apply an associated termination fee of £10k/MW.

Transparency publications

In relation to the forthcoming 2016 capacity auctions, the UK Government will need to publish details of State aid granted under the Capacity Market to meet the European Commission's transparency requirements. The Capacity Market Register already publishes the capacity obligations for each Capacity Provider which can be used to calculate the total amount of State aid granted to each beneficiary under each capacity auction. However, capacity payments following secondary trading, over-delivery payments or non-delivery penalties mean that the total aid received by each beneficiary may differ from the amount published on the Capacity Market Register. Therefore, the UK Government intends to require the Electricity Settlements Company ("ESC") to make available a 6 monthly report of the cumulative amount of aid paid to each beneficiary under the Capacity Market scheme where this has reached or exceeded €500,000. This will apply to all capacity agreements awarded from 1 July 2016 onwards. To comply with this requirement, we propose to include two additional information requirements at pre-qualification: VAT number of the Applicant, and the beneficiary type ('Large enterprise' or 'Small and medium-size').