



Department for
Business, Energy
& Industrial Strategy

TECHNICAL AMENDMENTS TO THE CAPACITY MARKET

Government response to consultation

February 2019



OGL

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Executive Summary

The Government believes the GB Capacity Market (“the CM”) remains the right mechanism to deliver secure electricity supplies at least cost. The Government ran a consultation from 19 December 2018 to 10 January 2019, which covered proposals for:

- conducting a replacement T-1 auction by re-arranging the T-1 auction which was planned for January 2019 and which was postponed following the General Court judgment¹;
- changes regarding obligations under and enforcement of existing capacity agreements during the standstill period²;
- deferred payments to capacity providers who have met their obligations during the standstill period; and
- arrangements for suppliers to pay supplier charge to the Settlement Body during the standstill period for the purpose of funding deferred payments to capacity providers.

In total, 61 responses were received from a wide range of stakeholders, including capacity providers, developers, suppliers, trade associations, investors and others.

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

- conduct the replacement T-1 auction;
- allow capacity providers holding agreements greater flexibility in dealing with forthcoming milestones affected by the standstill period;
- broaden the Secretary of State’s discretion with regard to dealing with termination and non-completion notices; and
- enable suppliers to make payments to the Settlement Body during the standstill period toward their post-standstill supplier charge liability to fund deferred payments to capacity providers who have met their obligations during the standstill period (subject to a positive final State aid decision).

¹ On 15 November 2018, the General Court of the Court of Justice of the European Union handed down its judgment in a case against the European Commission’s decision-making process for giving State aid approval for the GB CM scheme (Case T-793 14). The judgment annulled the State aid approval for the main GB CM scheme and the Commission must now undertake a formal investigation before the scheme can be approved again. The judgment is available at <http://curia.europa.eu/juris/document/document.jsf?text=&docid=207792&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=1430154>

² The ‘standstill period’ means the period beginning on 15 November 2018 and ending on the date on which the deferred capacity payment trigger event or the agreement termination trigger event occurs (see Section 3.2). During the standstill period, the scheme does not have State aid approval and aid cannot be granted under the scheme.

1. Introduction

Since its introduction in 2014, the GB Capacity Market has been an important part of the energy market, ensuring that we maintain and bring forward sufficient capacity to secure electricity supplies.

The 15 November 2018 judgment of the General Court of the Court of Justice of the European Union had the effect of annulling the European Commission's State aid approval for the CM scheme and introducing a standstill period until the scheme can be approved again.

On 21 February 2019 the European Commission announced that they will be launching an in-depth investigation as required for the scheme to be approved again, and that they will be appealing the General Court judgment³. The Secretary of State for Business, Energy and Industrial Strategy, Greg Clark, set out in his Written Ministerial Statement published on 21 February 2019⁴, that the Government and the Commission are clear that the Court ruled on procedural grounds and did not find that the CM was incompatible with State aid rules. He also confirmed that the UK Government will be supporting the Commission in their appeal.

We expect that a positive State aid decision would cover past capacity payments, deferred payments and future capacity payments. Both the European Commission and the Government recognise the urgency of resolving this matter.

1.1 Summary of consultation proposals

The Government has conducted a consultation on the regulatory changes necessary to operate the CM during the standstill period. This includes allowing for a replacement T-1 top-up auction for the 2019/20 delivery year to take place in the summer of 2019. The consultation proposed that the award of agreements through this auction would be conditional on the outcome and timing of the European Commission's formal investigation. It was also proposed that a positive State aid decision would allow deferred payments to be made to existing capacity providers who had met their obligations during the standstill period. The consultation also contained proposals to allow capacity providers greater flexibility in dealing with forthcoming milestones affected by the standstill period.

In light of representations received across industry, the consultation confirmed that Government was minded to support the supplier charges being collected from suppliers during the standstill period to fund deferred payments to capacity providers who have met their obligations during the standstill period (subject to a positive final State aid decision). It sought views on a number of options for taking this forward to allow a decision to be taken in early 2019.

³ http://europa.eu/rapid/press-release_IP-19-1348_en.htm

⁴ <https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-02-21/HCWS1351/>

1.2 Summary of responses to the consultation

In total, 61 responses were received from a wide range of stakeholders, including capacity providers, developers, suppliers, trade associations, investors and others.

Broadly speaking, the majority of respondents were supportive of the proposals across each of the four areas and supported the Government taking action to continue the operation of the CM during the standstill period to the greatest extent possible.

The vast majority of respondents were supportive of the Government's intention to run a replacement T-1 auction in summer 2019 for delivery year 2019/20, and most respondents were in agreement with the proposals made in relation to the design of this auction, including proposals not to re-open prequalification and to allow those who have currently prequalified to withdraw from the auction. By and large, respondents welcomed the proposal for increased flexibility with regards to delivery milestones for the replacement T-1. Some concerns were raised about compressed timelines and resource implications.

The majority of respondents were in favour of making deferred payments to capacity providers following the end of the standstill period.

A number of respondents felt that all obligations should be maintained throughout the standstill period, whilst others welcomed the Government's proposed approach to extend the time available for capacity providers to meet certain milestones and/or waive certain obligations that arise during the standstill period. Some stressed the need for the Government to minimise the number of modifications to relax obligations and to consider the security of supply impacts of any changes.

The majority of respondents were in favour of re-starting collection of the supplier charges during the standstill period. Most argued that this would provide confidence that sufficient funds would be available to pay capacity providers' deferred payments at the end of the standstill period. Of those in favour of re-starting supplier charging, there was almost unanimous support for the CM Settlement Body, the Electricity Settlements Company (ESC), continuing to collect.

1.3 Next steps

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

- Decisions in relation to the 2019/20 delivery year are covered in Chapter 2.
- Decisions in relation to deferred payments are covered in Chapter 3.
- Decisions in relation to the obligation and enforcement of existing agreements are covered in Chapter 4.
- Decisions in relation to the supplier charge during the standstill period and the Government's latest thinking on post-standstill supplier charging are explained in Chapter 5.

Government has confirmed that it will lay draft regulations (the Electricity Capacity (No. 1) Regulations 2019) (“the draft regulations”) to make the necessary amendments and modifications of the Electricity Capacity Regulations 2014 (“the Principal Regulations”) and the Electricity Capacity (Supplier Payment etc.) Regulations 2014 (“the Supplier Payment Regulations”) shortly after this Government Response is published. The draft regulations must be debated and approved by both Houses of Parliament before they can come into force. The necessary amendments and modifications of the Capacity Market Rules 2014 (“the Rules”) will be laid in two separate instruments:

- The Capacity Market (Amendment) Rules 2019 will come into force first in early March 2019 in time to make the necessary modifications to upcoming milestones for existing capacity agreements;
- The Capacity Market Amendment (No. 2) Rules 2019 will come into force alongside the draft regulations, as they rely on the modifications those regulations are putting into effect.

Like the consultation, the Government Response does not comprehensively address what might happen if the European Commission does not give State aid approval for the CM, or if they require changes to the CM before approval is granted. A small minority of responses suggested that the Government should explain the implications for stakeholders if unconditional State aid approval is not granted, for example bidders who had committed resource to participating in the replacement T-1 auction or bidders who had previously been unsuccessful in earlier auctions because of aspects of the CM scheme that were found to be unlawful.

In reaching the decisions set out in the Government Response, we have taken into account the risk that the European Commission will not grant State aid approval for the CM. In the event that it does not grant State aid approval for the CM, or if it makes that approval conditional on changes to the scheme, the Government will take all steps necessary in the light of that decision, including further consultation if appropriate. We do not consider, however, that it would be appropriate or proportionate for us to make proposals in respect of the range of possible outcomes other than State aid approval at this stage.

2. 2019/20 delivery year

2.1 Summary of responses

Consultation question:

1. Do you agree that the amendments to the usual T-1 auction design/process proposed above are appropriate for this replacement T-1 auction?
3. Are there any further issues that the Government should consider in implementing the replacement T-1 auction?

Summary of responses

42 respondents provided an answer to question 1, and 40 respondents provided an answer to question 3.

The vast majority of respondents were supportive of the Government's intention to run a replacement T-1 auction in summer 2019 for delivery year 2019/20, and most respondents were in agreement with the proposals made in relation to the design of this auction. Comments received in response to the specific proposals in the consultation are summarised below.

State aid compatibility: Just under half of responses expressed concerns regarding the proposed "T-1 agreement trigger". These tended to focus on the proposed discretion of the Secretary of State not to activate the trigger. Several responses stated that the trigger should be automatically activated when State aid approval is received, and that the current proposals suggested that the Government was not fully committed to the CM. If a trigger were to be retained, a few responses suggested that the Secretary of State's discretion regarding whether to activate it should be limited, well-defined and transparent. Some responses suggested that there was no need for a T-1 trigger at all, and that there were no State aid implications of awarding full capacity agreements immediately following the auction.

Timing: Few responses addressed the proposed extension to the auction window directly, but a number of general comments were made that the auction should be held as soon as possible. Those responses that did comment on the auction window extension tended to agree that this should not apply to future auctions.

Pre-qualification/eligibility: Proposals relating to not re-opening pre-qualification and providing a mechanism for applicants to withdraw from participation in the auction were widely supported. Respondents felt that this approach was sufficiently flexible, whilst avoiding replication or unnecessary extensions to the auction timeline. A few respondents requested that CMUs which were not successful at pre-qualification should be given the opportunity to re-submit their applications for reconsideration, generally suggesting that this would lead to lower costs in the auction. A significant number of respondents suggested that it would be necessary to reconfirm or make changes to information provided at the pre-qualification stage, with some respondents providing specific examples.

Secondary trading: A number of responses raised issues relating to secondary trading. These tended to focus on one of two issues. Firstly, that trading of T-4 agreements for the 2019/20 delivery year should be enabled now, given the delay to the T-1 auction, to reduce the risk of terminations. Secondly, that any agreements arising from the T-1 auction should be tradable from the point immediately after the auction, rather than not before the T-1 agreement trigger is activated. Responses highlighted the improvements to the security of supply position that effective secondary trading could provide.

Capacity Market Register: A number of responses suggested that the CM Register should record the results of the auction in some form, even if capacity agreements had not yet been awarded.

Delivery assurance: Respondents welcomed the proposal for increased flexibility with regards to delivery milestones for the replacement T-1. Some responses suggested specific changes, such as additional extensions of particular milestones, a general extension of the grace period to 2 months after the T-1 agreement trigger and allowing the DSR Test to be completed before the auction and/or during prequalification periods. Several respondents also expressed concerns about the resourcing implications of the proposed compressed timescales on the Delivery Body and on providers, given the risk that pre-delivery year actions will coincide with the pre-qualification period for future auctions. One respondent felt that the proposed two deadlines seemed overly complicated.

Credit cover: The position of respondents on the issue of credit cover was mixed, with some supporting the proposed suspension of credit cover requirements during the standstill period and others suggesting that allowing providers to withdraw their credit cover could cause difficulties with reposting later on.

A variety of **additional issues** were raised by respondents:

- Many responses requested that the Government provide clarity on the timescales associated with the replacement T-1 auction. Several responses suggested that it would be sensible to avoid running the replacement T-1 in parallel to pre-qualification exercises for future auctions.
- Many responses highlighted various risks (delays to State aid approval, No Deal Brexit), and requested that Government provide greater transparency on the plans for these scenarios.
- Several responses expressed concern about the 'risk premium' that could be factored into bids in the replacement T-1 auction and the associated cost to consumers.
- Two responses suggested that renewable participation should be enabled.
- Calls for the pre-qualification process for future auctions to be simplified.
- Some responses also discussed the planned T-3 auction for 2022/23, suggesting that the Government needed to provide greater clarity on how this auction would work and consider the challenges that the delay to this auction will have for new build capacity.

Consultation question:

2. In particular, will the requirement for participants to hold TEC for the T-1 auction delivery year in line with existing Rules cause any unintended consequences?

Summary of responses

27 respondents provided an answer to this question.

The vast majority were in agreement with our proposal to maintain the existing Rules requiring participants to hold TEC for the T-1 delivery year for participation in the replacement T-1 auction. Several respondents suggested that maintaining this requirement could cause some plant to withdraw from the auction, but most thought that this effect would be minimal.

A single response was in clear opposition to the proposal to retain the requirement for TEC, suggesting that it would present an unfair burden and that it would be preferable to allow CMUs to release their TEC and to resubmit connection agreements after the auction.

2.2 Government response

As set out in the consultation, it is the Government's intention to run a 'replacement' T-1 auction in summer 2019 to secure the 'top-up' capacity required for delivery year 2019/20.

The replacement T-1 auction will be held by rearranging the T-1 auction that was previously scheduled for January 2019, retaining an auction design and process that is as consistent as possible with that of a normal T-1 auction (Section 2.2.1). The Government understands the need to hold this auction as soon as possible, and currently expects to be able to schedule it so as to avoid it running alongside the summer's pre-qualification exercises for next year's auctions. However, this timescale is subject to securing approval by both Houses of Parliament to the required Regulatory changes, and as such, as per our consultation proposals, the auction window will be extended to the end of August as a contingency measure.

The replacement T-1 auction is likely to conclude at a time when State aid approval for this auction has not yet been granted. To address this issue, the agreements awarded to successful bidders through this auction will not provide them with an entitlement to capacity payments unless and until State aid approval is obtained. We anticipate that State aid approval will be received ahead of the start of the 2019/20 delivery year, allowing capacity payments to be made to successful bidders in accordance with the usual schedule. However, in line with the Government's approach for holders of capacity agreements from previous CM auctions (see Section 3.2), we will also make provision for back-payments to be made to successful bidders in the auction where State aid approval is received after the start of the delivery year.

Allowing for back-payments to be paid to people awarded agreements through the replacement T-1 auction will enable bidders to have confidence in the revenues that they can expect to receive through the auction, providing better value for bill payers by reducing the risk premium which might otherwise inflate auction bids.

Back-payments will replace any capacity payments which have been missed from the start of the delivery year to the date that the T-1 agreement trigger⁵ occurs. As is the case for existing capacity agreement holders, back-payments will be paid to those who have delivered against their obligations and will be subject to reductions to account for fees and penalty charges for non-compliance, which would otherwise have been levied but for the standstill period. Back-payments for the replacement T-1 and the supplier charges that will fund these payments will be administered by the Settlements Body similarly to the way in which deferred payments and supplier charges are administered for existing capacity agreement holders (see Sections 3.2 and 5.2).

To enable back-payments to be paid, 'conditional capacity agreements' will be awarded following the auction (section 2.2.2), which will convert to full capacity agreements following a decision by the Secretary of State (section 2.2.3). Conditional capacity agreements will impose the usual obligations on capacity providers to meet delivery milestones and to provide capacity during stress events from the point the agreements are awarded after the auction. However, a capacity provider's entitlement to receive capacity payments in respect of a capacity obligation awarded to them, and liability to pay penalties and fees in respect of any non-compliance, will be conditional on State aid approval being obtained (section 2.2.4).

Consultation respondents also identified a number of concerns with the Government's consultation proposals on secondary trading and re-posting credit cover. We now intend to allow secondary trading of conditional capacity agreements after the T-1 auction and existing capacity agreements ahead of the replacement T-1 auction (section 2.2.5) and will waive credit cover requirements for this auction (section 2.2.6).

2.2.1 Auction design and process

The replacement T-1 will be held by rearranging the T-1 auction which was previously scheduled for January 2019, resulting in an auction design and process which will remain as consistent as possible with that of a normal T-1 auction.

Our proposals on pre-qualification and eligibility requirements received widespread consultation support. We therefore intend to proceed as proposed, retaining the existing eligibility requirements and pre-qualification results. This includes the usual requirement for transmission-connected CMUs to confirm they have entered into one or more grid connection agreements that secure Transmission Entry Capacity (TEC) for the replacement T-1 auction delivery year (Rule 3.6.3(a)(i)).

The Government recognises that the delay to the T-1 auction may have impacted on the plans of some capacity providers, who may no longer wish to participate in the rearranged auction. We will therefore also proceed with the proposal to provide a window during which all those who are currently pre-qualified or conditionally pre-qualified may choose to withdraw. This window will follow the Secretary of State's direction to the Delivery Body to rearrange the T-1 auction and will last from the date of the direction by the Secretary of State till 31 working days before the auction. During this window, pre-qualified and conditionally pre-qualified applicants will be required to submit a written notice to the Delivery Body if they wish to withdraw from the auction. Mandatory CMUs who choose to withdraw will be required to submit some of the same information⁶ that they would usually be required to submit as part of an 'opt-out' notification. Following the withdrawal process, the Delivery Body will advise the Secretary of

⁵ Referred to in the draft regulations as the "T-1 capacity agreement trigger event".

⁶ Contained in Rule 3.11.2(f)

State on whether the demand curve for the replacement T-1 auction should be adjusted and the Secretary of State will confirm the final target for the auction in the usual way under Regulation 13 of the Principal Regulations. Non-mandatory CMUs should note that they will, as usual (in accordance with Rule 5.5.14), be required to confirm their entry into the auction between 15 and 10 working days ahead of the first day of the first bidding window, and therefore may alternatively take the decision not to participate at this stage.

As indicated above, the Government is not minded to re-open pre-qualification to new CMUs once the Delivery Body has been directed to re-arrange the T-1 auction. We note that a few respondents disagreed with this approach and called for the auction to be open to participants who did not pre-qualify or who were unsuccessful in pre-qualifying last summer, suggesting that this would lead to more competition and lower auction costs. We are concerned that any re-opening of pre-qualification would result in a significant delay to the auction date, and that this could lead to a reduction in available capacity for the auction as it becomes unviable to bring forward new-build projects in the remaining time available. Our approach (retention of the existing results, and the provision of a withdrawal window) recognises the need to proceed with the auction at pace, to minimise the risks associated with a further delay.

A number of respondents suggested that they would like the opportunity to update information that was provided at the pre-qualification stage. The Delivery Body has confirmed that, in line with the usual process, it will continue to allow administrative updates and/or standard agreement management processes in accordance with the Rules. For example, this can include (but is not limited to) updates to DSR capacity, agreement length and company address changes. Guidance is provided on the Delivery Body website⁷, and the Delivery Body has confirmed that it can support participants should they wish to utilise any of these processes.

The Government also intends to proceed with the changes indicated in the consultation to Schedule 1 of the Regulation and Schedule 1 of the Supplier Payment Regulations, to ensure that the relevant information is available to the Settlement Body when they are required to make calculations, and to make other minor changes to these Schedules to accommodate the concept of a conditional capacity agreement.

2.2.2 Conditional capacity agreements

In the consultation we proposed to address the State aid issues which might otherwise arise in respect of the replacement T-1 auction by modifying the Principal Regulations to prevent capacity agreements from accruing to successful bidders in this auction until after State aid approval is obtained.

Several consultation respondents suggested that the Government should enable full capacity agreements to be awarded following the T-1, giving rise to usual rights and obligations immediately after the auction. The Government's view is that this would not be consistent with State aid requirements, and that the entitlement to receive capacity payments should be conditional on obtaining State aid approval for the replacement T-1 auction.

As outlined above, the Government is committed to making provision for back-payments to be paid to successful bidders in the replacement T-1 auction, if State aid approval is received after the start of the delivery year. However, for back-payments to be payable, it is necessary for capacity providers to be performing the obligations that entitle them to receive capacity

⁷ <https://www.emrdeliverybody.com/CM/CMDocumentLibrary.aspx>

payments from the start of the delivery year. The Government therefore now believes that the Principal Regulations should be modified to allow for the award of ‘conditional capacity agreements’. These agreements will accrue to successful bidders immediately after the replacement T-1 auction but will not confer a right to receive capacity payments until State aid approval is obtained, at which point any back-payments will also become payable. A capacity provider will be required to perform their obligations in respect of a conditional capacity agreement from the point at which it accrues to them. However, liability to pay penalties charges and fees in respect of non-compliance prior to State aid approval will also be conditional on State aid approval being obtained.

Conditional capacity agreements will otherwise mirror existing agreements from previous CM auctions as closely as possible. The agreements will be tradable (see section 2.2.5) and will be recorded on the CM register to enable effective management of these agreements during the standstill period. Capacity agreement notices will be issued within 20 working days of the auction, but will make clear the conditional nature of conditional capacity agreements. In addition, capacity providers will be subject to requirements which mirror existing capacity agreements, such as not holding a long term STOR contract as outlined in the Regulations.

2.2.3 The T-1 agreement and termination triggers

In the consultation we proposed that after State aid approval covering the replacement T-1 auction was obtained the Secretary of State would have a discretion to direct that agreements should be awarded in respect of the auction.

The Government has taken note of the significant concern from stakeholders regarding a discretionary trigger mechanism for activation of capacity agreements. Consequently, we now intend to make the T-1 agreement trigger mandatory. Where a relevant authority⁸ makes a decision, which means it would be in accordance with the law relating to State aid for capacity payments to be made in respect of the replacement T-1 auction, the Secretary of State will be required to activate the T-1 agreement trigger by notifying the Delivery Body and the Settlement Body of the decision that has been taken. The T-1 agreement trigger will occur on the date this formal notification is given and conditional capacity agreements will become full capacity agreements on this date.

This change is designed to give bidders confidence in the Government’s commitment to the replacement T-1 auction as a mechanism for ensuring security of supply for the 2019/20 delivery year, and to reassure stakeholders of the Government’s confidence in the CM mechanism.

It will remain possible for the conditional capacity agreements awarded through the replacement T-1 auction to be terminated where State aid approval is not obtained, but this would only occur in specified circumstances: namely, where State aid approval is declined, or where there is no reasonable prospect that a decision allowing capacity payments to be paid will be made before 1 October 2020 (the end of the 2019/20 delivery year). This more narrowly defined termination mechanism (the “T-1 termination trigger”) is necessary, but is transparent and well-defined, in line with consultation requests.

Should the T-1 termination trigger occur, all conditional capacity agreements will be terminated without a termination fee. This termination will not follow the ordinary termination notice procedure, and capacity providers will not be able to appeal against the termination under

⁸ i.e. the European Commission, European Court, or Competition and Markets Authority (where this body responsible for the law relating to State aid as it applies in the United Kingdom).

regulation 33 or Part 10 of the Principal Regulations. Any termination notices (i.e. where the CMU is in the termination notice period, but not yet terminated) will be superseded, including when there has been a written representation submitted to the Secretary of State. Any consequences, such as payment of termination fees and restrictions on participation in future auctions, from the termination of a conditional capacity agreement before the T-1 termination trigger will not apply. Any payments made by suppliers and held by ESC during the standstill period would be returned to suppliers with interest.

2.2.4 Obligations and delivery assurance milestones

In the consultation we outlined our proposals on delivery assurance ahead of the delivery year:

- a non-enforceable ‘delivery year readiness’ deadline of 30 September 2019, which would allow CMUs to demonstrate their capacity from the start of the delivery year;
- followed by an enforceable ‘grace period deadline’ after the T-1 agreement trigger, which would result in penalties and/or termination if missed.

Our proposals in this area were based, in part, on capacity agreements being awarded after the T-1 agreement trigger. With this approach, successful bidders were unlikely to have been awarded capacity agreements immediately after the replacement T-1 auction, and would not have been subject to obligations under these agreements until a later point in time. The “grace period deadline” addressed this situation by providing for a further binding deadline set with reference to point at which agreements were awarded and the legal obligation to meet milestones arose.

As explained above, we now intend to award ‘conditional capacity agreements’ through the replacement T-1 auction. In light of this change, we have also modified our approach to delivery assurance. Our revisions seek to retain as much flexibility as possible and provide sufficient time for CMUs to meet the necessary pre-delivery year milestones. A single, enforceable ‘delivery year readiness’ deadline will now be introduced for all pre-delivery ‘Key Milestones’ (section 2.2.4.1), with additional flexibility provided through the existing termination notice procedure under the Rules (section 2.2.4.2).

2.2.4.1 ‘Delivery year readiness’ deadline

It remains the Government’s intention to defer the deadlines for all ‘Key Milestones’ (see Table 1) to a single ‘delivery year readiness’ deadline. Milestones that prove the CMU can deliver the bid capacity have been prioritised as ‘key’⁹. As part of meeting the financial commitment milestone, we will maintain the requirement for Prospective CMUs to submit a funding declaration (Rule 6.6.1(b)). The funding declaration is needed as it checks whether the CMU is in receipt of other State aid, which then influences their CM payments under 49A of the Principal Regulations. However, we will displace the requirement for a report from an independent technical expert (Rule 6.6.1(a)), which we do not deem key for the circumstances of this replacement T-1 auction. Other (non-key) milestones will be removed, and the

⁹ We will also defer some other deadlines to the delivery year readiness deadline to assist CMUs, in recognition of the potential compressed timelines. For example, the deadlines in Rule 13.3.2A, for providers who are subject to a metering test and are required to notify the CM Settlement Body before commencing the metering test. In addition, the deadlines for amending a metering assessment will be deferred to the delivery year readiness deadline for all CMU types.

requirements for satisfactory performance days and the demonstrating extended performance milestone will remain unchanged as these are not required until within the delivery year.

The existing Rules define the Long Stop Date as the start of the relevant delivery year for a T-1 auction, i.e. by 30 September 2019 for this auction. As this is usually the final deadline for the milestones that demonstrate a CMU's capacity is available under a T-1 agreement, the Government intends to set the delivery year readiness deadline at this date.

As we now intend to enable entitlement to back-payments from the start of the delivery year, the delivery year readiness deadline will be enforceable and capacity providers who fail to comply with milestones will be served a termination notice where this would ordinarily be required under the Rules. Although it will remain the responsibility of CMUs to meet the delivery year readiness deadline, Government will work with the Delivery Body and the Settlement Body to produce guidance to assist CMUs to understand and schedule the work associated with meeting each Key Milestone. This guidance will include advice about when and how CMUs should approach each of the milestones to allow the process to be completed as smoothly as possible.

The Government recognises the shorter than usual lead-in time between the replacement T-1 auction and start of the delivery year may make it more difficult for DSR providers to complete DSR tests before the delivery year readiness deadline. We intend to proceed with our proposal to enable unproven DSR CMUs to complete the DSR test during prequalification periods, and, as suggested by respondents, we will also modify the Rules to allow participation in a DSR test before the replacement T-1 auction, should DSR CMUs wish to do this. The same approach will apply to joint DSR tests. These modifications will be included in the Capacity Market (Amendment) Rules 2019 to come into force in early March.

Where an unproven DSR CMU completes its DSR test before the replacement T-1 auction, the DSR test certificate will be issued after the auction. This preserves the existing structure of the auction regime (where an unproven DSR CMU participating in the auction becomes a proven DSR CMU after the auction), avoiding any confusion or complication that may otherwise arise if an unproven DSR CMU became a proven DSR CMU during the auction process. DSR CMUs who begin the DSR test in sufficient time before the auction will be notified by the Delivery Body of the DSR test's verified calculations (under Rule 13.2.9) before the first day of the auction. As normal, through Rule 5.5.11, DSR CMUs will be able to update their bid capacity within 10 working days of the auction.

As is ordinarily the case, CMUs may choose to complete (or work towards completing) other milestones (for instance, the metering assessment) before the auction, and doing this will help CMUs ensure the delivery year readiness deadline is met.

Table 1: Replacement T-1 Auction Key Milestones¹⁰

Key milestones (1/10/2019 deadline)	Non-key milestones (not required for this auction)	In delivery year deadlines (unchanged)
Metering Assessment	Six monthly progress reporting date 1 (new build only)	Demonstrating extended Performance (01/05/2020), or additional period deadline 31/07/2020)
Metering Test	Six monthly progress reporting date 2 (new build only)	
DSR Test Certificate (unproven DSR only)		Satisfactory Performance Days (01/05/2020), or additional period deadline (31/07/2020)
Minimum Completion Requirement (new build and refurbishing only)		
Substantial Completion Milestone (new build and refurbishing only)		
Financial Commitment Milestone (the Funding Declaration only) (new build and refurbishing only)		

2.2.4.2 Termination process

As outlined above, we no longer intend to set a second separate grace period deadline after the 'delivery year readiness' deadline. This is because conditional capacity agreements will impose obligations on capacity providers from the date they are awarded, rather than from date of the T-1 agreement trigger as originally proposed. We consider the existing termination procedure under the Rules as sufficiently flexible to manage any issues that arise in relation to the timing of the auction. Utilising this existing flexibility in the termination and appeals process will limit additional complexity for capacity providers.

Under the Rules, the issue of a termination notice denotes that a capacity agreement will terminate after 60 working days from the date of its issue. A capacity provider issued with a termination notice can appeal to the Secretary of State within 20 working days of receiving a termination notice asking for it to be withdrawn if the grounds for termination have been addressed. Alternatively, where this is not possible within 60 working days, the Rules allow a capacity provider to seek an extension of up to 20 working days by submitting a cure plan demonstrating how they will meet the grounds for termination within that timeframe. This

¹⁰ The table in Annex A (listing T-1 obligations, milestones and the 2018/19 deadlines) of the consultation included connection agreement and the Long Stop Date, which are not in this table. For the 2019 delivery year, connection agreements were required before the auction as part of prequalification. The Long Stop Date, for T-1 agreements, is the deadline for new build to complete the Minimum Completion Requirement.

means a capacity provider who is unable meet a milestone by the ‘delivery year readiness’ deadline will have at least 60 working days from this date to complete the necessary milestones¹¹. The Government’s view is that in the majority of cases this existing 60 working day period is likely to provide sufficient time to remedy issues that have arisen due to time constraints associated with the late auction date, with the discretionary 20 day extension providing an additional level of flexibility if required. This approach differs from the one being applied to existing agreements for future delivery years due to the shorter lead-in time to the 2019/20 delivery year (see Section 4.2.2).

When reviewing appeals for extension (of 20 working days) or withdrawal of the termination notice for this replacement T-1 auction, the Secretary of State will consider the specific circumstances of each CMU outlined in any written representations made, and the unusual timing of the auction. This is likely to lead to more flexibility in granting such extensions where the issue that has arisen is attributable to the compressed timelines for the replacement T-1 auction. Ahead of the delivery year, the Government will publish further guidance on how the appeals process will work.

As outlined in section 4.2.2, in exceptional circumstances the Secretary of State will also have a discretion (when considering an appeal against a termination notice under regulation 33 of the Principal Regulations) to direct the Delivery Body to terminate a conditional capacity agreement on a new termination ground, which is not associated with a termination fee. See section 4.2.2 for more details.

Overall, the Government believes that this approach offers fairness and parity with existing agreement holders with regards to back-payments and obligations, whilst enabling additional flexibility for individual CMUs where required to accommodate the specific circumstances of this auction.

2.2.4.3 Multiple termination notices

Should a CMU fail to meet the ‘delivery year readiness’ deadline for multiple milestones, in line with existing processes, the relevant capacity provider will receive a termination notice for each relevant termination event.

A capacity provider can then, as usual, appeal to the Secretary of State against each concurrent termination notice to either extend the time to comply with specified requirements in the termination notice or withdraw the termination notice. The capacity provider’s written representations to the Secretary of State, should they choose to appeal, will need to inform the Secretary of State of every termination notice that has been issued against the relevant CMU and must state whether they are applying for an extension or withdrawal for each termination notice.

A conditional capacity agreement (or capacity agreement) will be terminated 60 working days after the issue of a termination notice, subject to the termination notice being withdrawn or any extension granted by the Secretary of State. Where multiple termination notices expire on the same day, in respect of a failure to meet more than one milestone falling on the delivery year readiness deadline, the Delivery Body will determine the ground for termination (and therefore the applicable termination fee) by reference to a list of termination events for each relevant

¹¹ If a new build CMU has not completed the minimum completion requirement by the Long-Stop Date (also the “delivery year readiness deadline “), if no other termination events have occurred, a Note of Intention to Terminate is issued. There are then 20 working days until a termination notice is issued. So, for new build CMUs this could be at least 80 working days from the issue of a Note of Intention to Terminate.

CMU type. These are listed in Annex A and will be specified in the Rules. The termination events are ordered according to the usual chronological ordering of these milestones, meaning, where an agreement is terminated on multiple grounds on the same day, the termination event that would ordinarily have occurred first is the one that applies. This approach is consistent with how CMUs would normally be penalised when missing multiple milestones.

2.2.4.4 Receiving a payment before completing the DSR test

As is ordinarily the case, most capacity providers¹² will (subject to the T-1 agreement trigger), be eligible for capacity payments from the start of the delivery year, even if a termination notice has been issued. The timeframes and revised milestones for the replacement T-1 auction mean it is more likely than usual that unproven DSR CMUs will be paid their first payment before they have completed the DSR test milestone. Normally, where an unproven DSR CMU's DSR test certificate evidences a capacity smaller than their bid de-rated capacity their payments and penalties are reduced proportionally under Rule 8.3.2(c). However, there is currently no process in legislation to apply this proportional approach when the DSR test is completed after the first payment. Therefore, where this results in an overpayment, we intend to require, in the Principal Regulations, the Settlement Body to invoice the capacity provider for an appropriate amount reflecting the proportional adjustment to their capacity payments. Where the CMU also faced a penalty charge, we intend to create a similar process so that they will be credited an appropriate amount reflecting the proportional adjustment to their penalty charge. If the CMU does not complete their DSR test in time and is terminated, repayment of capacity payments will be required as normal (under Regulation 43B of the Principal Regulations) in addition to payment of any relevant termination fee.

2.2.5 Secondary trading

A significant number of respondents to the consultation expressed concerns with the Government's proposal to defer trading of agreements flowing from the replacement T-1 auction until after the T-1 agreement trigger. Since the replacement T-1 auction will now award conditional capacity agreements, the Government intends to enable secondary trading of these agreements following the auction. Holders of conditional capacity agreements will also be able to participate in Volume Reallocation, should this be necessary.

Holding the T-1 auction later than usual also impacts secondary trading timescales for holders of T-4 agreements covering the 2019/20 delivery year. Therefore, the Government will also make the necessary changes to the Rules to enable trading of T-4 agreements ahead of the T-1 auction, including during pre-qualification assessment windows. This was also highlighted by consultation respondents as a matter of concern. These modifications will be included in the Capacity Market (Amendment) Rules 2019 to come into force in early March.

These changes are intended to address stakeholder concerns, and are also made in recognition that an effective secondary trading regime benefits security of supply.

2.2.6 Credit Cover

As proposed in the consultation, we intend to suspend the requirements for prequalified CMUs to post credit cover in order to participate in the replacement T-1 auction. Conditionally

¹² New build and refurbishing CMUs are required to meet their Minimum Completion Requirement, as a minimum, before their capacity agreement (or conditional capacity agreement) takes effect and any payments can begin (Rule 6.8.5).

prequalified CMUs for the T-1 auction will therefore be deemed fully prequalified following the end of the withdrawal window, unless planning consents are still required.

For the replacement T-1 only, the Government now also intends to waive the requirement for CMUs to resubmit credit cover following the end of the standstill period. As suggested by a few respondents, there may be difficulties if resubmission was required for this auction. Depending on the timing of any T-1 agreement trigger:

- The re-submission window may coincide with the period in which CMUs are completing their milestones, which may lead to confusion about whether re-submission is required;
- It may be unclear whether credit cover would be re-submitted by the point at which it was required (for draw-down – see below).

Under current Regulations, when an unproven DSR CMU underperforms in their DSR test, or has not met obligations tied to the requirement to maintain credit cover by the start of the delivery year, some or all of their credit cover is drawn down. These provisions exist to encourage unproven DSR CMUs to bid for capacities they can achieve and are therefore an important part of the CM regime. Having removed the requirement to post credit cover for the T-1 auction, they will no longer work as intended so the Government will replace these provisions with alternative arrangements for this auction only to achieve the same outcomes.

Firstly, an equivalent termination fee will be introduced (one does not exist currently) for the existing termination event (Rule 6.10.1(i)) for failing to provide a DSR test certificate with more than 2MW of capacity. The fee will be rate TF1 (£5000/MW) as specified in Regulation 32 of the Principal Regulations, replicating the normal level of credit cover required by unproven DSR CMUs under Regulation 59(2)(a)(i). This fee will mirror the existing process of unproven DSR CMUs having credit cover drawn down if, by the start of delivery year, they have not met the obligations tied to the requirement to maintain credit cover (Regulation 61(1)(a)(i)). The same approach would apply to joint DSR tests.

Secondly, we intend to introduce an “unproven capacity fee”, mirroring the credit cover draw down requirements under Regulations 61(1)(a)(ii) and 60(1)(f)(ii)/60(3) of the Principal Regulations, which apply where an unproven DSR CMU provides a DSR test certificate that evidences a proven DSR capacity below its de-rated capacity. Again, the fee will be for the amount of credit cover that would otherwise have been drawn down under these provisions.

The Government’s view is that these changes negate the need for re-submission of credit cover following the T-1 agreement trigger. This change should also limit additional burdens to capacity providers and the delivery partners. To maintain flexibility, the Government will enable CMUs to voluntarily post or maintain existing credit cover as a source to be drawn from to satisfy any termination fees or the unproven capacity fee should they prefer to do so. In line with payments, terminations fees and penalties, credit cover draw down and the unproven capacity fee will not apply until after the T-1 agreement trigger.

Should credit cover remain voluntarily posted at the time of the T-1 termination trigger event, this will be returned to capacity providers as soon as reasonably practicable after this trigger event.

3. Deferred payments for capacity agreements that existed on 15 November 2018

3.1 Summary of responses

Consultation question:

4. Do you have any comments on the proposed arrangements for making deferred payments to capacity providers for missed capacity payments during the standstill period, and for making deductions to reflect termination fees or penalties as necessary?

Of the 44 respondents to this question, the large majority were in favour of making deferred payments to capacity providers following the end of the standstill period. A substantial number also requested that the ESC provide capacity providers with a monthly statement of accounts that records payments, penalties and termination fees due by or owed to capacity providers to prevent the need for a lengthy reconciliation at the end of the standstill period that could further delay the making of payments. A significant number argued that interest should be paid on deferred payments (or the deferred payments should be increased in line with the Consumer Price Index) and others called for the deferred payments to be paid in a single lump sum. A number of respondents highlighted the importance of re-starting supplier charges (question 7) to ensure the policy of deferred payments is feasible, particularly if sufficient funds are to be available to make a lump sum payment to capacity providers.

There were also a range of comments on the penalties and termination fees incurred by capacity providers during the standstill period – see question 6 in Section 4 for details – and a number of respondents suggested capacity providers should be able to voluntarily terminate their existing agreements if they waive their right to deferred payments.

A few respondents were opposed to deferred payments because they consider that, following the General Court judgment, the CM should not continue to operate during the standstill period, and therefore that the Government should not be providing reassurances that deferred payments can be made pending a positive final State aid decision from the European Commission to approve the scheme.

3.2 Government response

As explained in the consultation, it is the Government's intention to make provision for deferred payments to capacity providers, following the end of the standstill period, to replace capacity payments missed as a result of the standstill period¹³. Deferred payments will:

¹³ Missed capacity payments could include: (a) payments to capacity providers who hold agreements for the delivery year 2018/19, i.e. from 1 October 2018 to the end of the standstill period; and (b) potentially, payments to

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- reward delivery by capacity providers against their capacity agreements and compliance with obligations in those agreements (subject to any reductions in payments to account for non-compliance); and
 - maintain confidence in the CM amongst capacity providers, many of whom will have made investments, in part, on the basis of the CM revenues they were expecting to receive during the standstill period. Over the long term, industry confidence in the CM as an investable mechanism can be an important driver of security of supply, cost-savings and value for money overall.

Deferred payments will be conditional on (a) a positive decision by the European Commission following their formal investigation and so cannot be guaranteed (see Section 3.2.1), and (b) capacity providers' continued compliance with obligations in their capacity agreements (some of which we propose to modify – see Section 3.2.2).

A significant number of consultation responses requested that interest that accrues in relation to any supplier charges collected and held by ESC during the standstill period should be paid to capacity providers, together with the deferred payments, following State aid approval. However, payment of interest to capacity providers would represent an additional payment outside the scope of the State aid notification currently being investigated by the European Commission.

Similarly, several respondents requested that, if payments are made after September 2019, they should be further adjusted in line with the Consumer Price Index (CPI). The CM already includes a provision to adjust payments for CPI values, to account for changes in a CMU's operating costs in the intervening years since a T-4 auction. However, adjusting the capacity clearing price for 5 years instead of 4 years would be an inappropriate cost to consumers, since most CPI-connected costs will have been incurred during the delivery year in question rather than when the payment is received. The CPI adjustment will remain relative to the delivery year.

We also note the significant interest amongst respondents for a monthly statement of accounts. We have considered whether this would be feasible but have decided not to require such statements to be issued because significant resource would need to be diverted by the Settlement Body to make the necessary system changes to enable the production of a monthly statement of accounts – this could risk a delay to other important system upgrades, most notably work to implement component reallocation (Of12) which we consider to be a higher priority. We consider that it should be relatively straightforward for capacity providers to monitor and calculate for themselves the monthly capacity payments that would be payable during the standstill period (but for the State aid position preventing those payments), taking into account any termination fees or penalties which will become due once State aid approval is obtained. Capacity providers will be able to access information about any termination fees that arise during the standstill period from the associated termination notices. Capacity providers can request from ESC by email information on any penalties accrued due to non-delivery in any stress events that may fall within the standstill period.

Deferred payments will be made as soon as reasonably practicable after the end of the standstill period. The Settlement Body will issue credit notes for the deferred payments within 28 working days after the end of the month following the month in which the 'deferred capacity

capacity providers who hold agreements in respect of delivery year 2019/20 in the unlikely event that the timescale for State aid approval slips beyond 1 October 2019 (the start of that delivery year).

payment trigger' is made (see below), unless there are outstanding penalty charges. The credit notes will be paid within 5 working days.

3.2.1 State aid trigger events

We are working closely with the European Commission to ensure that the CM is reinstated as quickly as possible.

To ensure there is legal clarity whatever the timing and outcome of the State aid decision, the Government will introduce regulations that provide for the following "State aid trigger events" from which time there will be consequences set out in the CM legislation. The trigger events take the form of a notification by the Secretary of State to the Delivery Body and the Settlement Body.

- **Deferred capacity payment trigger event** – the Secretary of State must give a notification following a decision by a "relevant authority" to grant State aid approval to the scheme as a result of which deferred capacity payments can be made. The relevant authority is the European Commission, the European Court of Justice (which is hearing an appeal of the General Court's judgment which could have the result of setting aside that judgment) or the Competition and Markets Authority (which will be the domestic State aid regulator if the draft State Aid (EU Exit) Regulations 2019, currently laid before Parliament for approval, come into force). If this trigger event occurs, it will enable capacity providers to be paid deferred payments. (The equivalent trigger in respect of conditional capacity agreements is the "T-1 capacity agreement trigger event").
- **Agreement termination trigger event** – the Secretary of State must give a notification following a decision by a relevant authority that it would not be in accordance with State aid law for capacity payments to be made (e.g. State aid approval is not given). Alternatively, if the Secretary of State does not consider there is a reasonable prospect that the relevant authority will make the necessary decision for the "deferred capacity payment trigger event" to occur by 1st October 2020, the Secretary of State must give the notification for the "agreement termination trigger event" to occur. If the Secretary of State's notification in respect of this trigger event covers agreements that existed on 15 November 2018, those agreements will be terminated immediately and capacity providers will not receive deferred payments. Any penalties or termination fees that accrued to capacity providers during the standstill period will not become due, and any payments made by suppliers and held by ESC during the standstill period will be returned to suppliers with interest.

3.2.2 Compliance with capacity obligations

Deferred payments are intended to reward delivery by capacity providers against their capacity agreements and compliance with obligations in those agreements. To that end, they will be reduced to reflect any termination fees and penalty charges for non-compliance incurred by capacity providers during the standstill period (but not due to be paid until after the standstill period).

- **Termination fees** – If a capacity provider's agreement is terminated during the standstill period, the amount of any deferred payments owed to the capacity provider will be calculated by reference to when payments should cease to have been paid because the capacity agreement had been terminated (were it in accordance with State aid law to

make capacity payments). We will ensure any termination fees will be offset against any deferred payments owed to the capacity provider.

- **Penalties** – The calculation of the deferred payments will also take into account the imposition of penalty charges incurred by capacity providers because of non-delivery during any stress events during the standstill period. Invoices for penalties will be issued after the end of the standstill period but before deferred payments are made, with non-payment of the invoice reflected in a reduction to the deferred payments.

The Government recognises that, during the standstill period, some capacity providers may find it difficult to achieve compliance with certain obligations in capacity agreements by the deadline specified in the Capacity Market Rules. The Government will, therefore, and as proposed in the consultation, modify some of the obligations on capacity providers (see Section 4.2.1). Moreover, the Secretary of State will be provided with additional discretion when determining appeals of termination notices issued during the standstill period under modifications to Regulation 33 of the Principal Regulations (see Section 4.2.2).

However, the Government does not intend to allow capacity providers to withdraw from their agreements voluntarily, as requested by a number of respondents. Mandating continued compliance:

- encourages capacity providers to act in a way that promotes security of electricity supply. For capacity providers for the 2018/19 delivery year, this would entail making capacity available in case there is a system stress event, and for capacity providers for future delivery years this would entail continuing with plans to ensure capacity is available from the start of those delivery years; and
- enables the UK to make a robust case to the Commission that capacity providers for the 2018/19 delivery year (and future delivery years if the standstill period slips) should receive deferred payments because they have continued to comply with their obligations under their capacity agreements. The continued exercise of rights and enforcement of the agreements would help to show that only the minimum aid necessary would be paid under the notified CM scheme, as the calculation of the deferred payments will take into account any non-compliance/non-performance by capacity providers for which capacity providers would be subject to a financial penalty. Allowing capacity providers to voluntarily withdraw from their agreements would, on the other hand, substantially weaken our case for deferred payments as it would represent a significant change to the nature of capacity agreements outside the scope of the State aid notification currently being investigated by the European Commission.

Moreover, we note that the Principal Regulations do not expressly make the obligations within capacity agreements dependent on the receipt of capacity payments. The Rules also make clear that the obligations forming a capacity agreement are not excused by events outside the control of the capacity provider and apply regardless of any assertion of force majeure, frustration or equivalent legal doctrine.

3.2.3 Linkages with supplier charging

Respondents to the consultation identified the importance of ensuring there are sufficient funds available at the end of the standstill to enable deferred payments to be made promptly. Section 5.2 describes the arrangements being put in place to achieve this.

4. Obligations under and enforcement of existing agreements

4.1 Summary of responses

Consultation question:

5. Are there any obligations that arise during the standstill period that should be postponed? If so, what are they? To what extent should they be postponed? What is your justification for postponing them?

There were 40 responses to this question.

A number of respondents felt that all obligations should be maintained throughout the standstill period, whilst others welcomed the Government's proposed approach to extend the time available for capacity providers to meet certain milestones and/or waive certain obligations that arise during the standstill period. Some stressed the need for the Government to keep the number of modifications to relax obligations to a minimum and to consider the security of supply impacts of any changes.

The following comments were received in relation to the modifications proposed in the consultation:

- **Financial Commitment Milestone** – several responses suggested this milestone should be postponed to the earlier of 5 months after the end of the standstill period or 20 June 2020.
- **Connection agreement** – one response noted that the proposed extension to Rule 3.7.3(c) doesn't extend to Distribution Network Operators.
- **Metering assessment** – several responses suggested the deadline should be postponed until 16 September 2019 to avoid issues with secondary trading.
- **Metering tests** – one response suggested the metering test deadline should be delayed until 5 months after the end of the standstill period as it requires full site shut down (i.e. it is high cost) and there is no need for it to be done so far in advance of the delivery year.
- **Mock stress event** – a significant number of responses commented on the proposal to waive the requirement for the Delivery Body to hold a mock stress event in 2019. Some agreed with the proposal – noting that Delivery Body resource would be better employed dealing with the implications of the standstill period – whilst others argued it should still proceed given the event held in 2018 highlighted a number of issues and it would be useful to test improvements made since.
- **Sterilisation of terminated CMUs** – some responses agreed that this requirement should be suspended during the standstill period, whereas others argued it should be maintained otherwise it might encourage CMUs to withdraw from their agreements.

Suggestions were also made for postponing or waiving various other obligations:

- **Satisfactory Performance Days (SPDs)** – a large number of responses commented on SPDs. A number argued they should be maintained to help provide a justification for the deferred payments. Others felt that, given capacity providers are not receiving any payments at the current time and SPDs can be costly for some types of capacity such as Demand Side Response (DSR), SPDs should be waived, be subject to a relaxed deadline (e.g. 30 June, 1 month following standstill, 2 months following standstill), or not subject to termination fees.
- **Total Project Spend confirmation** – one response suggested this requirement should be delayed by a length equal to the duration of the standstill period.
- **Six monthly progress report** – Several responses suggested that the six monthly progress reports be suspended during the standstill period, in particular the requirement for the progress report to be accompanied by a report from an Independent Technical Expert in the event that there is a material change to a milestone of more than 2 months.
- **Substantial completion milestone and minimum completion requirement** – a number of responses requested these milestones be delayed.
- One response suggested Rule 8.3.4(d) should be waived so that DSR components that have been withdrawn are permitted to be reinstated in future delivery years. This was considered equivalent to the proposal to suspend the sterilisation of terminated CMUs.

Consultation question:

6. Do you have any comments on the proposed arrangements for the administration of agreements, termination fees and appeals during the standstill period?

33 respondents provided comments in relation to this question.

A number of respondents supported the proposal to suspend the collection of termination fees until one month after the standstill period. One respondent, however, argued that the Government should consider whether enforcing termination fees during the standstill period is appropriate to ensure that it has the best view of procurement needs for the replacement T-1 auction.

A number of respondents supported the proposal to amend Regulation 33 to provide the Secretary of State with discretion to award more time to capacity providers to achieve compliance. Others questioned the rationale for this amendment or stressed that additional time should only be awarded in exceptional circumstances.

A significant number of respondents argued that, where capacity providers can demonstrate financial stress as a direct result of the standstill period, then there should be leniency in the application of any termination fees, potentially by providing the Secretary of State with discretion to set termination fees to zero in such circumstances.

Once again a number of respondents argued that capacity providers should be able to withdraw from their agreements voluntarily without incurring termination fees during the

standstill period, and others suggested that no termination fees or penalties should be incurred during the standstill period. However, others noted that continued administration of the agreements is in the interests of consumers, helps ensure security of supply and limits harm to investor confidence by increasing the likelihood of deferred payments to providers.

4.2 Government response

As noted in the consultation, and by a number of consultation respondents, continued administration of agreements is in the interests of consumers, helps ensure security of supply and supports our case for making deferred payments to capacity providers. However, the Government recognises that the standstill period may make compliance with some of the obligations that fall on capacity providers more difficult. The Government therefore believes it is necessary to make some adjustments to the manner in which agreements are administered during the standstill period including modifications to the timing for some of the obligations, the Secretary of State's discretion in the appeals process and the timing for the invoicing of termination fees and penalties.

4.2.1 Modification of obligations

The consultation proposed a number of modifications to some of the obligations and milestones that fall upon capacity providers in the lead up to the delivery year and in the delivery year itself: either by extending the time available for capacity providers to meet certain milestones, or waiving certain obligations that arise during the standstill period.

A significant number of respondents to the consultation felt the Government's approach was pragmatic. Others argued that modifications should be kept to a minimum given the potential impact on security of supply due to, for example, undermining the timely delivery of capacity in relation to future delivery years. The Government is mindful of these risks and therefore modifications will only be made where there is a high cost associated with the obligation and its modification will not create risks to security of supply. We are also satisfied that the changes do not unfairly benefit a particular sub-group of CMUs.

The Government intends to implement all but one of the modifications proposed through the consultation, via changes to the application of the Principal Regulations and CM Rules (in a phased manner commencing with the Capacity Market (Amendment) Rules 2019, so that changes are brought into effect at the appropriate time), albeit with some refinements made in light of consultation responses.

- **Financial Commitment Milestone (Rule 6.6)** – Currently, new build CMUs with capacity agreements for the 2021/22 delivery year must meet the Financial Commitment Milestone (FCM) by 20 June 2019. This represents a significant financial commitment for the CMU (and their investors) and we believe an extension to the FCM deadline is unlikely to affect timely delivery of the new build CMUs for 2021/22 given much of this capacity has relatively quick construction times. We will, therefore, extend the time available for these CMUs to meet the FCM to whichever is the later of: 31 March 2020, or five months following the deferred capacity payment trigger event. An alternative deadline was proposed through the consultation – five months following the domestic law trigger or 20 June 2020, whichever is the earlier – but will not be taken forward as it does not allow sufficient flexibility given potential timings of the State aid approval.

- **Credit cover (Regulations 59(4) - (5) and 60 and the termination event in Rule 6.10.1(ba))** – In November 2018, we advised that those CMUs with credit cover lodged with ESC could request this be returned i.e. the requirement to maintain credit cover would be waived during the standstill period. As noted in the consultation, a consequence of this position is that the increase in credit cover, due by 13 March for those new build CMUs with capacity agreements for the 2021/22 delivery year that have not achieved their FCM within 11 months of the 2018 T-4 auction, will also be waived¹⁴. Following the deferred capacity payment trigger event, the Delivery Body will notify CMUs if they need to resubmit credit cover¹⁵. Following consultation, we have concluded that it would be reasonable to request credit cover be re-posted within 40 working days of receiving notice from the Delivery Body. The arrangements for resubmitting credit cover will be modelled upon those in place with respect to prequalification¹⁶.
- **Connection agreements (Rule 3.7.3(c))** – Currently, new build distribution-connected CMUs with capacity agreements for the 2020/21 delivery year must submit a distribution connection agreement by 29 March 2019. Given connection agreements tend to be high cost, and the deadline for this requirement will fall in the standstill period, we intend to delay this deadline until five months following the deferred capacity payment trigger event or 31 March 2020, whichever is the later.
- **Metering assessments (Rule 3.10.2(b))** – Following comments made in response to the consultation, we intend to extend the metering assessment deadline for Unproven DSR CMUs with T-4 capacity agreements for the 2019/20 delivery year to 16 September 2019 (in line with the DSR test deadline) to ensure there is a window for secondary trading following the replacement T-1 auction. Note also that we are proposing to enable secondary trading of T-4 agreements for the 2019/20 delivery year ahead of the replacement T-1 auction – see Section 2.2.5. Aggregators should continue to aim to complete the metering assessment as soon as practicable to provide time for metering tests (if necessary) and DSR tests by the required deadline.
- **Metering tests (Rule 8.3.3(e))** – Currently, existing CMUs and Proven DSR CMUs with T-4 capacity agreements for the 2020/21 delivery year must complete a metering test by the end of March 2019. The consultation proposed extending this deadline until the end of September 2019. Responses to the consultation highlighted that installing and commissioning bespoke metering can be costly and disruptive, particularly on industrial sites which can require a full site shutdown, and that the Opening Decision is unlikely to give sufficient comfort to commit to these costs. Given the metering test can be completed nearer to the start of the delivery year without affecting timely delivery, we intend to delay the deadline until 20 June 2020 or 5 months following the deferred

¹⁴ Note – the trigger date for the requirement to increase the level of credit cover, if the FCM had not been met by that point, has already passed – it was 20 January 2019. Therefore, this proposal will be implemented by suspending the termination event in Rule 6.10.1(ba) in the Capacity Market (Amendment) Rules 2019, and associated fee, relating to a failure by CMUs to provide the increased level of credit cover by the 13 March deadline. If capacity providers provide credit cover after the standstill period, as will be required by the proposed modifications to the Principal Regulations, they will be deemed to have complied with the credit cover requirements during the standstill period.

¹⁵ Credit cover will not need to be submitted in relation to CMUs participating in the replacement T-1 auction.

¹⁶ The consultation document said that we would consult at a later stage on amendments to require capacity providers to repost credit cover after the standstill period. However, following the consultation, we have decided to make provision for applicant credit cover in the draft regulations because we are merely making technical changes which are closely modelled on existing arrangements for posting credit cover – only timeframes have been adjusted, as per consultation proposals, to provide more flexibility for capacity providers.

capacity payment trigger event, whichever is the earlier. In acknowledgment of the extension, we also intend to make the same deadline available to the relevant CMUs to notify the Settlement Body that a metering test is required (if that has not already been done).

- **Mock stress event** – This is an administrative event only, the purpose of which is to test the functionality of National Grid’s and ESC’s operational processes in readiness for a stress event occurring – waiving this test will not affect security of supply. A significant number of respondents disagreed with the consultation proposal to not hold a mock stress event during the standstill period. However, as noted by other respondents, we believe our delivery partners’ resources are better utilised responding to the additional demands created by the standstill period (e.g. preparing for the replacement auction), whilst continuing with other higher priority system improvements (e.g. preparing for asset reallocation and completing the necessary process improvements following lessons learnt from the mock stress event held in 2018, including the publication of a consolidated Stress Event Manual and improvements to the Capacity Volume Register, which ESC is seeking views on via a separate publication)¹⁷.
- **Sterilisation of terminated CMUs (Rule 3.3.3(e))** – Given the increased risk of insolvency during the standstill period, the consultation proposed waiving the Rule which, in effect, prevents terminated capacity from participating in future auctions. Having reflected on the consultation responses, the Government has decided not to proceed with this proposal. Rule 3.3.3(e) only applies if the termination was triggered by a failure to maintain Transmission Entry Capacity and so its waiver would not deliver on the intended policy objective (insolvency is a different termination event not linked to Rule 3.3.3(e)). Moreover, its removal could weaken incentives to act in a manner which ensures security of supply.

In light of the consultation responses, we intend to make the following additional changes:

- The requirement in **Rule 12.2.1(c)** for prospective CMUs to provide, as part of the six monthly progress report, a report from an Independent Technical Expert (ITE) in the event of a material change to a construction milestone will be waived during the standstill period. This is in recognition of the increased likelihood of delays to such milestones, the cost of an ITE report is not insubstantial, and its removal will not directly impact security of supply.
- **Total Project Spend (Rule 8.3.6(a))** – New Build CMUs are required to provide, 3 months after the start of the first delivery year, a certificate from an ITE stating the total project spend incurred. We intend to clarify that the first delivery year commences, in this context, after the Minimum Completion Requirement and/or Substantial Completion Milestone has been met. This amendment, together with some other amendments to the Rules which we intend to include to correct typographical errors, will be enduring (i.e. it will permanently amend the Rules).

Additional changes suggested through the consultation that will not be implemented include:

- **Satisfactory Performance Days** – A range of different modifications to SPDs were proposed by respondents to the consultation (e.g. they should be waived, be subject to a relaxed deadline, or not subject to termination fees) as they can be costly for some types of capacity. Current arrangements require CMUs with T-4 capacity agreements for

¹⁷ To be published here: <https://www.lowcarboncontracts.uk/capacity-providers>

the 2018/19 delivery year to complete three SPDs by 30 April, otherwise payments are suspended. Where three SPDs are subsequently delivered before 30 September, payments restart from the date of the third SPD. If the additional SPDs are not delivered, all CM payments are repayable. CMUs with T-1 capacity agreements for the 2018/19 delivery year have slightly different SPD requirements, following changes to the CM Rules in 2017: if three SPDs are not completed by 30 April, the deadline to achieve three additional SPDs is 31 July (rather than 30 September), and if the additional SPDs are not achieved by this date a termination event is triggered and a termination fee of £15,000/MW is payable (in addition to the requirement to repay earlier capacity payments). In the event of termination, CMUs are able to appeal via the routes provided for in the Regulations. Whilst the Government accepts there are costs associated with SPDs (particularly for some types of CMU), this requirement is the main way of demonstrating capacity is available in the delivery year; the rationale for making deferred payments would be significantly undermined if this requirement were to be weakened or removed. We also note that the existing requirements already provide considerable flexibility in relation to the timing of the tests, as described above. Moreover, we do not wish to make changes to the Rules that might unfairly disadvantage those CMUs that have already incurred costs to comply with the SPD requirement.

- **Minimum Completion Requirement (MCR) and Substantial Completion Milestone (SCM)** – Some respondents requested these milestones be delayed. Currently, new build CMUs must have more than 50% (MCR) or 90% (SCM) of their capacity obligation operational by the long stop date (12 months after the start of the first scheduled delivery year). These arrangements already provide for significant flexibility around the late delivery of new build CMUs. At the present time, we do not plan to introduce additional flexibility within these arrangements.

4.2.2 Appeals and termination fees

As explained in the consultation, National Grid will continue to administer and monitor compliance with capacity agreement obligations during the standstill period (as modified by the proposed regulations and rules). This will include issuing notices of intention to terminate and termination notices as necessary.

The Secretary of State will also continue to consider any appeals from capacity providers of termination notices, and to consider exercising his discretion under Regulation 33 of the Principal Regulations to direct National Grid to withdraw termination notices or extend the date by which capacity providers must meet any requirements specified in termination notices. In light of consultation responses, we intend to introduce two amendments to Regulation 33, and the necessary accompanying Rules, to provide the Secretary of State with a greater degree of discretion when determining appeals. The Secretary of State will have discretion, when determining appeals of termination notice issued during the standstill period, to:

- in relation to agreements that existed on 15 November 2018, extend the date by which capacity providers must meet any requirements specified in termination notices by up to 12 months, instead of 6 months as is currently the case¹⁸. Whilst the Government has attempted to identify and modify the obligations which capacity providers are most likely to have difficulties meeting during the standstill period, it is possible that some may have

¹⁸ This amendment will not apply in relation to conditional agreements awarded through the replacement T-1 auction.

been overlooked – in which case the flexibility to grant longer extensions in any such cases could prove useful; and

- in relation to agreements that existed on 15 November 2018 and conditional capacity agreements, direct the Delivery Body to terminate the agreement on a new termination ground which does not carry with it a termination fee. The new termination ground will only arise in exceptional circumstances where a capacity provider can demonstrate it would involve undue financial hardship to require them to pay a termination fee owing to the exceptional circumstances of their particular case arising from the non-payment of capacity payments during the standstill period. If an agreement is terminated on this new ground, the capacity provider must repay all capacity agreements it has received under the relevant capacity agreement. As noted earlier, whilst the Government does not intend to provide capacity providers with the option to voluntarily withdraw from capacity agreements, we do recognise that it could in exceptional circumstances be unfair to impose termination fees¹⁹.

These amendments will apply in relation to termination notices issued during the standstill period only. Termination notices issued outside of the standstill period will be subject to the existing arrangements. The Government will publish further guidance on how the appeals process will work.

As explained in the consultation, termination fees (and non-completion fees) will not be required to be paid during the standstill period. Instead, as soon as reasonably practicable after the deferred capacity payment trigger event occurs, capacity providers will be invoiced by the Settlement Body for any termination fees incurred during the standstill period. The invoice will be payable by the payment due date specified on the invoice.

CM penalty charges for non-delivery during system stress events will also not be required to be paid during the standstill period. However, any penalties incurred during the standstill period will continue to be recorded and capacity providers will be invoiced by the Settlement Body within 21 working days after the end of the month following the month in which the deferred capacity payment trigger event occurs. The invoice will be payable by the payment due date specified on the invoice. If the invoice has not been paid by the time credit notes for the deferred payments are due to be issued, adjustments will be made to the deferred payments.

Over-delivery payments, which are normally paid at the end of the delivery year, may also be subject to delay if a State aid decision has not been reached by this point. Credit notes for any over-delivery payments will be issued either 28 working days after the end of the delivery year (if the deferred capacity payment trigger event occurs before the end of the delivery year) or otherwise as soon as reasonably practicable after the deferred capacity payment trigger event occurs.

¹⁹ The termination event linked to insolvency does not carry a termination fee and so we expect this additional flexibility to be used in exceptional circumstances only.

5. Payments administered by the Settlement Body

5.1 Summary of responses

Consultation questions:

7. Do you agree there is a strong case for re-starting collection of the supplier charges? If so, what is your preferred option?
8. Do you have any comments on the possible technical changes to regulations or rules that would be required to clarify the operation of the collection of the supplier charge during the standstill period or make payments in respect of the proposed T-1 agreements?
9. Are any changes desirable to the supplier credit cover, mutualisation and enforcement provisions that apply during the standstill period?

There were 47 responses to question 7, 21 to question 8 and 20 to question 9.

The majority of respondents to question 7, including suppliers, were in favour of re-starting collection of the supplier charges during the standstill period. Most argued that this would provide confidence that sufficient funds would be available to make deferred payments to capacity providers at the end of the standstill period and noted that re-starting collection in a timely manner is crucial in bolstering confidence amongst capacity providers. Some noted that, without this confidence, it was more likely that assets will seek to mothball. One respondent noted that re-starting collection would also help to provide confidence to the supply chain and creditors to capacity providers. A significant number pointed to experience with the Renewables Obligation scheme as evidence of the risks arising from allowing charges to build up over time and then requiring payment from suppliers. A number also claimed that re-starting charges now would minimise the risk of price volatility in future and provide a clear basis for calculating the price cap going forwards.

Most of those opposed were energy intensive industries (EIs). They were critical of the uncertainty around the CM Supplier Charging arrangements to date, and highlighted that this risked having a significant cost impact on their businesses – they were unclear whether to manage their load requirement over the winter weekday peaks to minimise their exposure to the CM charges (passed through to them by suppliers), and were concerned that if they did (at cost) then ultimately this may be proven to be unnecessary (e.g. if State aid approval for deferred payments is not forthcoming). They argued that re-starting collection of supplier charges would not provide confidence over and above that already gained through the commitment to make deferred payments. A number claimed they would prefer to pay a double charge in 2019/20 if necessary, and several noted that as they were both an EI and a capacity provider they were facing both the loss of CM revenues during the standstill and higher CM charges due to uncertainty around load management.

Two suppliers argued that the supplier charges should only resume once State aid approval had been reinstated. These suppliers accepted that deferred charges may be due for the

standstill period after State aid approval is granted – one indicated an intention to continue tariffs that enabled them to collect monies from customers and the other stressed the importance of ensuring the Ofgem price cap is set at an appropriate level to enable continued collection.

Of those in favour of re-starting the supplier charges, there was almost unanimous support for ESC continuing to collect. The BSC modification was considered to be a useful alternative in the event that the ESC option is delayed or not possible. Reasons given for favouring the ESC option include:

- The design of the BSC modification is not equivalent – it will not provide reconciliation or mutualisation, creating potential for costly surprises at the end of the standstill period (and the price cap may make it difficult to deal with these). Some respondents also had concerns as to whether the BSC modification would be approved by Ofgem.
- The ESC option was seen as: well-established and understood by the market, thereby maximising continuity and confidence; likely to be the cheapest and quickest to implement; specifically designed for the purpose of funding the CM and so most appropriate; and providing the most legitimate basis for suppliers to pass on costs to their customers, minimising the risk of customers refusing payment.

A number of respondents requested clarity on arrangements for collecting the missed supplier charges for the October 2018 to January 2019 period, noting it could pose risks if done too quickly (e.g. causing cash flow problems for suppliers), or too slowly (e.g. suppliers may have already used previously collected charges for their own working capital). Some noted that suppliers have maintained tariffs over that period that enable them to reflect the continued imposition of the CM charge, given that the Government's plans for making deferred payments and re-starting supplier charges have been well signalled.

Others requested clarity on arrangements for returning funds to suppliers in the event that State aid approval for deferred payments is not forthcoming. A number argued that interest should be paid on the funds and several stressed there should be an obligation on suppliers to return any funds to customers.

In relation to the approach to enforcement, a significant number of respondents highlighted the importance of ensuring the reinstatement of credit cover (one response noted that suppliers should be given at least one week to re-post credit cover) and taking action in the event of non-payment by suppliers in order to protect against mutualisation risks and knock-on impacts on other suppliers. A number of respondents also highlighted the importance of maintaining the reconciliation and mutualisation processes to avoid unexpected and unwelcome additional bills on suppliers at the end of the standstill period.

5.2 Government response

The proposal to restart collection of the supplier charge was put forward in light of earlier representations from industry who argued that this would:

- minimise financial risks to the CM by ensuring sufficient funds are available to cover the deferred payments, and maintain capacity providers' confidence in the CM; and

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- minimise uncertainty amongst suppliers by ensuring that they do not face unexpected and unfunded liabilities when the CM is restored.

The consultation outlined two options for how the supplier charge could be collected – (1) Electricity Settlements Company (ESC) to restart collection of the supplier charge under the Supplier Payment Regulations, or (2) a modification to the Balancing and Settlement Code (BSC) to require suppliers to pay the equivalent of the supplier charge into escrow to be held until State aid can be secured and the money transferred to ESC.

The consultation also noted potential interactions between the policy on CM supplier charging and the setting of the Standard Variable Tariff (SVT) Price Cap for the period April – September 2019.

5.2.1 Ofgem retail price cap

Ofgem has since confirmed that the CM supplier charge will be factored into the methodology for setting the price cap.²⁰ This means suppliers can and should continue to maintain tariff structures under the price cap that enable them to collect monies from their customers during the standstill period for the purpose of meeting the CM supplier charge. In the event that the State aid approval for deferred payments is not forthcoming, we expect suppliers to reimburse customers. In this circumstance, Ofgem would consult on the best way to ensure consumers recover any unnecessary charges collected under the price cap relating to the CM scheme.

5.2.2 BSC modification

The BSC modification (Option 2) was the subject of a separate consultation run by Elexon.²¹ A recommendation was presented to Ofgem on 5 February and Ofgem announced, on 20 February, that it does not consider it has the power to approve the modification.²²

5.2.3 ESC collection of the supplier charge

We agree with the majority of respondents that it is important to provide confidence that sufficient funds will be available to make deferred capacity payments at the end of the standstill period and that suppliers are making appropriate provision to ensure that this is the case. This could be achieved by resuming mandatory collection as proposed in the consultation. However, mandatory collection by the ESC is not the only way to achieve this.

Taking into account the concerns raised about the mandatory collection of the supplier charge during the standstill period, we have decided that the best approach would be:

- to mandate that supplier charges are collected and paid in full shortly after the standstill period ends, with robust enforcement by ESC. Ofgem also has enforcement powers in the event of any late or non-payments at that stage, and
- to encourage suppliers to make prudent provision in the interim, including through making voluntary payments to the ESC, to ensure that they are in a position to pay the full amount of supplier charges promptly when they become due.

²⁰ <https://www.ofgem.gov.uk/publications-and-updates/decision-capacity-market-allowance-default-tariff-cap>

²¹ <https://www.elexon.co.uk/mod-proposal/p378/>

²²

https://www.ofgem.gov.uk/system/files/docs/2019/02/p378_introduction_of_a_cm_supplier_interim_charge_0.pdf

Working with Ofgem and the ESC, we are adopting a number of measures, described in more detail below, to help to ensure that capacity providers can be confident that they will be paid in full and promptly following state aid clearance. These measures will encourage suppliers to make appropriate provision during the standstill period, enable suppliers to continue to pay the supplier charge to ESC during the standstill period and ensure suppliers meet the charges which will fall due at the end of the standstill period.

At the same time, our approach will give suppliers a degree of flexibility about how they make appropriate provision to meet their supplier charge liability at the end of the standstill period.

5.2.4 Supplier charge arrangements during the standstill period

It is in suppliers' interests to make prudent provision during the standstill period to ensure they are in a position to meet the full outstanding balance of supplier charges promptly when it becomes due and, in so doing, avoid volatility in prices for their customers or costly enforcement action. Feedback received through the consultation process suggests that suppliers already take such action. Arrangements to further encourage suppliers to make prudent provision during the standstill are outlined below.

Ofgem price cap – As already explained, the CM supplier charge has been included within the price cap which means suppliers can and should continue collecting the charge under the price cap during the standstill period.

Ofgem, as part of their monitoring of the financial resilience of suppliers, will be particularly interested to understand how any suppliers that are not paying into the ESC system (below) are making suitable provision to cover their supplier charge liabilities

Payments toward supplier charge liability – To ensure suppliers have clarity regarding the size of their post-standstill payment liability, which will help them manage their finances effectively during the standstill period, ESC will issue to suppliers:

- in mid-March 2019, a revised “schedule of post-standstill payments”²³ which comprises the revised monthly supplier charges payable for the remainder of the 2018/19 delivery year calculated according to the current methodology based on suppliers' actual peak-time demand over winter 2018/19, and
- after the replacement T-1 auction is held and conditional agreements are awarded, a provisional “schedule of post-standstill payments”²⁴ which comprises the provisional monthly supplier charges payable for the 2019/20 delivery year calculated according to the current methodology based on suppliers' forecast peak-time demand over winter 2019/20.

Suppliers will also be able to request information from ESC on their position against their estimated cumulative post-standstill liability.

ESC will accept and hold payments from suppliers during the standstill period. ESC will hold any monies received in an interest-bearing account that will accrue interest at the Government Banking Service rate (the Bank of England base rate minus 0.11%). In the event that there is:

²³ The schedule to include every month in the 2018/19 delivery year which is (or may become) a standstill month.
²⁴ The schedule to include every month in the 2019/20 delivery year which may become a standstill month (if any).

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- **State aid approval to make deferred payments:** Any payments held by ESC on the day of the relevant trigger event (and any interest accrued on those monies) will be used to offset a supplier's post-standstill supplier charge liability. The new draft regulations we have prepared will establish enhanced mutualisation and reconciliation arrangements at the end of the standstill period; or
 - **No State aid approval to make deferred payments:** Each supplier would receive a refund equivalent to the amount of the payments it had made during the standstill period which the ESC still hold on the day on which the relevant trigger event occurs, including any interest accrued on those monies. If a supplier has been made insolvent in the intervening period, then the refund would be returned to the appointed administrator.

The draft regulations make modifications to the Principal Regulations and Supplier Payment Regulations to: provide for ESC to issue the schedules of post-standstill payments, require ESC to hold payments from suppliers, require ESC to offset these against a supplier's post-standstill supplier charge liability if there is State aid approval for deferred payments, and require ESC to repay such payments with interest in the event there is no State aid approval for deferred payments or where suppliers request ESC return their payments prior to a State aid decision.

5.2.5 Post-standstill arrangements

In the consultation document, we said that we would consult at a later stage on any further amendments setting out how, at the end of the standstill period, ESC will calculate and pay deferred capacity payments (including deductions) and reconciliation adjustments to the supplier charge. However, we feel it is possible to progress these issues now (without the need for further consultation) and appropriate for us to provide as much certainty as possible as early as possible by making provision in the draft regulations: for deferred payments to be made to eligible capacity providers, reflecting any deductions for termination fees and penalty charges; and for reconciliation adjustments to be made to the supplier charge paid by suppliers. These arrangements are consistent with the consultation proposals and with the approach to the collection of the supplier charge that we are taking in the light of that consultation. In taking this view, we had regard to the fact that a consistent and overarching message from many consultees was that the current lack of clarity over supplier charge arrangements is unhelpful to industry. By settling these points of detail now, rather than deferring them, we are helping to provide the certainty that industry is seeking.

Following comments made in consultation responses, we recognise the importance that capacity providers place on receiving deferred payments in full and as soon as possible following the end of the standstill period. To this end, the Government is introducing draft regulations which establish arrangements to help ensure the integrity of the funds available to make payments to capacity providers. Following State aid approval – and the deferred capacity payment trigger event occurring – suppliers will be legally required to pay in full any outstanding supplier charges for any “standstill month”.²⁵

Invoicing – The ESC will invoice suppliers for the full outstanding balance of supplier charges in respect of the “standstill collection period”²⁶ to enable deferred payments to be made to capacity providers as soon as possible (see Table 2 for a summary timetable). As explained in

²⁵ The draft regulations define a “standstill month” to be a month from and including October 2018 until the end of the month after the month in which the deferred capacity payment trigger event occurs.

²⁶ The draft regulations define “standstill collection period” to mean the period from the start of the first standstill month to the end of the last standstill month.

Section 5.2.4, we expect suppliers to make adequate and provision during the standstill period to ensure they have the funds to pay this invoice in full and on time.

ESC will ensure the total amount payable by a supplier is adjusted to account for any payments made during the standstill collection period, and any accrued interest. If a supplier has paid too much through their payments during the standstill collection period, this is to be noted on the statement and the surplus returned to the supplier. The post-standstill invoice will have been adjusted as part of the revised annual calculations under the Supplier Payment Regulations to take into account: changes in supplier market share, and reductions in the amount of capacity payments that will need to be funded as a result of terminations, reductions of capacity payments or forfeiture of capacity payments during the standstill period.

Robust enforcement – A number of respondents to the consultation identified that non-payment of the supplier charge by a significant number of suppliers could risk increasing the costs faced by the non-defaulting suppliers by virtue of the mutualisation process (below) and, in extremis, undermine the integrity of the funds available to make payments to capacity providers. The Government recognises the importance of taking robust enforcement action wherever necessary to mitigate these risks.

Suppliers who fail to pay the full invoice by the due date will be entered on the non-payment register. Late payment interest (i.e. interest of 5% above base rate) will start to accrue from the due date, as is already the case, to provide an incentive for prompt payment.

Any non-payments will be pursued by a combination of action by the ESC and, where appropriate, Ofgem who have powers under Regulation 67 of the Principal Regulations to impose financial penalties and, ultimately, to revoke supplier licences.

Enhanced mutualisation and reconciliation – Responses to the consultation highlighted the importance of the mutualisation and reconciliation processes in ensuring sufficient funds are available for making deferred payments to suppliers in full and promptly.

The draft regulations establish a new post-standstill mutualisation calculation for the entire standstill collection period. No later than ten working days into the second month after the month in which the deferred capacity payment trigger event and/or the T-1 capacity agreement trigger event occurs, ESC will conduct a mutualisation exercise treating suppliers with entries on the non-payment register in respect of the standstill period as in default unless the entry shows the supplier charge has been subsequently fully paid by the time of the mutualisation. Non-defaulting suppliers will be invoiced for mutualisation payments according to their market share to maintain the integrity of the funds available to make deferred payments. If there is a shortfall after the first mutualisation, due to late or non-payment of the mutualisation invoice, then there will be a supplementary mutualisation process.

To ensure deferred payments to capacity providers are not delayed, initial capacity payments will be made shortly following the first mutualisation exercise and proportionally adjusted if there is a shortfall. If these capacity payments are proportionally reduced, capacity providers will be entitled to receive a supplementary capacity payment in respect of this reduction following the supplementary mutualisation process.

As noted above, robust enforcement action will be taken in relation to any defaulting suppliers to minimise mutualisation risks to other suppliers and ensure the integrity of the funds available to make payments to capacity providers. ESC will undertake a series of ad hoc reconciliation

calculations in relation to the standstill period to ensure any non-payments recovered following enforcement action are returned to those suppliers that had to make mutualisation payments.

Supplier credit cover – The draft regulations will provide that suppliers are not required to provide credit cover in respect of any standstill month. Therefore, suppliers will not be required to provide credit cover in relation to this post-standstill invoice for the full outstanding balance. Suppliers will, however, be required to provide credit cover as normal for months following the standstill period.

Table 2 – Timeframes for post-standstill collection and backdated payments

Event	Deadline in regulations
Deferred capacity payment trigger event.	Other deadlines set with reference to the month the relevant trigger event occurs.
Invoices issued to suppliers for supplier charge for “standstill months”.	No later than 12 working days before the commencement of the second month after the month in which the trigger event occurs.
Earliest “due date” for invoices issued. Standard practice is to allow 5 working days for payment.	“Due date” specified must be no less than 3 working days after the date on which the invoice was issued.
Invoices issued to suppliers for mutualisation payments to cover non-payment of supplier charge in respect of standstill months.	No later than 10 working days into the second month after the month in which the trigger event occurs
Earliest due date for payment of mutualisation invoices issued. Standard practice is to allow 5 working days for payments.	“Due date” specified must be no less than 3 working days after the date on which the invoice was issued.
Date by which supplier charge must have been received for payments to be made.	By the 26th working day after the end of the month following the month in which the relevant trigger event occurred.
Last date for issue of credit notes for deferred capacity payments.	No later than the 28th working day after the end of the month following the month in which the relevant trigger event occurred.
If there is a shortfall after the first mutualisation:	
Date by which supplementary mutualisation invoices must be issued (if required).	No later than the 40th working day after the date on which the regulation 40(6) reduction crystallised
Date by which supplier charge must be received for residual capacity payments.	This is checked on the 26th working day after the date on which supplementary mutualisation invoices are issued.

Date by which credit notes for residual capacity payments must be issued.	No later than 28 working days after the date on which supplementary mutualisation invoices are issued.
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Note: the deadlines in the Regulations represent the latest date by which the actions must be completed. The actions could be undertaken sooner if necessary.

5.2.6 Penalty residual supplier amount

ESC calculates and pays suppliers a share of the penalty charges collected from capacity providers (once any over-delivery payments have been made to capacity providers) under the Principal Regulations – this share is called the penalty residual supplier amount. Regulation 8(3) of the Supplier Payment Regulations provides that within 28 working days of the end of the delivery year, the Settlement Body will have calculated the amount and issued a credit note to each supplier. Regulation 13 requires the Settlement Body to pay each supplier issued with a credit note within 33 working days of the end of the delivery year.

This amount can only be calculated after the standstill period as non-compliant capacity providers will only be invoiced for CM penalty charges (and over-delivery payments made to capacity providers) after the standstill period. The draft regulations will therefore modify the application of Regulations 8 and 13 to require this calculation, credit note and payment to take place as soon as reasonably practicable after the end of the standstill collection period where it is not possible for these payments to be made in accordance with ordinary timeframes.

6. Corrections and Errors

Whilst reviewing the Rules we have identified some minor points, which unfortunately have arisen through errors in consolidation, and we will correct via the Capacity Market (Amendment) (No. 2) Rules 2019 so that the Rules properly reflect policy intent. The majority are typographic, cross-referencing, and numbering errors.

Annex A: Termination event ordering where concurrent termination notices are issued for milestones with the delivery year readiness deadline²⁷

Ordering by generation type	Termination event	Milestone deadline (by the end of)
Existing Generating:		
Metering Assessment	Rule 6.10.1(ha)	30/09/2019
Metering Test	Rule 6.10.1(h)	30/09/2019
New Build:		
Financial Commitment Milestone (the Funding Declaration only)	Rule 6.10.1(b)	30/09/2019
Minimum Completion Requirement (includes completion of the Metering Assessment and Metering Test)	Rule 6.10.1(c)	30/09/2019
Refurbishing:		
Minimum Completion Requirement (includes completion of the Metering Assessment and Metering Test)	Rule 6.10.1(c)	30/09/2019
Proven DSR:		
Metering Assessment	Rule 6.10.1(ha)	30/09/2019
Metering Test	Rule 6.10.1(h)	30/09/2019
Unproven DSR:		
Metering Assessment	Rule 6.10.1(ha)	30/09/2019
DSR Test	Rule 6.10.1(i)	30/09/2019
Metering Test	Rule 6.10.1(h)	30/09/2019

²⁷ The Six monthly progress reporting date 1, and Six monthly progress reporting date 2 will not be required from Capacity Providers awarded obligations in the replacement T-1 auction. The Substantial Completion Milestone is not on the list because there is currently no termination event attached.

Annex B – overview of impacts

A separate Impact Assessment has not been prepared for these changes as they relate to the maintenance of the CM and the existing regulatory standard to maintain 3 hours loss of load expectation (LOLE). LOLE is the expected number of hours during the year (before any mitigating / emergency actions are taken) when demand is higher than available generation, after all system warnings and System Operator balancing contracts have been exhausted.

The CM was subject to a full Impact Assessment when it was first introduced. It will be subject to further assessment as part of a statutory review that will report to Parliament later in 2019, to meet review requirements under the Energy Act 2013 and the Principal Regulations.

Broad figures and an overview of impacts are set out in proportionate analysis below.

Replacement T-1 auction - National Grid recommended in their 2018 Electricity Capacity Report that 4.6GW of capacity should be procured in the T-1 auction to maintain the standard 3 hours LOLE to ensure security of electricity supply in Winter 2019/2020. If the regulatory changes are not made, the T-1 auction cannot be run and this capacity will not be procured which may increase the LOLE above 3 hours. 465 Capacity Market Units (CMUs) with almost 14GW of capacity prequalified for the postponed T-1 auction scheduled for January 2019.

Deferred payments – The value of deferred payments is uncertain because it is dependent on the duration of the standstill period. But for context, there are 321 CMUs that secured agreements in the 2014 T-4 auction that are due forecast payments of £956m for the delivery year 2018/19. There are a further 218 CMUs that secured agreements in the 2017 T-1 auction that are due forecast payments of £35m for the same delivery year.

Obligations under and enforcement of existing agreements – The legislation makes modifications to obligations under existing agreements to reduce the regulatory burden on some companies. The impact of this is difficult to quantify but the figures below provide an indication of the scale of companies involved.

There are 100 CMUs with capacity agreements for the 2021/22 delivery year with a total of over £8m of credit cover. There are 41 new build CMUs with capacity agreements for the 2021/22 delivery year who must meet the Financial Commitment Milestone (FCM) by 20 June 2019. We are extending the time available for these CMUs to meet the FCM to whichever is the later of: 31 March 2020; or five months following the domestic law trigger signalling end of the standstill period. The increase in credit cover, due by 13 March, will be waived for any that have not achieved their FCM within 11 months of the 2018 T-4 auction.

There are 9 CMUs with capacity agreements for the 2020/21 delivery year due to provide a deferred connection agreement by 29 March 2019. We intend to delay this deadline until one month following the domestic law trigger signalling the end of the standstill period.

Administration of agreements, termination fees and appeals - It is not possible to quantify this impact as it will depend on the number of terminations during the standstill period which is highly uncertain.

Annex C – list of respondents

ADE	Mercia Power Response
Ameresco Ltd.	National Grid (EMR)
BOC	National Grid Interconnector Holdings
Bryt Energy	NWG
Carlton Power	Peak Gen Top Co Ltd
Client Earth	Plutus PowerGen
Drax	Renewable Energy Association
EDF	RES Group
Emma Rosling	RWE
Energy UK	Scottish Power
Enel X UK	Smartest Energy
Engie	Triton Power (Saltend Cogeneration Company Ltd)
ESB Energy	UK Power Reserve
First Utility	Uniper Energy
Foresight Group	University of Surrey
Gazprom Energy	Utilita
Green Frog	VPI Immingham LLP
InterGen	Welsh Power
Limejump Ltd	

*we also received 24 confidential responses from various organisations.

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

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