The voice of the energy industry

Energy UK response to Proposals for Further Amendments to the Capacity Market

5th April 2019

About Energy UK

Energy UK is the trade association for the GB energy industry with a membership of over 100 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership encompasses the truly diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 27 million homes and every business in Britain. Over 730,000 people in every corner of the country rely on the sector for their jobs, with many of our members providing lifelong employment as well as quality apprenticeships and training for those starting their careers. Annually, the energy industry invests over £11bn, delivers £88bn in economic activity through its supply chain and interaction with other sectors, and pays £6bn in tax to HMT.

Executive Summary

Energy UK welcomes the opportunity to respond to the Proposals for Further Amendments to the Capacity Market consultation. The Capacity Market (CM) standstill is continuing to have an unprecedented impact on energy market participants. With Capacity Providers facing ongoing financial pressures due to the absence of capacity payments, Government must continue to address this as a priority, to avoid failure to deliver capacity and ensure security of supply.

We are encouraged by measures being taken by government to maintain the CM operating in the standstill period and preparing for the CM to recommence pending the outcome of the European Commission's review of the CM. Energy UK continues to support the Government's view that the CM is the most appropriate way to competitively procure capacity among a wide range of technologies to ensure the security of supply. Capacity Providers are currently experiencing financial concerns as the major revenue stream that the CM provides is being withheld.

We agree with proposals to replace the scheduled T-4 auction with a T-3 auction. Some Energy UK members consider running a full new pre-qualification exercise to be unnecessary. It may be more efficient to carry over the 2018 pre-qualification for the T-4 auction to the replacement T-3 auction for existing Capacity Market Units (CMU) (so long as there have not been material changes since) whilst also giving these CMUs an opportunity to opt-out. This would provide value to those parties. We note, however, that a pre-qualification process would still be required to allow new CMUs to bid in and for pre-qualification to be completed for those CMUs that have changed since the previous pre-qualification.

Proposals to allow the participation of renewable technologies in the CM is also welcomed and applying the de-rating factor methodology is appropriate. However, there should be scope for the de-rating factors to be modified, and it should be an evolution of work to analyse performance data, particularly around regional performance in Great Britain. Further, most of Energy UK's membership agrees with the amendments to the interconnector de-rating methodology, and the separate de-rating factors of component technologies making up hybrid CMUs.

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Question 1 Do you agree with the proposal to run a T-3 auction for delivery year 2022/23?
Energy UK agrees with the proposals to run a T-3 auction for delivery year 2022/23. Government should be aware, however, that the shorter timescale between the auction and the delivery year restrict the ability for new-build CMUs (such as new-build gas turbines) to compete for contracts in the replacement T-3 auction.

Question 2 Do you agree that the amendments to the usual T-4 auction design/process proposed above are appropriate for this T-3 auction?
We agree, that a pre-qualification for the replacement T-3 auction is a vital process in order to enable the newly-proposed technologies (wind and solar) to actively participate in this auction, and also for those CMUs that have experienced material changes.

We see an opportunity for existing CMUs, however, that have already successfully pre-qualified for the postponed T-4 auction in summer 2018. We consider it more appropriate to allow these parties to carry over the summer 2018 pre-qualification outcome to the replacement T-3 auction. Pre-qualification is a high risk, resource intensive process, which has in the past resulted in CMUs failing due to minor administrative errors. For some parties, the pre-qualification process can also prove to be financially intensive, particularly if the final decision is negative, resulting in high appeal costs. Although there is evidence to show that in the past it has been possible for Capacity Providers to manage multiple pre-qualifications in the same window (for example the T-4 for 2020/21, T-1 supplementary auction for 2017/18 delivery and the T-1 transitional arrangements auction for 2017/18 delivery), this could be an appropriate measure to reducing barriers to participation of this auction, as this was deemed as unfavourable by many participants.

Another pre-qualification could cause issues for Demand-Side Response (DSR) providers. If existing pre-qualified CMUs were to be carried over for the proposed T-3 auction (so long as no material changes are declared), this could avoid any unnecessary disincentive to DSR providers customers, from having to engage in a further, onerous pre-qualification process, and therefore difficulty for DSR providers to secure commercial agreements with customers (to reduce energy demand). Some DSR members of Energy UK have also highlighted that customers to DSR may be easier to obtain in the scenario of an 8-week pre-qualification period.

We would urge BEIS to confirm that following the pre-qualification session the order of the auctions will be first T-1 for 2020/21, then T-3 for 2022/23 and finally T-4 for 2023/24. We recognise that, in principle, the T-3 should (in its original T-4 auction form) already have occurred. However, since it has not occurred, it makes decision-making for participants clearer and easier if the T-1 auction for 2020/21 is held first. There will be a reduced requirement for participants to price risk into their bids if auctions for early delivery years occur before those for later delivery years.

With regards to the Capacity Target, Energy UK believes that it would be more efficient and cost effective for an appropriate break between the T-3 auction and T-4 auction to allow time for an accurate Target Capacity to be published for industry. Participants will need time, however, to take into account the outcome of the T-3 auction and to any parameter changes. We would urge government and the Delivery Body to minimise the extent of parameter changes to ensure that the T-3 and T-4 auctions proceed efficiently. If there are significant parameter changes, the period must be sufficient for participants to adjust for the subsequent T-4 auction. This interval must not be longer than absolutely required, and any extensive delay may start to compromise the ability of some capacity providers to meet the T-4 Substantial Commitment Milestone (SCM). This would be on top of difficulties for new build CMUs in being able to meet the SCM for the T-3 auction.

Energy UK also notes that some members would see value in re-adjusting the amount of capacity available from the proposed T-3, and increasing the amount of capacity available in the supplementary T-1 for the delivery period, to allow Capacity Providers to bid in at a time when there is more certainty in the CM. However, it is worth considering that this would not be appropriate for participants that would see it favourable to bid into the T-3 over the T-1, and could disincentivise new build CMUs.

Question 3 Are there any further issues that the Government should consider in implementing the T-3 auction?
Energy UK supports the Long Stop Date for T-3 capacity agreements remaining the same.

Pre-qualification for the T-1, T-3 and T-4 auctions should not start until after the T-1 2019/20 capacity auction has been completed and the results confirmed. We would encourage the Delivery Partners to publish an indicative timeline for pre-qualification for the for the T-1, T-3 and T-4 capacity auctions alongside the T-1 2019/20 capacity auction timeline as soon as possible would enable capacity providers to manage resources more effectively to meet the additional requirements over summer 2019.

The auction timetable for the T-1, T-3 and T-4 auctions should be fixed once the legal framework to proceed with the replacement T-3 auction is in place. To allow prospective CMU credit cover to be posted and to provide clarity on other pre-auction delivery milestones to be facilitated and the resultant timescales to complete internal approvals, we propose that there should be a set minimum period of eight weeks before the start of the T-3 auction. It may also be prudent to use this legislative opportunity to put in place contingency measures in the event of a delay to state aid approval, such as making agreements conditional on state aid approval.

There remain considerable issues with the functionality of the Delivery Body's portal both for pre-qualification and for other activities. BEIS should reflect on how much easier it would be for participants to deal with the workload issues referred to in the consultation if the portal was more appropriately designed. Unfortunately, timescales are now such that no major improvements are likely to be implementable by the Delivery Body in time for summer 2019.

Nevertheless, we encourage BEIS to take the opportunity to engage with the Delivery Body and industry to determine whether or not we should now look to replace the current portal with a new design for the CM for 2020 and onwards.

Question 4

4a. Do you agree with the addition of generating technology classes for these renewable technologies to Schedule 3 of the CM rules?
Energy UK agrees with the provisions to make renewable technologies able to compete for capacity agreements subject to the condition that a project is not receiving any other form of support for their output.

An issue that should be addressed in Ofgem's upcoming Five-Year Review is of the current process of ex-ante secondary trading needing to be declared 5 days prior to the delivery period. The intermittent nature of renewables and its reliance on weather conditions, of which forecasts become more reliable closer to the point of delivery, means that enabling secondary trading to take place closer to real time is necessary. Changing secondary trading rules will be key to enable participation of these technologies, and should be taken into consideration in these proposals.

4b. Are you in agreement that the Equivalent Firm Capacity methodology should be applicable to wind and solar technologies, if and when it is deemed appropriate by the Delivery Body? If not why not and what alternatives would you propose, if any?
We are in agreement that the EFC methodology should be applicable to wind and solar technologies. It should be recognised that further refinement of modelling assumptions is likely to become necessary as more data becomes available. We believe there should be a robust process for developing and refining the modelling approach with industry input and consultation.

As more data is gathered through renewables' participation in the CM, data should be used to inform de-rating factors on a regional basis in Great Britain, based on historical performance. This avoids comparing a high output CMU with optimal generating conditions, to a low-output CMU with poor generating conditions related to location.

We note that the consultation confirms there will be a need to devise a de-rating methodology for existing renewables assets whose current Renewables Obligation (RO) subsidy has expired. Energy UK recognises that other potential capacity providers previously supported under other expired subsidy systems such as Feed-In Tariffs and Contracts for Difference could meet the requirements of the CM, therefore BEIS should consider recognising this to ensure a consistent policy approach.

We note also the suggestion in question 5a, that interconnectors would continue to be de-rated on an average basis (for both new and existing interconnectors) which appears to be inconsistent with the proposed treatment of renewables.

4c. Are you aware of any additional Low-Carbon Supports or funding programs that need to be accounted for or monitored to ensure that wind and solar technologies participating in the CM are not receiving State aid from other sources?
We are not aware of any other renewable support schemes that would need to be accounted for or monitored.

4d. Do you agree that the existing approach of separately de-rating the component technologies included in a hybrid CMU containing renewable technologies is appropriate to use until reliable data on their observed performance is available? If not, what alternative methodology would you propose?
Energy UK agrees that the existing approach of de-rating technologies in hybrid CMUs including renewable technologies is correct. We believe that, at present, this methodology is most appropriate, however, as more reliable data on their observed performance becomes available in future, it should be made possible to amend this approach.

Some members of Energy UK are encouraging of individual CMUs being charged with setting their own de-rating factors, if agreed by National Grid Delivery Body. This would allow them to use their own commercial knowledge to manage their own risk against their delivery, to better meet the needs of demand. Although outside of the scope of the proposals in this consultation, this would be a consideration for the CM Five-Year Review, and Energy UK would welcome confirmation from BEIS that the CM Five-Year Review is still to go ahead as planned.

4e. Do you have any evidence of the impact the addition of technologies noted in 4a will have on your business, or are you aware of any impacts we have not considered above?
No comment.

Question 5

5a. Do you agree that the historical 'floor' should be removed from the legal interconnector de-rating methodology? What are your views on how historical data should be used in future to inform the setting of interconnector de-ratings?
Energy UK's generating members (including DSR) agree that the historical 'floor' should be removed from the interconnector de-rating methodology. They are concerned that the floor may distort interconnector de-rating factors and therefore believe it should be removed. Energy UK generating members are of the understanding that the floor has, historically, artificially increased the de-rating factors applied to interconnectors. However, we are aware that National Grid Ventures has a view to the contrary. Submissions of specific representation to this point from all members will be submitted in individual responses.

Energy UK generating members believe that historical data on prices and flows between interconnected markets should not be used to support the validation of modelling of future price differentials. Price differentials will increasingly depend on the correlation of weather (temperature, solar irradiation and wind speed) between interconnected markets. National Grid Ventures holds a differing opinion to that of Energy UK generating (including DSR) members, and would argue that this is not the case.

5b. Do you have any further comments or suggestions on the proposed interconnector de-rating methodology?
Energy UK notes that the current methodology to de-rating raises contrary views. Some generating members of Energy UK have opened discussions with BEIS, Ofgem, and National Grid, representing their views on the opaqueness of the methodology, which therefore, needs to be addressed and reviewed.

Energy UK welcomes Government and National Grid's initiative to hold an annual workshop where industry participants can subject the methodology to review and improvement; taking account of new information.

Question 6 Do you agree with these proposed corrections and additions?
We do not support BEIS's proposal to amend numbering of sub-paragraphs for 9.2.6. This seeks to introduce additional and unnecessary criteria to Acceptable Transferees (9.2.6. (a, b and c) who should, by default, in the CM Rules already able to participate in secondary trading. This CM Rule has been discussed at length at Ofgem's winter 18 stakeholder workshops with many participants in attendance agreeing that the sub-paragraphs should only apply to 9.2.6 (d). We encourage BEIS to delegate the review of the more intricate rule changes on secondary trading in this consultation to Ofgem, to be considered holistically in their CM Five-Year Review.

However, Energy UK supports BEIS's remaining proposed changes to the CM Rules and Regulations. We consider that these proposals are in line with the original mechanism intent.