The voice of the energy industry

Energy UK response to Capacity Market Consultation on Future Improvements

5th March 2020

About Energy UK

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering almost all (90%) of both the UK's power generation and energy supply for over 27 million UK homes as well as businesses.

The energy industry invests over £13.1bn annually, delivers around £85.6bn in economic activity through its supply chain and interaction with other sectors, and supports over 764,000 jobs in every corner of the country.

Executive Summary

Energy UK welcomes the opportunity to respond to the Department of Business, Energy and Industrial Strategy's (BEIS) Capacity Market (CM) consultation on future improvements. In general, we are supportive of BEIS's proposals. We recognise the intention to enable all relevant capacities (other than interconnectors) to access multi-year agreements, if demonstrably required. We, however, do not expect a large amount of Demand Side Response to come to market with a multi-year agreement due to it not being able to meet the CAPEX threshold, this may need to be reviewed in the future to account for other factors that would make a multi-year agreement necessary. We support the position that a one-year contract should be the default, and that multi-year agreements should be for requiring circumstances. When addressing the coming to market of multi-year agreements for all capacities, as a matter of principle in the CM, requirements and obligations should be technology neutral, facilitating a level playing field, whilst also trying to reduce unnecessary burden, as committed to in the Five-Year review.

In regards to the implementation of Regulation 2019/943 of the European Parliament on the internal market for electricity (recast) 2019 Article 22 (4)[1], and ACER's subsequent opinion on the calculation of CO2 emission limits[2], Energy UK does not deem BEIS's proposals to submit data for the year prior to prequalification to exhibit the ability and intention to comply with the 350kg/kWe (the "yearly limit") appropriate. This is unfavourable and restrictive to the running of a Capacity Market Unit (CMU) and unnecessary administrative burden. A self -certified declaration is suitable followed by appropriate monitoring to ensure compliance.

I can confirm that we are happy with this consultation to be published.

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0943&from=EN

[2] https://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Opinions/Opinions/ACER%20Opinion%2022-2019%20on%20the%20calculation%20values%20of%20CO2%20emission%20limits.pdf

1. **We would welcome your views on the impacts that access to multi-year agreements might have on Unproven DSR participation in the capacity auctions, including on levels of participation and bidding behaviour.**

Energy UK agrees with the principle that the CM must be technology neutral, and should be a level playing field. In the context of this consultation, we agree that all capacities (other than interconnectors[3]) should be able to access multi-year agreements, so long as the relevant CAPEX thresholds are met.

Interconnectors are an important asset to resource adequacy, and should be able to access appropriate revenues to recognise this and this should be addressed through the methodologies and common rules for cross-border participation in capacity mechanisms, recently published for consultation by ENTSO-E[4]. This being said, interconnectors should not be able to access multiyear agreements as this would implicitly act to delay the movement to direct foreign participation until these agreements come to a close, and the current model is merely interim. Cross-border participation in capacity mechanisms should be implemented as soon as practically possible.

In our experience, the overly burdensome process of achieving prequalification in the CM has acted as a deterrent in the past to the customer of DSR providers. This could be significantly reduced if multi-year agreements were accessible, and prequalification was less frequent. However, the obligation of being tied into agreements longer than one year may also act to disincentivise participation. Therefore, we believe that there will be relevant DSR Capacity Market Units bidding for both multi-year, and single year agreements depending on suitability. It could then be assumed that this would incentivise a greater proportion of DSR to participate in the CM.

It is Energy UK's view that there will be limited uptake of multi-year contracts from DSR CMUs. This is largely due to the CAPEX threshold required, and DSR not being able to meet this except in very particular scenarios. DSR is fundamentally a low CAPEX intense capacity, and therefore, some DSR providers would see value in the criteria to assess multi-year eligibility to be addressed. We would expect UK Government to review the appropriateness of this, to understand whether DSR is being appropriately rewarded.

It is difficult to predict the bidding behaviour of DSR of these changes were to be brought forward, as it will be entirely dependent on individual Capacity Market Units (CMU) and their cost for coming to market. The CM in its design encourages CMU's to be as competitive as possible in relation to the assumed marginal CMU. Therefore, if a DSR unit was able to meet the relevant criteria to access a multi-year agreement, it could be assumed that it would put forward a lower bid than if it were to access a single year contract. If the CAPEX, however, were to meet the threshold for a relevant multi-year agreement, then this in itself would require a higher clearing price in order to generate the required return

2. **Is the proposed application of the CAPEX thresholds for Unproven DSR fit for purpose? In particular: (i) the definition of CAPEX for Unproven DSR (ii) the application of thresholds at CMU level (iii) the 77-month cut-off date. Should we reduce the cut-off date for DSR seeking to access multi-year agreements?**

We support the continued implementation of the CAPEX threshold to determine accessibility to multi-year agreements, however, as it is UK Government's intention to allow DSR to access multi-year agreements (where appropriate) we do not foresee this criterion bringing multi-year DSR agreements forward. Multi-year agreements should only be awarded in necessary circumstances, and by design, the CM should maintain a principle of one-year agreements being the default awarded. Single year contracts ensure that the CM delivery year in question remains market reflective in cost, acting in the interest of the consumer. This also ensures that the CM remains open to new capacity entering the CM, and ensures continued liquidity.

The additional reference for the definition of what should be included in the CAPEX threshold is concerning as it is a deviation away from industry practices which have been developed and are suitable for this purpose. It is unclear from the consultation whether this definition would refer to all capacities,

[3] Interconnectors being able to access multi-year agreements would act to delay the proposed direct participation of foreign capacity in the CM.

[4] https://consultations.entsoe.eu/markets/proposal-for-cross-border-participation-in-capacit/

of just unproven DSR, and we would welcome clarification. Although we acknowledge the intention for clarity or what should be assessed as CAPEX, the addition of *"CAPEX of Property, Plant and Equipment which has the primary purpose of delivering capacity"* creates some ambiguity. For example, this would raise concerns that it would not account for high-cost activities for commissioning generation, such as, testing, connection design and agreement, and permitting, which would otherwise be captured by International Accounting Standard 16 (IAS16). We recognise the urgent need for guidance to be produced with appropriate engagement and consultation with stakeholders, clarifying what should be included in the CAPEX of a project.

In order to maintain a level playing field in the CM, we believe that it would be appropriate to assess CAPEX on a CMU level rather than component level, in line with generation. This would maintain simplicity, as the calculation for the CMU's £/kW would be maintained, however, we agree that for verification that DSR CAPEX should be componentised.

Similar to how the Rules were implemented at the CM's conception, where generation could meet the CAPEX threshold up to 77 months in the past, we would deem it appropriate for this to be maintained in line with the thinking in 2014. However, there may be value in enabling a CMU to participate in a later auction if it were to be unsuccessful (i.e. the following T-4 auction), and it had been unable to complete commissioning due to this. A unit's success would still be reliant on being competitive in the pay-as-clear CM auction format.

3. **Do the proposed additional checks at prequalification provide sufficient certainty that the CAPEX thresholds will be met by Unproven DSR? If not, what additional requirements should be applied at prequalification?**

We believe that the additional checks should replicate the requirements placed on generation as much as possible, and the proposed additional checks would be appropriate.

4. **Is the proposed increase in credit cover for Unproven DSR bidding for a multi-year agreement suitable for ensuring that these CMUs will be committed to delivering their capacity, and will it prevent Unproven DSR from speculatively bidding for multi-year agreements? Is there a need to consider, in addition to increased credit cover for Unproven DSR bidding for a multi-year agreement, draw down of credit cover for Unproven DSR that has its agreement length reduced?**

The increase of Credit Cover for Unproven DSR from £5,000/MW to £10,000/MW for those seeking to obtain a multi-year agreement is consistent with what is required of generation CMU's and therefore, Energy UK supports this approach. We recognise the need to deter speculative bidding and this has proven to be appropriate in the past, however, there is also the need for a strong penalty regime and termination fees in order to disincentivise speculative bidding. It should be recognised that this may act to disincentivise smaller market participants to bid into the CM for multi-year agreements.

5. **Should the Extended Years Criteria be applied to DSR? If so, how could it be applied to turndown DSR?**

It is our understanding that DSR efficiencies do not reduce overtime similar to generation. Extended Years criteria should also be applied to DSR. For both generating and DSR CMUs, the risk of penalties and termination fees should ensure that the CMU provides the capacity required and can leverage secondary trading (and DSR can also use component reallocation) to ensure that its Capacity Obligation is met.

6. **Are the proposed arrangements for a partial release of credit cover suitable for incentivising Unproven DSR with a multi-year agreement to make early progress towards delivery? Is there anything we could change to improve the incentive? Do you agree that Unproven DSR with multi-year agreements shouldn't have to provide progress reports, as is required of generation?**

We see no reason for credit cover to be maintained at full, and support the partial credit cover release milestone, so long as relevant information can be provided, and verified, satisfying commitment to deliver capacity in the relevant delivery years. It is crucial that the termination and penalty regime is appropriately strong in order to disincentivise failure to deliver capacity.

There is some question surrounding the necessity for and Independent Technical Expert as being the most appropriate method for verifying information and declarations. For many smaller CMU's, employing an Independent technical Expert (ITE) is a highly costly exercise, and also, experiences of Capacity Providers have varied of its usefulness. Progress reports in general for all CMU's seem unnecessary. Draft Rules were published shortly before pre-qualification in 2019 that removed the requirement to submit 6 monthly progress reports from an ITE. It is disappointing that these changes were not captured in the final set of Rules. The requirement to submit these 6 monthly ITE reports could be removed for 2020 pre-qualification.

7. **Is the proposed application of the Long-Stop Date to Unproven DSR CMUs with a multi-year agreement suitable? Are there any risks or unintended consequences that we should be aware of?**

We believe that in order to not unfairly disadvantage DSR accessing multi-year agreements, that a Long-Stop date should be applied. Equal CAPEX thresholds would apply to both Generation and DSR, and therefore, this would seem sensible to offer the same framework.

8. **Is the proposed application of the Evidence of Total Project Spend milestone to Unproven DSR CMUs with multi-year agreements suitable, in particular the requirement to componentise costs? Are there any risks or unintended consequences due to the Evidence of Total Project Spend occurring after the start of the delivery year and DSR CMUs being able to reallocate components?**

We believe that the verification of Total Project Spend should be maintained from generation CMU's, to ensure that it does not unfairly benefit one type of capacity to another. Due to the complex make-up of DSR we recognise the requirement to declare to component level, however, it seems unnecessary to declare cost down to this level, this would create unnecessary administrative burden. Existing accounting validation seems appropriate to give reassurance of compliance.

9. **Do you agree that Unproven DSR with multi-year agreements should not be able to increase their capacity obligation after the DSR Test, or be subject to a Minimum Completion Requirement? Please provide reasons. Are there any unintended consequences that may arise from this proposal?**

Energy UK supports the proposal that DSR is not allowed to increase its capacity obligation after the DSR test, or be subject to a minimum completion requirement.

10. **Will the proposed amendment suitably clarify our policy intent and address the issue of standalone storage units being entered into the CM as DSR CMUs?**

We recognise the policy intent to prevent standalone storage from participating in the CM as Unproven DSR, and we do not see any issues with the proposals to amend.

11. **Are there any unintended consequences that may arise as a result of applying storage de-rating factors and requiring extended performance testing for DSR CMUs with multi-year agreements that contains behind-the-meter storage components? Is our proposal to check whether these CMUs contain a storage component through a declaration at prequalification suitable?**

Although we recognise the security of supply concern that government has in regards to behind-the-meter storage coming to market as unproven DSR, the impact of de-rating all unproven DSR with a storage component with storage de-rating could have the unintended consequence of disincentivising

storage, that helps to reduce electricity system demand from energy users. To incentivise participation of energy consumers in the CM to reduce their electricity demand, they must have the option of maintaining some electricity supply on site through auxiliary back up power and not the electricity system. Energy UK would welcome consideration of this whilst implementing the necessary changes to prevent standalone storage from accessing the CM as DSR.

12. **Is the proposal to restrict each DSR component to being used only once to meet Evidence of Total Project Spend requirements sufficient to prevent gaming through component reallocation? Do we need consider preventing DSR with multi-year agreements from reallocating components until the cut-off date has passed?**

We agree that a DSR component should only be used once to meet the Evidence for Total Project Spend, and that the onus of compliance with this should be placed on the Capacity Provider. Although it would seem astute to collect all serial numbers and identification numbers of all components, this would be hugely burdensome on DSR providers, and seemingly unnecessary.

Additional restrictions on component reallocation seem unnecessary in the context of multi-year agreements, so long as the cost can only be attributed to the CAPEX once. Any additional restrictions could act to impede the ability to replace failed components. Rules should be put in place to prevent CMU components being re-located and accounted for again in the Total Project Spend, whilst maintaining the ability to replace failed components.

13. **If we allow DSR with multi-year agreements to reallocate components, is the proposal for an annual repeat of the DSR Test for CMUs that have reallocated components (in line with current arrangements for DSR) suitable and are there any unintended consequences that may arise?**

Energy UK is unaware of any unintended consequences from maintaining the current arrangement for annual repeats of the DSR test for CMUs that have reallocated components.

14. **Are there any unintended consequences which may arise from preventing Unproven DSR CMUs with a multi-year agreement from secondary trading until after completing the DSR Test?**

From current understanding, we are not aware of any unintended consequences of not allowing Unproven DSR to participate in secondary trading without completing a DSR test. Energy UK supports this principle.

15. **Are further legislative changes required to enable DSR to access longer-term agreements, which have not been identified in Section 2.1 of this consultation? Please provide details.**

In the context of this consultation, and with the proposed continuation of the CAPEX threshold, Energy UK does not deem any changes necessary. However, it would be prudent of UK Government to maintain under review how to best reward DSR capacity providers, and how multi-year agreements should be deemed necessary.

16. **How much participation of CMUs sized 1-2MW do you expect there will be in future capacity auctions and what impact might this have on auction liquidity and price?**

As a matter of principle, Energy UK supports the reduction of the CMU floor from 2MW to 1MW, and this should increase participation in the CM. It is difficult to predict the appetite of those units to participate in the CM, however, by opening up the market to more participants, this will ensure that the CM maintains security of supply at the lowest cost to consumers, a product of greater liquidity and competition in the market. It will also allow those larger units that currently require aggregation to participate directly in the market, if the commerciality of such a move makes sense.

We support the commitment to maintain the review of the CMU capacity floor.

17. **Are there any unintended consequences which may arise from formalising the 50% set-aside commitment and the 95% confidence interval methodology in legislation?**

We have long supported the commitment by UK Government to auction at least 50% of the set-aside target capacity for the T-1 auctions. This is a key enabler for many technologies, including DSR, which do not see value in multi-year agreements, and also, to allow certainty of availability closer to delivery year, and therefore reducing risk of penalty or termination fees.

Energy UK does note, however, errors in capacity tendered could results in over procurement from required. This formalistion of this commitment does require greater accuracy in capacity forecasting, to maintain confidence in the T-1 auctions.

18. **Are you aware of any new capacity types not currently participating in the CM which can effectively contribute to addressing the generation adequacy problem? If so, please provide details.**

We are not aware of any further, or emerging technologies that are currently not able to participate in the CM that could improve generation adequacy.

19. **Do you agree with the proposal to introduce a new duty on the Secretary of State to review annually whether there are any new capacity types, not currently participating in the CM, which can effectively contribute to addressing the generation adequacy problem? We would welcome your views on the scope and steps of the review itself.**

Energy UK supports the continuous review of technologies able to participate in the CM, to enable the immediate entrance into auctions of technologies that can evidence its ability to improve generation adequacy.

20. **Do you agree with the proposed reporting and verification mechanism, outlined in this section? Please set out your reasons.**

In terms of emissions declaration, and running profile if meeting the yearly emissions limit, Energy UK agrees that this is appropriate for the pre-qualification of a CMU.

We agree that all reporting should be independently verified. We would welcome, however, clarification surrounding the sub-1MW exemption threshold for not requiring its emissions to be verified by an independent verifier, and how these submissions would be verified to be accurate. Without an appropriate verification process, this could open the CM up to gaming to avoid the emissions verification burden. We do not disagree with the proposal to not require an ITE to verify the declarations, and welcome efforts to reduce unnecessary burden, we also welcome the ability to carry declarations over into consequent delivery years.

CMU's currently participating in the European Union Emissions Trading Scheme should be allowed to use its emission factor for CO_2. This would create significant, unnecessary burden if not allowed. We encourage UK Government to include this, however, with the condition of *"if a participant of a recognised Emission Trading Scheme".*

21. **Do you have any views on the proposal that applicants in respect of Unproven DSR will be allowed to declare in their prequalification applications that they commit to recruiting only components that comply with the emissions limits, and to provide an updated declaration as part of the notifying DSR components milestone?**

Energy UK agrees with the logic of allowing Unproven DSR to update its Fossil Fuel Emissions Declaration as part of the Notifying DSR Components milestone. However, we believe that if the DSR CMU was to be found to be exceeding the emissions limit as outlined in the Clean Energy Package, then this should be subject to a robust penalty regime and termination penalty, if necessary, as would be applied to generation CMUs.

22. What are your views on the proposal in section 2.5.4 for requiring reporting for CMUs which seek to take advantage of the yearly limit?

Although we acknowledge the principle behind requiring one year of emissions data to understand the commercial running of a higher emissions Unit, demonstrating the ability of a unit to restrict its running in order to meet the yearly limit in the year prior to prequalification for delivery in four years-time is unreasonable. The unit restricting would do so to the detriment of its market activity in speculation that a CM agreement may be secured. This could have unintended impacts on security of supply. We would deem that it is suitable for a declaration of self-certification of running profile to commensurate the requirement in the delivery year, followed by a monitoring regime to ensure compliance over the delivery year to be suitable. Any failure to adhere to this commitment should result in the repayment of CM payments. We do not deem penalties necessary in the situation of exceeding running limits, as the capacity need has been delivered in line with the aim of the CM.

It is our view that being required to provide independently verified data, ending before prequalification would be unfavourable for all parties. This proposal would create a surge in work for ITE's, and would result in applications being submitted shortly before the application deadline, in turn, creating more work for the Delivery Body. This could be greatly mitigated by accepting a declaration of self-certification of running profile to commensurate the requirement.

It is worth noting that Section 6b of the ACER Guidance on the calculation of the values of CO2 emission limits[5] sets out the equation to determine a limit on operational hours commensurate with the annual emission limit. Although this is provided in the context of operating a Strategic Reserve Mechanism the equation can be used generally and provides a method for determining the maximum plant operational hours consistent with the Regulation on the internal market for electricity (recast) 2019.

23. What are your views on the proposal in section 2.5.6 for not establishing a monitoring regime as advised in the ACER opinion?

Energy UK agrees with UK Governments reasoning that in line with ACER's guidance the required monitoring categories do not apply to the GB market. If the proposal is adopted to allow plant to pre-qualify based on a commitment to limit operational hours then *"c) Generation units that, based on the provisions of point (a) in Section 6 of this Opinion, have participated in a capacity mechanism (validation of the Specific Emissions)"* will need to be revisited. Energy UK's position is that a check on actual operation hours that are reports to Environmental Regulators or alternatively a restriction on operational hours could be enforced via Environmental Permits, but only for the years in which the plant was participating in the CM.

24. What are your views on the proposal in section 2.5.7 for not applying the emissions limits to waste to energy plants?

Energy UK supports the maintenance of the CM Rules as originally drafted, incentivising waste-to-energy, and not deeming it under the definition of fossil fuel.

25. Do you have any further comments or any suggestions on how the proposed emissions limits reporting and verification mechanism could be improved?

Energy UK does not have further comments or any suggestions on how the proposed emissions limits reporting and verification mechanism could be improved

5 https://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Opinions/Opinions/ACER%20Opinion%2022-2019%20on%20the%20calculation%20values%20of%20CO2%20emission%20limits.pdf

26. Do you agree that it is appropriate to remove the exclusion on Long-term STOR? What would you expect the impacts of removing the exclusion on Long-term STOR to be? Are there any unintended consequences that may arise from removing the exclusion?

Energy UK does not have views on the removal of the exclusion of Long-term STOR. As a matter of principle, Energy UK supports that the CM should be able to be stacked with other products. We would welcome further clarity around the new evidence that BEIS is aware of that deems that windfall profits will not be presented in the future (considering BM availability payments also) for all assets in the CM, including foreign capacity.

27. Do you agree with our proposals to require additional information to be added to the CM Register? Do you agree this will advance our fraud and error objectives? If not, can you please provide reasons?

Energy UK supports UK Government in its proposals to improve its monitoring to prevent fraudulent behaviour within the CM, and as this information is already provided, does not have any objections to this being included in the CM Register. We understand that this would not result in additional administrative burden to Capacity Providers, and would provide for easier information sharing between Delivery Partners.

28. Do you agree with our proposal to require that the same information requirements should apply to capacity providers who already hold capacity agreements?

We believe that all information required of new applicants to monitor and prevent fraudulent behaviour should apply to both new and existing participants of the CM.

29. Do you agree with these proposed corrections?

Energy UK supports these minor corrections to the Rules. We also understand that aggregation members of Energy UK have encountered concerns with some amendments, and will be addressing them in their individual response for correction. Of note is Rule 3.7.1. that the Applicant must declare that it will obtain all Relevant Planning Consents and will have the Legal Right to use the land. There are some scenarios where a Capacity Provider acts as the aggregator and the Dispatch Controller, but does not own the site. In the situation where a New Build or Refurbishing asset is being bid into the CM, the Capacity Provider as the Applicant acting as the Dispatch Controller, but not the Legal Owner, it is not appropriate for the Applicant to make the declarations required under Rule 3.7.1.

Matthew Deitz
Policy Manager, Power
Energy UK
26 Finsbury Square
London
EC2A 1DS
Tel: +44 20 7747 2942
matthew.deitz@energy-uk.org.uk
www.energy-uk.org.uk