

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

10th January, 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 this urgent consultation issued by BEIS. We share in the Government's continued belief that the market-wide Capacity Market (CM) is fundamentally the right mechanism for promoting the necessary investment to maintain security of supply. Added to which, in facilitating competition, we are confident that it has helped deliver substantial cost benefits to the consumer.

The recent General Court of the European Union ruling surprised our membership and the wider energy sector. The CM has for five years underwritten hundreds of millions of pounds of investment in a diverse range of new and existing plant in order to guarantee security of supply during our transition to a low-carbon market. As such, ensuring that the CM is reinstated as quickly as is practicable and the standstill period is managed effectively is even more important while recognising the need to work closely with the European Commission (EC) to achieve a robust decision.

As we detail below, the reinstatement of the CM supplier charge should take place as soon as is possible using the existing Electricity Settlements Company (ESC) model, along with the associated credit cover requirements. Should this not be deemed viable then we would similarly support an expedited delivery of the Balancing Settlement Code (BSC) modification currently in development.

Whilst we believe that the replacement T-1 auction should take place as soon as possible, we would urge BEIS to do whatever possible to avoid it taking place in parallel with prequalification for subsequent auctions. We have concerns that the resource availability in both industry and delivery partners would be stretched beyond what is practical.

We would advise BEIS to reconsider the potential suspension of the mock stress event. Considering the uncertainty that the General Court's judgement has fostered within the market, there is an increased need to ensure that once the CM is reinstated that it can effectively manage stress events as this uncertainty could create a greater likelihood of such eventualities.

This uncertainty has extended to the developers looking to build new plant and it has had serious implications for financing of these projects. To minimise the loss of project pipeline developers could be allowed to defer their future delivery years and new-build obligations providing they can prove that they can deliver in order to receive payments upon reinstatement of the CM.

Under CM Rules secondary trading takes place following a T-1 auction; considering the challenges posed to the market and security of supply following this ruling, we believe that for this extraordinary auction secondary trading should be allowed prior to the T-1 top-up auction. We believe that this could be done through a simple, short-term change to the CM Rules. Whilst normally addressed by Ofgem, considering the impact on the volume Government procures, we would appreciate that BEIS reviews this issue.

BEIS's leadership and open engagement with industry has been invaluable in the process to-date. We appreciate the efforts underway to reinstate the CM and will continue to support the Government in this aim in any way that we can. We welcome any further early signposting that the Government can provide for the timetable of events throughout 2019.

Should you have any questions regarding this consultation response then please do not hesitate to get in touch via the details below.

I can confirm that this response may be published on the BEIS website.

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Responses to Questions

Q1 Do you agree that the amendments to the usual T-1 auction design/process proposed above are appropriate for this replacement T-1 auction?

We support the proposed amendments, with some changes detailed below, and will continue to work with Government and Delivery Partners to ensure that the standstill period is managed as effectively as possible and the replacement T-1 auction's delivery is expedited as far as is practicable.

We understand that BEIS believe that capacity agreements under the T-1 auction cannot be awarded until the end of the CM standstill period to remain State Aid compliant. We would like to understand this further. Some of our members believe it would provide greater assurance of security of supply if capacity agreements were awarded after the auction following the normal process, albeit that the right to payment would be suspended until State Aid clearance had been achieved; this would also put T-1 capacity agreement holders on an equal footing with T-4 capacity agreement holders for 2019/20 delivery year.

Provided that it is clear that there is no commitment to make any payment to capacity providers unless State Aid clearance is obtained, then we believe that the issue of capacity agreements with the right to CM payment suspended would be compliant with the requirements of the State Aid standstill.

In all other respects the information requirements etc. could remain as they are for existing agreements (other than perhaps a delay in some deadlines to take account of the auction being held later in the year). T-1 top up capacity agreement holders would have obligations to deliver capacity for the full 2019/20 Delivery Year even if State Aid approval is delayed beyond 1st October 2019. This would minimise risks to security of supply. This approach would also simplify the changes required to Regulations and CM Rules and avoid the need to reallocate all milestones to one of the two new deadlines proposed by Government¹.

We would welcome clarity as to what BEIS intends to do if the CM standstill period extends much longer than currently anticipated as we note the statements at the bottom of page 8 that "the Secretary of State would retain the power to decline to activate the T-1 Capacity Agreement trigger (for example, if State Aid approval was delayed until a time when the award of agreements is no longer the most effective way to secure capacity for the 2019/2020 delivery year)". This creates unnecessary uncertainty over whether capacity providers will receive CM payments for meet their obligations. Government should provide assurance that it intends for holders of T-1 top up capacity agreements to be paid in full for the 2019/20 delivery year, even if the standstill period extends beyond 1st October 2019. We believe it would be appropriate for there to be a requirement in the Capacity Regulations for the Secretary of State to publish reasons providing a full justification for any decision not to activate the capacity agreements.

We also welcome the suggestion that successfully prequalified CMUs may be allowed to withdraw from participating in the T-1 top-up auction as well as allow prequalified CMUs to update details, where appropriate.

Many demand side response providers that pre-qualify assets in to the CM as either 'Existing Generating CMUs' or as 'Unproven DSR', choose to defer the 'Metering Assessment' and 'DSR test' (in the case of Unproven DSR). This is because of the time it takes to install metering equipment and/or the customer sites are unwilling to install expensive metering equipment until successful in the auction. Ordinarily, assets have a sufficient lead time to schedule site load downtime and install meters; this is much more challenging on a tighter timescale, and is especially so in the month of August.

Therefore, Unproven DSR and Existing CMUs on customer assets that require new metering to be installed should also be provided with additional timescales for milestones, notably the Metering

¹ Delivery year readiness deadline and the grace period deadline

Assessment, Metering Test and DSR Test. The T-1 auction is the main auction for these assets – much more so than New Build assets – therefore we believe that the “delivery year readiness deadline” and “grace period deadline” should be extended to Unproven DSR and Existing CMUs.

Consensus within the Energy UK membership is that holders of capacity agreements secured in the T-1 top up auction are unlikely to wish to carry out secondary trading for 2019/20 delivery year. However, holders of capacity agreements secured in the T-4 auction, unsuccessful participants in prequalification and the T-1 top up auction should have the opportunity to carry out secondary trading before the start of the delivery year.

We believe that for this extraordinary auction secondary trading should be allowed prior to the T-1 top-up auction; and that this can be achieved through a simple, short-term change to the CM Rules. This would enable a CMU with a T-4 agreement to trade out the full capacity obligation and associated Satisfactory Performance Day (SPD) requirements for the 2019/20 delivery year if they wished to do so. This will minimise unnecessary risk for capacity providers and will contribute to reducing security of supply risks for 2019/20 by helping to ensure that replacement capacity can be secured where necessary.

We also believe that the CM Register should record the outcome of the T-1 top-up auction for delivery year 2019/20 as it would normally have done following at T-1 auction.

Q2 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?

We note that as capacity payments have been suspended market participants are under significant financial pressure until CM payments can be restarted. We consider that for some plant the large, fixed cost of TEC combined with no CM income could result in early closures or a need to mothball plant. The lead-time to closure (statutory consultations, agreed company notice periods etc) is long, so those anticipating closure at the end of their current CM agreements in September 2019 will need to make announcements on potential closure long before this date (with the impact this has on staff seeking alternative employment, etc). Unless the auction is held early enough, regardless of a delay being offered in the TEC deadline, plant would still need to make the decision to close to avoid carrying large unfunded operating costs beyond September. Therefore, unless the T-1 top-up auction could be held as early as March or April 2019, delaying the TEC deadline may have no impact on participation in the auction.

Holding TEC is another potential source of financial stress for developers. Some of our members believe that if they can prove financial stress – as a direct result of the current circumstances – then there should be leniency in the application of termination fees. The Secretary of State should allow zero charging of termination fees during the standstill period; in such an eventuality the effected CMU would give back their entire agreement and waive any right to future back payments.

Q3 Are there any further issues that the Government should consider in implementing the replacement T-1 auction?

Industry would welcome clarification as to the status of prequalified units and the timing of any future prequalification processes. Following engagement with BEIS and delivery partners we have serious concerns that three separate prequalification processes could be taking in parallel with the replacement T-1 auction. Therefore, we would urge BEIS to ensure that the date for the T-1 auction is set as soon as possible and that the timing of the T-1 auction does not coincide with pre-qualification for future auctions (e.g. the T-1 auction for 2020/21, T-3 for 2022/23 and T-4 auction for 2023/24).

Prequalification is a demanding process and industry will require appropriate sign-posting and clarity as to when this will take place. There have also been well-documented, ongoing issues with the prequalification process and we are concerned about not only industry’s ability to fully engage but also the Delivery Partners’ ability to support such an arduous, resource intensive process. We would support BEIS if the Department opted to roll over the existing T-1 prequalification results.

Considering the series of prequalification processes due to take place in parallel this could be a prime opportunity for Ofgem to progress changes to the prequalification process, namely that if units which have been prequalified can roll forward that prequalification it would streamline the underlying requirements of CM participation and expedite the reinstatement of the framework.

We set out in our response to Q1 our views on ensuring secondary trading can take place in advance of the 2019/20 delivery year. Under the current CM Rules (9.2.5), a capacity provider can only transfer their full obligation (including SPD and other testing requirements) if it is transferred for the whole delivery year. If State Aid clearance is not achieved prior to the end of September 2019 and the T-1 top-up capacity agreements are not 'live' then it is unclear how such a transfer would take place.

There should be a time limit written into the Rules between notification from the European Commission of a positive State Aid decision and the Secretary of State to instruct the Delivery Body to recommence issuing CANs.

Q4 Do you have any comments on the proposed arrangements for making deferred payments to capacity providers for missed capacity during the standstill period, and for making deductions to reflect termination fees or penalties as necessary?

We very much welcome BEIS's intention to make deferred payments and support the statement that suppliers may feel it is sensible to continue to collect money from their customers to fund this charge.

It would be unfair for a CM participant to face termination fees if it is not receiving payments. Furthermore, the value of the termination fee could be subject to change if contract values are reviewed following the reinstatement of the CM. There should be more explicit discretion on behalf of Government regarding CMU's market exit.

Currently the Regulations² set out that the ESC must issue Credit Notes to Providers. For the purposes of establishing a clear audit trail of entitlement to payments following re-instatement of the CM, we believe that the ESC should resume the issue of the information contained in the Credit Notes. The ESC should calculate and issue on a monthly basis a 'CM Standstill 'statement of account'' which would set out CM payments due, penalty fees and termination fees owed. Parties would be able to challenge ESC calculations in the interim if there is any dispute; this would ensure that there is not an enormous reconciliation process at the end of standstill. There would be clarity of each party's position and therefore be better prepared to meet financial obligations. We would appreciate clarity from BEIS as to the process and policy in place should insufficient monies have been paid by suppliers i.e. whether this would be pro-rated or if the Government would step in to fulfil missed obligations.

Q5 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?

We do not support the proposal to withdraw the planned second MSE. The challenges faced during the first MSE demonstrated that there is a pressing need to be prepared for a stress event. As set out in our [June letter](#) to National Grid, we identified a number of issues during the process that we believe need to be addressed urgently and ideally before the next Delivery Year. If this had been an actual CM stress event, we believe that neither the Delivery Body nor the EMRS would be able to demonstrate that the CM Volume Reallocation Register was accurate. This would leave the EMRS open to a challenge under Regulation 74 and put the application of penalty charges or over-delivery payments in accordance with Regulations 41 and 42 at risk. Furthermore, Ofgem and BEIS would need to have engaged in the process as they would have been contacted by affected Capacity Market participants immediately following a stress event. The process as it stands would lead to an unsatisfactory outcome and would leave participants liable for penalties that they have no control over

² Regulation 40

or ability to trade out of. We also believe that there would be significant adverse reputational impact on all energy market participants, the Delivery Partners, Ofgem and the Government.

The consultation says that Government recognises that there may be an increased risk of terminations of capacity agreements whilst the CM is in standstill – this points to an increased potential for a security of supply event. Testing of systems is therefore more important during the standstill period. There was only a small window for the last mock stress event to be held as it could not take place around prequalification or auctions.

Furthermore, we agree with Government's view that all capacity providers should continue to meet their obligations, including SPDs as these are essential to demonstrate performance and would help to ensure that the CM back payments can be made. However, some members view that SPDs should be waived during the CM standstill period as there is an inherent cost of holding SPDs for some CMUs over others and there is no guarantee of receiving CM payments. However, all members agree that all participants should be treated equitably with regards to CM obligations; clarity from BEIS and Ofgem regarding their position on this issue would be appreciated.

Q6 Do you have any comments on the proposed arrangements for the administration of agreements, termination fees and appeals during the standstill period?

Some members acknowledge the need to levy termination fees however, as set out in our response to Q4, this is subject to the assumption that capacity agreements will be reinstated. We would encourage acknowledgement by BEIS that there is a risk that a developer could lose out on a previous capacity agreement but would pay termination fees based on it. We welcome further clarity as to if and when termination fees will be levied as they could be raised after the CM is reinstated and payments are retrospectively made. Such a change emphasises the importance for having a CM Standstill 'statement of account'.

We would welcome clarification on the rationale for extending the date for capacity providers to meet any requirements specified in Termination Notices from 6 to 12 months.

Q7 Do you agree there is a strong case for re-starting collection of the Supplier Charges? If so, what is your preferred option?

We support resumption of the collection of CM supplier charges as soon as possible and we strongly prefer that the existing ESC route is maintained. The ESC route maintains continuity and should enable a quicker implementation rather than via the BSC route. Additionally, it is important to maintain consumer trust and the ESC option gives greater credibility to the collection of CM costs from customers as it is based on legislation rather than industry codes. The code route may be perceived as weaker by consumers and there is a possibility that some larger consumers could test their contract terms to avoid payment. We would, however, appreciate clarity as to the recovery period – we expect that all CM supplier charges will be collected from the 1st October 2018 although it is unclear how the costs associated with those suppliers who have exited will be calculated given that the invoices for those periods before the suppliers exited have been credited and credit cover returned (presumably to the failed supplier administrators).

We note that the profile of the collection of the missing months is different under the BSC mod and the BEIS proposals. If the BSC mod can be implemented more quickly than the ESC, then we support using the BSC as an interim measure, but it would be helpful if the profile of collection between the two options can be aligned. As we understand that the BSC Panel has maintained the power to adjust the mod, if BEIS think such a route is likely they should advise the Panel and Ofgem of the profile they prefer.

The recent shortfall to the 2017/18 Renewable Obligation shows the risk to bringing additional costs in the industry if unpaid charges are built up over a long period of time, so continuing to collect CM Supplier Charges will help to mitigate this risk. We would welcome clearer and swifter enforcement action by the Authority against any supplier that enters CM stage two credit default, these could

include preventing new customer registrations or similar, rather than simply placing the burden on other suppliers via the mutualisation route.

We would also welcome clarity from BEIS as to what happens in the event that State Aid approval is re-approved and deferred capacity agreements paid – but there have been insufficient funds paid into the ESC (due to suppliers exiting). Will the government provide the shortfall, will the invoices be paid on a pro-rated basis (if there is 80% of the funding, would all providers get the equivalent of 80% of their payment and over what timeframe?).

Continued collection of the CM charges is also in consumer interests because:

- It protects industrial and commercial pass-through customers from bill shock and reconciliations which could otherwise destabilise budgets and payments.
- Avoids complicated reconciliations if customers switch supplier whilst collection is suspended, it may be difficult for the previous supplier to recoup historic CM costs.
- The validation of supplier invoices is “business as usual” if the ESC solution is maintained due to a consistent bill format and calculation method.
- For domestic consumers it maintains charges consistent with Ofgem’s price cap allowance and supplier’s own cost models.

In our opinion, the BSC solution should be regarded as a reserve option should collection under the CM regulations be deemed not possible. It is important that the BSC modification continues to ensure that there is a potential back-up solution should the ESC route fail – it should not be considered as an equivalent, given the likely difficulties of establishing and implementing a new charge, which may take time to deliver and result in monies being collected from customers.

It is vital that BEIS work closely with Ofgem to ensure that CM costs remain part of Ofgem’s methodology for the default tariff price cap and are not removed as part of its February review of the cap level. If Ofgem were to remove CM costs from April 2019, it could leave suppliers in the unacceptable position of having to pay CM costs to the ESC/BSC (should BEIS make a decision later), but not being able to recover this money from customers. To this end Ofgem need a clear policy direction from BEIS on this issue by the end of January at the very latest.

Q8 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?

We believe that minimal changes are needed to the Regulations and CM Rules to restart collection of the CM Supplier Charge. However, as stated earlier, we believe that changes are required to the Regulations to enable deferred capacity payments that have been accrued since 1st October 2018 to be made to the capacity providers following a positive State Aid decision and reinstatement of the CM.

We would expect the technical changes to be made so that the CM Supplier Charges are collected from 1st October 2018; this would also include a requirement for the ESC to calculate and issue on a monthly basis a ‘CM Standstill statement of account’ to capacity providers which would set out capacity payments due less penalty fees and/or termination fees. CM participants should also be able to query expected payments/amounts owed on an ongoing basis reducing the administrative burden on both capacity providers and delivery partners once the standstill period is over.

We would appreciate clarity as to how BEIS will mark the end of the CM standstill period. Should State Aid clearance not be provided for the reinstatement of the CM, the Government need to make it clear how and when funds will be reimbursed to suppliers.

Q9 Are any changes desirable to the supplier credit cover, mutualisation and enforcement provisions that apply during the standstill period?

We believe that supplier credit cover should be reinstated and that both stricter enforcement and as a last resort, mutualisation should continue throughout the standstill period. For this to work, however, industry would require the 'statement of account' from the ESC.

It is our understanding that the enforcement provisions are not being applied during the standstill period in light of recent ESC notifications. We would expect that once supplier payments to the ESC are re-started then the enforcement provisions (along with credit cover and mutualisation) would apply immediately in line with the regulations.

BEIS and Ofgem need to consider how to recoup the CM Supplier Charge for the period from 1st October 2018. This is likely to be a significant amount of money raised from suppliers in February and, as such, could lead to further suppliers exiting the market as happened with the Renewables Obligation payments in the latter half of 2018. Therefore, we would welcome clarity on the Government's proposals on the CM Supplier Charge repayment schedule.

Issues Outside of Consultation

BEIS should take the opportunity to use these changes to the regulations to resolve the restrictive nature of Clause 69 (5) of the Regulations (as amended). Stopping parties providing additional information in appealing a pre-qual decision has not played any helpful role in delivering the CM in the most economic and efficient manner, and in fact has kept parties out of the market for no better reason than administrative error. We note it has also created a fundamental inconsistency when parties who are obligated to be in the CM can then fail to pre-qualify. The Delivery Body has provided no evidence that parties are not acting in a prudent manner when doing pre-qual and we therefore feel that parties should be allowed to correct administrative errors and provide further data if required. We very much hope that BEIS will therefore correct this clause now as it would be helpful for the pre-qualifications envisaged for the three outstanding auctions.