May 2020

THE ASSOCIATION FOR RENEWABLE ENERGY & CLEAN TECHNOLOGY

Member Briefing on the Government Response to Capacity Market Consultations

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Introduction

The Government has published responses to three important consultations on Capacity Market Regulations, which ran at different times. The consultation on future improvements ran between 3 February and 2 March 2020, the consultation on carbon dioxide limits between 22 July 2019 and 13 September. The Government has published its responses to these consultations together and you can view the full document here. The Government is preparing the necessary legislation for these amendments to receive approval from Parliament.

Response to consultation on future improvements

- **Allow Demand Side Response (DSR) to apply to prequalify to bid for all the agreement lengths available in the CM (up to fifteen years) if they can demonstrate they meet the relevant capital expenditure (CAPEX) threshold, minor changes**
- **Reduce the Minimum Capacity Threshold from 2MW to 1MW and enable Secondary Trading of Capacity Obligations** under the Minimum Capacity Threshold if an entire Capacity Obligation is being traded, no changes
- Provide **legislative underpinning for the long-standing 50% set-aside commitment for T1 auctions** and the methodology for determining the minimum amount of set-aside, no changes
- **Introduce a formal, annual review of new capacity technologies not currently competing in the CM but which could effectively contribute to security of supply**, no changes
- **Introduce a reporting and verification mechanism for the introduction of CO2 emission limits in the CM** in line with original proposals in the consultation, some **minor changes**
- **Remove the exclusion on LT STOR contract holders competing in the CM**, no change from original proposal
- The Government decided it is **not yet ready to implement proposals around fraud and error in the Capacity Market**, and intends to carry out further investigation and stakeholder engagement before updating proposals
- Two minor changes to the Capacity Market rules, no change from original proposal

Our Analysis

The REA welcomes these changes, which are encouraging for a range of sectors. We particularly support the decision to allow demand-response projects to bid for longer contract lengths. The reduced capacity thresholds will additionally ensure a greater number of smaller sites can participate. Introducing an annual review of new capacity technologies that could contribute to the Capacity Market will help to *ensure that the market keeps up with the pace of emerging technologies and feeds them into the market as they become viable. This is especially important as the cost of low and zero carbon technologies continues to fall.*

We hope that research and discussions around fraud and error in the market continue, noting that it will be crucial to effectively monitor for fraudulence and error when the emissions limit is introduced in October 2024.

The CAPEX requirements for DSR may end up being a barrier to some projects progressing (see page 18 of the response) – we would welcome member feedback on the detail of the decision here and how it may impact their projects.

The decisions complement the separate announcement from Ofgem on 14th May 2020 (link here) that the Balancing Service Use of System Charges will be removed for energy taken from the grid by energy storage facilities, strengthening the position of that sector.

Response to Consultation on Carbon dioxide emission limits

- The **emission limits will apply to capacity which existed before 4 July 2019** (described in this Government Response as "existing capacity") **from 1 October 2024;**
- It was **not necessary to restrict Refurbishing Capacity Market Units (CMUs) participating in the auctions held in early 2020 to one-year agreements**;
- The **arrangements relating to the termination of Capacity Agreements and recovery of Capacity Payments**, in circumstances in which Capacity Providers have made false or inaccurate declarations regarding their emissions, are satisfactory and **do not require amendment**.

Our Analysis

The REA strongly welcomes the decision to implement GHG (Green House Gas) emission limits, and it is a change which the Association has long called for. Currently, the Capacity Market mechanism does not recognise the urgent need to decarbonise nor meet legally binding renewables targets. This decision will help to rectify this and may help to discourage those who would seek to take advantage of low oil and gas prices in the wake of the pandemic by investing in more fossil fuel generation.

The new policy on emissions will bring the Capacity Market in line with emissions targets and remove the most polluting plants from the Market. It may encourage early retirement of fossil fuel generation, which will accelerate the shift to zero and low carbon generation, especially in the context of increasing electricity needs as the UK moves towards decarbonising transport.

The emissions threshold decision may be criticised, however, for the timing for when the threshold will come in at (2024/25) and the level that it is set at (550 g CO_2/kWh and annual limit of 350kg CO2/installed kW). *This level is likely to force out coal and diesel generation but those who wished to see other fossil fuels, such as gas, also excluded will be disappointed.*

The REA's response to the initial consultation in summer 2019 can be viewed here.

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Response Consultation on Proposed easements to the Capacity Market in response to the Coronavirus pandemic

- Enable, **for the current 2019/20 Delivery Year** only, any **Capacity Payments that have been suspended as a result of a CMU failing to comply with its satisfactory performance requirements, to be paid if and when the CMU meets its requirements**. Based on consultation feedback, the **Government will also extend the scope of this change to include agreements awarded in auctions before 21 December 2017**
- **Extend the deadlines associated with a number of milestones**, where Capacity Providers that meet eligibility requirements can demonstrate their project has been affected by the coronavirus pandemic. Based on consultation feedback, the Government will also apply the extended Long Stop Date to older agreements (e.g. agreements for the 2019/20 Delivery Year) that were delayed as a result of last year's standstill period
- **Remove the requirement for Independent Technical Expert (ITE) reports in relation to six monthly Progress Reports for certain CMUs** in the financial year 2020/21. In response to feedback from respondents, the Government has also removed the requirement for an ITE report to accompany Remedial Plans
- **Reduce the amount of data required to establish baseline demand for certain DSR CMUs.** In response to feedback from respondents, the baseline period will be reduced to three weeks rather than two as originally proposed in the consultation
- Allow a **longer period for a person to appeal** to the Secretary of State, the Delivery Body and the Authority, as per the original consultation proposal; and
- **Provide the Secretary of State greater discretion, when determining appeals against termination notices**, to extend the time for Capacity Providers to achieve compliance or to direct termination on a new ground (for which the termination fee is waived) where non-compliance arises as a result of the effects of coronavirus

Our Analysis

These relaxations are understandably necessary to help management of the crisis in the short-term and provide reassurance that the Government recognises some of the complex Covid-specific workstream issues that Capacity Providers are currently facing. However, we believe that this crisis provides the opportunity to reshape policy going forward so that it can accelerate the transition to the green economy. In the long-term, combining green investment with efforts to recover the economy, and ensuring that recovery packages are green, will lead to a sustainable and ultimately the most cost-effective recovery.

With questions or to feed in your views, contact:

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