ELEXON

Department for Energy Security and Net Zero
1 Victoria Street
London
SW1H 0ET

For the attention of: Luke Nightingale, Head of Electricity

23 February 2023

Re: The Capacity Market Advisory Group's (CMAG's) response to the Department for Energy Security and Net Zero (DESNZ) Consultation 'Capacity Market 2023: strengthening security of supply and alignment with net zero'

<u>Background</u>
The CMAG was established by Ofgem to improve the effective functioning of the Capacity Market (CM) by increasing industry engagement and transparency around changes to the CM Rules. As the DESNZ consultation seeks views on changes to the CM Rules, the CMAG have decided to provide the attached response to support to DESNZ regarding the development of the proposals detailed in the CM consultation.

<u>The CMAG's response</u>
At its meeting on 17 January 2023 representatives from DESNZ (formerly, and at the time of meeting the Department for Business Energy and Industrial Strategy (BEIS)) presented an overview of the proposals contained within the CM consultation to CMAG Members for comment and initial views.

The CMAG welcomes the opportunity to provide feedback to DESNZ on its consultation, and is grateful for the presentation and engagement. The accompanying summary in Attachment A outlines the discussion points from the CMAG meeting.

I note that the CMAG is due to meet again on 2 March 2023, where it will have a final opportunity to comment on the consultation. However, as this is close to the closing date of 3 March 2023, we felt it reasonable to provide this comprehensive response in advance. Should there be any further material comments made at the meeting on 2 March 2023, we will provide a summary accordingly.

The CMAG continues to value the active engagement of DESNZ around the CMAG, and looks forward to working closely with you in the future.

Yours Sincerely,

Elliott Harper
Head of Governance Services & CMAG Facilitator (Chair)

Signed on behalf of the CMAG

Attachment A – Summary of CMAG Discussion on DESNZ Consultation Proposals

Satisfactory Performance Days

Description of Proposal

- To improve assurance of the availability of capacity ahead of the most challenging winter months and at regular intervals throughout winter, BEIS propose the following approach to Satisfactory Performance Days (SPDs)

SPD Number	First Pass Window	Extended Pass Window (CMU suspended)	Termination notice risk begins
1	1st – 31st October	1st – 30th November	1 December
2	1st – 31st January	1st – 28th February	1 March
3	1st – 31st March	1st – 30th April	1 May

- BEIS also propose to clarify that SPDs should be demonstrated at the level of a CMU's Net Capacity Obligation.

Summary of Discussion

- A Member queried what the consequences would be if a Participant holds a multiyear agreement but misses an SPD in the stated windows. The BEIS representative noted the Participant would be able to appeal any termination notices and will be given opportunity to meet its SPDs as part of the appeal.
- A Member noted concerns where a Participant gets a 15 year agreement but has an outage longer than planned for circumstances outside of their control, they cannot meet their SPDs or secondary trade their obligation and therefore could be terminated and lose their agreement. A Participant may make a significant investment on the basis of securing a 15 year agreement which would ultimately be terminated.
- The BEIS representative noted that the majority of plants are in line with the proposed SPD windows and generating before the extended pass windows, this proposal looks to catch speculative participants rather than penalising those that operate in line with their obligations.
- A Member noted this proposal is over-penal, it can be difficult for Participants to find capacity when selling and this will become even harder if the CM Rules change proposals to allow secondary trading ahead of meeting a SCM are implemented. The Member further noted that the BEIS Consultation also considers increasing the penalty regime which increases the difficulty and pressure on Participants to comply with SPDs.
- A CMAG Member questioned whether the date ranges are suitable and whether there was a risk that this proposal could lead to undesirable outcomes. The Member illustrated this with the following examples:
- A Capacity Provider has an outage on 1 October which continues until 1 December which could result in termination for a two month outage.
- A Capacity Provider has an outage mid-October which continues until mid-February i.e. a four month outage but meets the SPD requirements (by demonstrating suitable performance at the start of October and the end of February) and avoids termination.
- A Member noted this anomaly could withdraw any incentive for CMUs to come online early and generate again if they have missed their SPDs due to an outage.
- A Member highlighted the important of not conflating SPDs with availability, there may be CMUs able to generate that have not yet completed their SPDs.
- A Member proposed an alternate option of stopping any CM payments to Participants until they meet their SPDs rather than serving a termination notice under the suggested amendments.
- A Member noted LCCC/ESC had looked at automating and improving the SPD process and queried if the support for 3 windows had come from this work. The LCCC/ESC representative noted the SPD data has

improved and participants have fed back that the automated process is much easier, with less than 4GW not meeting SPDs.

- It was highlighted that it is not always the case that low system margins are observed over the traditional winter period so there could be merit in exploring expanding the window for demonstrating SPDs.
- The BEIS representative noted the BEIS minded to position is that penalties for missed SPDs align with the current penalty regime.

Call for Evidence on the Extended Performance Test

- BEIS is aware of concerns stakeholders have raised about the ability of some storage CMUs to meet the requirements of the Extended Performance Test.
- Stakeholders have also raised broader concerns about how best to account for the risk of battery degradation over long multi-year CM agreements.
- BEIS are therefore seeking evidence from stakeholders on any barriers faced by storage CMUs in meeting the CM’s performance and duration testing requirements, and on potential solutions.

Summary of Discussion

- A Member noted the EPT should be based on net capacity rather than the original connection capacity, the issue currently is that you cannot secondary trade your obligation to reduce your connection capacity and one interpretation of Rule 4.4.4 does not allow a Participant to change the configuration of a CMU so they cannot add additional batteries or capacity. The Member noted a workaround for many Participants is to derate their battery when prequalifying to avoid future issues with EPT.
- A Member noted it is important to distinguish between whether this is a specific issue for a limited number of participants or a broader industry issue.
- A Member queried if a CM Rules change proposal was raised regarding battery degradation, how would that interact with this Consultation. The BEIS representative noted BEIS is keen to engage with CMAG and would identify the most appropriate route to take forward any proposed changes. The BEIS representative noted this is a Call for Evidence at this stage and BEIS is not looking to put forward a specific proposal but is seeking evidence of a wider industry issue.
- A Member noted that Participants with batteries could apply for shorter agreements to reflect degradation, there is a finite amount of charge cycles for batteries so CMUs could operate in a way that would maximise life or consider changing battery cells to minimise future degradation.
- A Member noted Participants would replenish battery cells to maintain a certain level of performance as agreed with suppliers, who are paying for a performance warranty for the entire agreement length.
- The BEIS representative noted that in practice, if storage providers find barriers or concerns with the process of swapping batteries or cells within the CM Rules, this should be raised in the Consultation response.

Connection Capacity

- To improve assurance that a CMU's connection capacity accurately reflects the total amount of capacity it can export to the grid, and to simplify the process for selecting connection capacity, BEIS propose that all CMUs will be able to base connection capacity on one of the following 3 options only:
    - Transmission Entry Capacity (TEC)
    - Maximum Export Capacity (MEC)
    - The CMU’s Average Output (calculated in accordance with Rule 3.6.1(a) on Previous Settlement Period Performance).
- BEIS also propose that Capacity Providers whose CMUs are part of multi-unit sites must cap the sum of the connection capacity of the relevant units at the site level of TEC or MEC.

- Finally, BEIS welcomes views on whether Capacity Providers should be permitted to self-nominate their connection capacity, provided this is capped at the level of TEC, MEC, or Average Output.

Summary of Discussion

- A Member noted an unintended consequence of this proposal could be Participants who are looking to increase their TEC effectively can already choose their capacity Connection based on their output.
- A Member noted that TEC is measured on a power station basis, some CMUs are eligible but others are not so cannot correct their cap sum of connection capacity at site level.
- The BEIS representative noted that the intention of this proposal is that the connection capacity at site for a multi-unit site is not connected to TEC or MEC.
- A Member noted that for some CMUs, purchasing TEC can be expensive and difficult where the CMU's derated capacity exceeds TEC, due to the expensive charging zone. This change may increase the cost of TEC in the CM, as it would push the demand curve higher in order to secure capacity.

Mothballed Plant

- Ahead of the auction prequalification window opening in 2022, BEIS introduced a time-limited amendment to enable plants which were unable to provide data from the required timeframe for demonstrating Previous Settlement Period Performance under Rule 3.6.1(a) – for example, due to being mothballed – to enter prequalification for CM auctions.
- BEIS now propose to make a permanent change to Rule 3.6.1(a) to enable CMUs which can only provide data from earlier than the required timeframe to enter prequalification, subject to the following conditions:
    - Capacity Providers must declare their CMU's inability to meet the requirements of Rule 3.6.1(a) at prequalification.
    - They will then be required to provide credit cover of £10,000 per MW of derated capacity of the CMU, which will be returned after the CMU demonstrates its first SPD.

Summary of Discussion

- The BEIS representative queried if CMAG had any comments on the additional credit cover alignment being proposed for these CMUs.
- CMAG Members noted this was a good proposal and agreed with its intention.
- A Member queried when a Participant would expect to not be required to provide £10,000 worth of Credit Cover under this proposal. The BEIS representative noted it would be returned once the plant has demonstrated it can meet its first SPD.

Penalty Regime

- To send a stronger signal to deter non-delivery in a System Stress Event, BEIS propose increasing the figure used in calculating the non-delivery penalty rate as follows:

Current Penalty Rate Calculation

$$Penalty\ rate\ \left(expressed\ in\frac{£}{MWh}\right) = Clearing\ price\ \left(\frac{£}{MWh}\right) \times \frac{1}{24}$$

Proposed Penalty Rate Calculation

$$Penalty\ rate\ \left(expressed\ in\frac{£}{MWh}\right) = Clearing\ price\ \left(\frac{£}{MWh}\right) \times \frac{1}{4}$$

- In order to ensure that non-delivery penalties are issued accurately, BEIS also propose changing the deadline for the ESC invoicing Capacity Providers from 21 working days after the end of the month in respect of which the penalty applies to 35 working days after the end of the month in respect of which the penalty applies.

Summary of Discussion

- A Member queried if there would be any change to the annual or monthly penalty cap. The BEIS representative noted the intention is for the monthly and annual caps to remain the same.
- A Member noted CMUs would reach their monthly cap within 40 minutes under this penalty regime in a System Stress Event.
- The BEIS representative noted the proposal seeks to avoid discouraging these CMUs to come back on the system when required. A Member noted the incentive for coming back on the system when under a System Stress Event would be limited by this proposal for CMUs that hit their penalty cap.
- A Member highlighted the monthly penalty cap calculation within the Regulations would incentivise CMUs to continue responding in a System Stress Event even after hitting their monthly penalty cap.
- A Member queried if this proposal would apply retrospectively and how over delivery is calculated.
- An EMRS representative noted that over delivery is calculated at the end of a delivery year, either using the penalty rate or total penalties collected through the penalty regime, whichever of these is smaller is applied.

Emissions Limits in the Capacity Market

- To move the CM towards closer alignment with government's goal of a fully decarbonised electricity system by 2035 (subject to security of supply) BEIS proposes the following changes:
    - To decrease the CM’s current emissions intensity limit to 100gCO2/kWh from 1 October 2034 (to align with the 2035 decarbonisation target).
    - To retain the CM’s annual emissions limit at the same level as existing capacity can currently access (350kgCO2/kW).
- This change also aims to incentivise unabated gas plants to either abate by 2035 or operate a limited peaking profile beyond 2035.

Summary of Discussion

- The BEIS representative noted this proposal only affects new builds and seeks to incentivise unabated gas plants to abate or operate a limited peaking profile.
- A Member noted that with limits on operating hours, some plants may use up these hours fairly early running the risk of less efficient plants operating later.
- A Member queried if this proposal would look at retro-fitted plants alongside new builds. The BEIS representative noted both new build and refurbishing plants are included in the consultation.

Call for evidence on barriers to decarbonisation for existing CMUs

- Feedback to the 2021 Call for Evidence demonstrated that stakeholders are seeking clearer indications about the future of carbon intensive capacity, particularly regarding options for Capacity Providers aiming to decarbonise their CMUs.
- In particular, stakeholders raised concerns about how CMUs with existing multi-year CM agreements would be able to access additional revenue support (if required) to decarbonise.
- BEIS are therefore seeking evidence on any barriers Capacity Providers may experience in decarbonising existing CMUs, and on the potential creation of ‘managed exit routes’ which would enable CMUs to be withdrawn from the CM in order to decarbonise, subject to security of supply.

Summary of Discussion

- A Member noted an unintended consequence of this could be Participants delaying entering auctions as they wait for higher prices to lock in, due to lower capex investment. This would therefore increase the total value of the CM.
- A Member noted they were supportive of a change in this area, the Call for Evidence needs to distinguish between clean DSR and DSR with behind the meter generation. Only clean DSR should qualify to partake in this process.
- A Member raised concern that the process of requiring an ITE to sign off on site emissions could be an administrative burden for participants.

Short Multi-year Agreements for Low Carbon, Low Capex CMUs

- The 2021 Call for Evidence considered whether the ability to access short, multi-year agreements without meeting the CM's Capex thresholds would be useful in removing barriers to participation for low carbon capacity such as DSR.
- BEIS now propose offering up to 3-year agreements with no capex thresholds to low carbon CMUs which also satisfy the proposed post-2034/35 Delivery Year emissions intensity limit.
- This proposal aims to increase the deployment of low carbon flexible capacity to support security of supply in a decarbonised power system.

Summary of Discussion

- A Member highlighted there is a clear interaction between this proposal and CP366.
- The BEIS representative noted there needs to be a review to understand which proposal is in the right place to take forward.
- A Member queried if BEIS decides to not take this change forward following the Consultation, would CMAG continue to proceed with CP366.

Changes to Capex Framework and Total Project Spend

In light of anticipated changes in the CM's capacity mix as the power sector decarbonises, BEIS propose a range of changes to the CM's Capex framework to ensure it remains fit for purpose:

Reference cost levels

- The reference cost level for 3-year agreements (current threshold of £140/kW) has been the cost of fitting a specific abatement technique to coal plant – BEIS now propose that it should be changed to the cost of refurbishing an OCGT, which results in a very similar threshold of £135/kW.
- The reference cost level for 15-year agreements (current threshold of £280/kW) has been the cost of a new build OCGT – BEIS propose to maintain the threshold at £280/kW, as evidence suggests this is likely to remain appropriate for a wide range of low carbon technologies.

9-year agreements

- In light of concerns that some low carbon new build and refurbishing capacity may fall between the current Capex thresholds, BEIS propose a new 9-year threshold (set at £205/kW) to ensure projects can access sufficient revenue support to come forward in the CM.

Total Project Spend definition

- In light of stakeholder feedback, BEIS propose to amend the definition of Total Project Spend such that the window for Capex for Refurbishing CMUs is aligned with that of new build CMUs to cover a period of 77 months prior to the commencement of the first Delivery Year.

Summary of Discussion

- No specific comments

Clarifications Concerning Auctions

- BEIS propose making a minor amendment to Rule 5.9.7 to provide additional clarity that in CM auction scenarios where the amount of capacity required for an auction to clear cannot be exceeded due to demand being higher than supply, then each eligible bidding CMU should be awarded an agreement.
- BEIS also propose reducing the administrative burden of CM auctions by amending the Regulations to require the Secretary of State only to write if an auction is not going to be held.

Summary of Discussion

- No specific comments

Removal of ITE Requirements for Construction Progress Reports

- BEIS understand that Capacity Providers have concerns about the administrative and cost burdens arising from the requirements under Rule 12.2 on the monitoring of construction progress of prospective CMUs – particularly regarding the need to have material alterations assessed by an Independent Technical Expert.
- BEIS therefore propose to remove the requirement for ITE assessment and to remove the requirement to provide an explanation if a Construction Date has moved more than two months earlier than the previous construction progress report's earliest date.

Summary of Discussion

- No specific comments

Amendments to the Transfer Route Between the CM and CfD Schemes

- Feedback from stakeholders has highlighted that due to the way the CM Regulations are currently worded, in practice Capacity Providers have been unable to use a route for terminating their CM obligations in order to become eligible to bid in a Contracts for Difference (CfD) allocation round.
- BEIS therefore propose amending the definition of 'CfD transfer notice' in the CM Regulations in order to make this transfer route operable.
- BEIS are also seeking views on whether this transfer route between the CM and CfD schemes should continue to be available to new CM agreement holders in future.

Summary of Discussion

- A Member noted support for the ability to move from CM to CfD, but this would depend on how wide the definition for CfD is. The BEIS representative noted BEIS had included proposals on the Call for Evidence to include low carbon and decarbonisation schemes in the CfD definition but will take forward the current definition within the Regulations.
- KG noted the ambitious timelines for getting these changes implemented and considering any consequential impacts as a result is difficult for all involved. Achieving this by July 2023 in line with the current delivery year seems very optimistic. The BEIS representative noted the timeline is tight but they have signalled to Delivery Partners and Participants in advance what the proposed changes will be and will continue to consult with industry on any changes.

Phased Implementation of IEV Requirements

- Stakeholders have raised concerns about the availability ahead of the auction prequalification window opening in 2023 of Independent Emissions Verifiers (IEVs) who are accredited to verify that CMUs with Fossil Fuel components meet the CM's emissions limits.
- To ensure prequalification 2023 runs smoothly, BEIS propose temporary modifications to the CM Rules to allow for a phased implementation of the IEV requirements as follows:
    - Verification will be required to submit an application to prequalification 2024 – any verifications completed in 2023 will remain valid for the following year, including complex verifications which would usually need to be verified annually.
    - This proposal would not make changes to the type of verification required and will be temporary – after 2024, it is proposed that the Rules will revert to their original format.

Summary of Discussion

- No specific comments