

Energy UK response to the Proposals for Capacity Market Emissions Limits

13th September 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 Capacity Market Emissions Limits' consultation. The majority of the Energy UK membership supports the bringing forward of the European Union Electricity Regulation Article 22 4 (b) from the latest implementation date possible of 1 July 2025, to 1 October 2024. This would achieve consistency with Great Britain's Capacity Market (CM) delivery year term (October-September), avoiding mid-year terminations or amendments to a Capacity Market Unit's ("CMU") delivery over the year and therefore ensuring that complexity of CM Rules ("the Rules") and regulations is kept to a minimum. In line with maximising simplicity of Rules and regulations, Energy UK supports 1-year contracts for refurbishing CMUs that would exceed the emissions limit in the upcoming T-3 auction (delivery year 2022/23) and T-4 auction (delivery year 2023/24), and no other future auctions.

The effect of implementing this regulation earlier than necessary must be fully understood, and it is the view of some Energy UK members that this could result in bringing forward the closure of coal-fired generation. The potential impact on security of supply should be carefully considered, factoring in the expected closure of old generating capacity. The optionality of maintaining technologies that may exceed the limits set out in this regulation after the 1 October 2024 date may be appropriate. Energy UK maintains its support for the current policy framework outlining the transitional closure of coal-fired generation one year later, by October 2025.

We are concerned that assessing emissions against kilowatt electric (kWe) under the current regulation could unfairly disadvantage highly efficient Combined Heat and Power (CHP) generation systems, and effectively exclude them from participating in the CM. By not assessing entire generation output (thermal and electrical), emissions will be deemed higher than actual, and therefore a plant's full generation contribution will not be considered. This would be detrimental to wider policy intentions, and we urgently request clarity on this methodology.

We encourage Government to consider setting termination and penalties in line with the wider review of the CM penalty regime committed to in the Capacity Market Five-Year Review report. We would deem it appropriate that the penalty applied to any excursion from a CMU's declared emissions on a technical or administrative basis, should be linked to a similar termination event. An identified fraudulent declaration of emissions, or deliberate attempt to deceive should be considered as a different type of termination event. Capacity payments should only be recouped from the moment of non-compliance is identified onwards (TP2). It would be inappropriate and detrimental to market confidence if all capacity payments were to be recouped (TP3).

General Comments

Agency for the Cooperation of Energy Regulators Guidance

Energy UK recognises that by 5 January 2020, the Agency for the Cooperation of Energy Regulators (ACER)¹ is required to publish an opinion providing technical guidance related to the calculation of the values referred in the first subparagraph, in particular providing a methodology for calculating the emissions limits for power stations. This guidance is welcomed by industry; however, it must be stressed that the timing of it is unhelpful, and makes it difficult to provide reasoned response, as we cannot fully establish the scope and impact of the regulation. Energy UK recognises that Government is in a similar position whereby the regulations must be implemented ahead of publication of the guidance. Capacity Providers would welcome this guidance as soon as possible, rather than on, or shortly before, the due date. This would provide greater clarity of what obligations will be and how to comply. This will provide Government with additional clarity on the necessary Rule changes that will be required, and allow for additional preparation time for these changes to be communicated to industry.

It should be considered that the proposals for implementing Article 22 4 (b) of the recast European Union Electricity Regulation would apply to some pre-qualifying units from the 2019 pre-qualification period. In order to ensure the continuity of understanding of CMU obligations from the pre-qualification period forwards, we would encourage Government to maintaining its own methodology for implementing these regulations for the relevant auctions in 2020 and seek to align with the ACER guidance, if appropriate, for future pre-qualification and auction rounds.

CHP

Energy UK notes that Article 22 4 (b) of the recast European Union Electricity Regulation states that *“generation capacity...that emits more than 550g of CO₂ of fossil fuel origin per kWh of electricity and more than 350kg CO₂ of fossil fuel origin on average per year per installed kW_e shall not be committed or receive payments or commitments for future payments under a capacity mechanism.”* Furthermore *“the emission limit of 550g CO₂ of fossil fuel origin per kWh of electricity and the limit of 350kg CO₂ of fossil fuel origin on average per year per installed kW_e referred to in points (a) and (b) of the first subparagraph shall be calculated on the basis of the design efficiency of the generation unit meaning the net efficiency at nominal capacity under the relevant standards provided for by the International Organization for Standardization.”*²

We recognise that monitoring emissions in relation to the electrical export only could negatively impact Combined Heat and Power (CHP) systems. These systems are highly efficient technology, which provides decentralised electricity and heat capacity for many Industrial and Commercial businesses. Dividing emissions into electrical export only and ignoring heat output is mathematically flawed and unfairly penalises CHP as its energy outputs are in two forms: electricity and heat. By only assessing emissions by electrical output, those reported by CHPs would appear inflated.

Energy UK would welcome clarification in regards to how CHP CMUs should assess their CO₂ emissions, and how this will be addressed (either through the ACER guidance, or implementation of the appropriate regulation article). It is our position that by implementing this regulation based on electrical output only could effectively prevent CHP units from participating in the CM, and would be detrimental to Government’s overarching policy intentions.

Acknowledgement, guidance and/or clarity is needed as soon as possible in order to maintain investor confidence in CHP units. The guidance should be designed in such a way that does not stop efficient CHPs from participating in the CM.

¹ Proposals for Capacity Market Emissions Limits consultation - https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/819768/proposals-capacity-market-emissions-limits-consultation.pdf

²REGULATION (EU) 2019/943 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 5 June 2019 on the internal market for electricity (recast) - <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0943&from=EN>

Q1 - Should the emissions limits for existing generation be implemented as of 1 October 2024 or 1 July 2025? What would be the potential impact of the two options on existing generation capacity?

Changes to the legislative and administrative processes and systems to meet the 1 July 2025 implementation date would be more burdensome and complex than if the changes applied from 1 October 2024 (i.e. at the start of the CM Delivery Year). For the purposes of implementing minimal change, Energy UK would welcome the implementation of Article 22 4 (b) of the recast European Union (EU) Electricity Regulation³ to be brought forward from the 1 July 2025, to the start of the 2024-2025 CM Delivery Year (1 October 2024). We believe that this implementation timeline minimises complexity to the Rules, an ambition of the CM from the outset. We also recognise that these emissions limits have already been implemented by other European Member States (i.e. the Italian capacity mechanism on the 14 June 2019⁴).

CM participants have consistently experienced regulatory complexity, often deemed unnecessary. This has been particularly noticeable since the Tempus Energy and Tempus Energy Technology v Commission judgement in November 2018, which resulted in the annulling of the GB CM and subsequent 'standstill' period shortly thereafter. The plethora of necessary regulatory and Rule changes, coupled with the delayed consolidation of the Rules, which were only forthcoming following the first week of 2019 prequalification, resulted in profound difficulty for all prospective participants. In line with the Capacity Market Five-Year Review report⁵, we encourage BEIS to enact the emissions limits from 1 October 2024 to ensure that regulatory complexity is minimised.

Some members of Energy UK have a different position, as a point of principle these members consider it important that implementation of a regulation should not determine or change established policy⁶. These members are concerned that the 1 October 2024 implementation date could effectively bring forward the coal phase out policy date by one year, and removes the Secretary of State's emergency power to suspend the emissions limits⁷. With the upcoming closure of various ageing plant, if there were to be a shortfall in capacity, optionality in retaining the maximum provision and competition for capacity for the 2024-25 delivery year could be prudent. Energy UK and its members maintain support for the current policy framework outlining the transitional closure of coal-fired generation in 2025.

We note that this consultation states that Government is currently undertaking analysis to assess any security of supply risks or price impacts associated with an earlier introduction of the emissions limits for existing generation on 1 October 2024. We believe that this is an important input into Government's decision making over when to apply the implementation date. If Government believes that there could be significant impacts on security of supply or price, then it would be right to mitigate these risks by going for sub option 2. If security of supply were to be deemed a concern, then this may take precedence over reducing the complexity of the CM Regulations and Rules.

Q2 - If you believe the 1 July 2025 date to be preferable, which sub-option do you prefer?

As above, it should be noted that Energy UK supports the bringing forward of the implementation of Article 22 4 (b) of the recast EU Electricity Regulation from the 1 July 2025, to the start of the 2024-2025 CM Delivery Year (1 October 2024). However, if Government were to implement this emissions limit as of 1 July 2025, then amending the Rules to provide for the termination of CMUs which exceed these limits as of this date would be complex and would contravene simplification intentions of the Capacity Market Five Year Review report. Therefore, Energy UK considers sub-option one to be unsuitable and would not support its implementation.

³ REGULATION (EU) 2019/943 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 5 June 2019 on the internal market for electricity (recast) - <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0943&from=EN>

⁴https://europa.eu/rapid/press-release_IP-19-3001_en.htm

⁵https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/819760/cm-five-year-review-report.pdf

⁶https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/672137/Government_Response_to_unabated_coal_consultation_and_statement_of_policy.pdf

⁷https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/395350/ImplementingEPSEPSGovtResponse.pdf

Energy UK deems sub-option one an unsuitable option which we would not support the implementation of. Clarity is needed on sub-option two *‘for the full 2024/25 delivery year until 30 September 2025, but will only be eligible for payments until 1 July 2025’* as to whether a CMU would be eligible for payments between 1 July and 30 September 2025 if the Capacity Provider was able to demonstrate its ability to meet the 350kg of CO₂/kWe annual limit. We would appreciate clarity around how this sub-option would work, as it could be deemed that, in the absence of capacity payments, there would be no requirement to meet CM obligations.

Q3 - Do you agree that refurbishing CMUs that will exceed the emissions limits should only be eligible for 1-year agreements? If not, please explain with reasons.

Energy UK supports the Government’s minded to position of introducing 1-year contracts for refurbishing CMUs that would exceed the emissions limit in the upcoming T-3 auction (delivery year 2022/23) and T-4 auction (delivery year 2023/24), and no other future auctions. We recognise that any changes to the length of agreements that any CMU can obtain would require Rule changes. Therefore, it is our belief that any approach taken must ensure simplicity to the Rules and minimise disruption.

Q4 - What termination fee level should apply to the termination event where a false declaration has been made, or where capacity fails to meet the relevant emissions limits?

Energy UK encourages Government to apply a termination fee for false declarations in line with what would be deemed a similar termination event. We recognise a requirement to be able to differentiate between a technical/administrative error in the accounting of emissions, and a fraudulent claim.

We believe that there is inconsistency across the termination events and the fees applicable to them, and therefore welcome Government’s intention in the Capacity Market Five-Year Review report to simplify fees and events⁸. The application of the termination fee to excursions over the emissions limit should be taken into consideration in the wider context of this review. We do recognise, however, that the higher level of termination (£35,000) would seem unduly harsh in consideration of other comparable termination events.

Q5 - In the event of termination, should payments be repaid from the beginning of the capacity agreement, or from the date that the CMU fails to meet the emissions limits?

Energy UK is of the position that CM payments should be repaid from the point in time that it has been identified that non-compliance has occurred/commenced by a CMU. Although we welcome the necessary environmental and emissions limits, and recognise that an adequate deterrence must be enforced, it would set an unwelcome and possibly detrimental precedent to industry to enforce a TP3 repayment period, requiring all CM payments to be returned, if delivery and availability has been maintained.

We would welcome clarification over how running hours will be monitored, and what body would be charged with this monitoring. In considering how compliance will be achieved, as this information is already provided and monitored for environmental reasons an important aim should be to minimise duplication and regulatory burden.

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⁸ Capacity Market Five-Year Review report

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/819760/cm-five-year-review-report.pdf