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3 November 2014

## **Consultation on Capacity Market supplementary design proposals and Transitional Arrangements**

This submission was prepared by the Consumer Futures team within Citizens Advice. It has statutory responsibilities to represent the interests of energy consumers in Great Britain. We welcome the opportunity to provide a submission on further design elements of the capacity market.

### **Summary**

The capacity market imposes a number of risks on consumers. The difficulties seen in incorporating non-generation technologies into the market are one example of the choices inherent in designing a Capacity Market distorting the wider market. The issues raised in this consultation highlight the risk of imposing competitive disadvantages on sources which could potentially be beneficial for consumers, including demand-side response and interconnection. It is welcome that DECC continues to seek solutions that would enable these technology types to participate in a way that appropriately rewards their benefits while penalising their risks, but, as the Department itself acknowledges, this process is clearly not complete.

This consultation response details Citizens Advice thoughts on the questions around interconnection (Questions IC1-7) and around demand-side response (Questions TA1-2).

### **Detailed Comments**

#### **Interconnection**

Interconnectors have the potential to increase supply of clean, reliable and low-cost electricity into Great Britain. By making better use of existing generation assets and spreading access to geographically restricted renewable energy sources (such as hydro, geothermal, or wind resources), greater interconnection can significantly lower the costs of security of supply and decarbonisation across Europe, reducing the pressure on consumer bills from policies in these areas. However, in terms of a capacity market, they introduce a number of complicating elements, from the need to effectively integrate decisionmaking across what remain largely separated markets, to the risks of not merely non-delivery, but of export during

times of system stress. Capacity market designers are faced with the difficult balance of trying to reward interconnection for the benefits it can provide, while acknowledging and providing some correction for its potentially disadvantageous aspects.

The introduction of a capacity market risked undermining the business case that has traditionally justified construction of interconnectors, peak price spikes. This disincentive to interconnection was further exacerbated by an initial Capacity Market structure that supports other types of capacity provision but does not support interconnection. We are therefore pleased that government is correcting this by taking steps to bring interconnection inside the Capacity Market. As long as the Capacity Market exists, it should aim for the greatest breadth of technology participation.

The lack of clarity at the EU level over the emergence of Capacity Markets in several EU member states is reflected in the lack of guidance from the EU as to how Capacity Markets should link. Historically, EU policy has attempted to steer Member States away from adopting capacity markets, and has also strongly backed interconnection. Given the moves in parts of Europe to develop capacity markets, the EU now faces the difficult task of reconciling its preferences for market integration and deeper cross-border trade with Member States' desire to reinforce their own electricity markets. It is far from clear how the EU intends to achieve this. It is certainly prudent to prepare for a scenario wherein the EU puts forward proposals to link capacity markets. In the meantime, the proposal to allow direct participation from interconnectors, rather than by overseas generators, appears the option that allows for quickest implementation with the least cumbersome verification procedures.

The Capacity Market is already a complicated policy, part of a package of proposals in EMR of almost unprecedented complexity. Any steps that can be taken to avoid further complication are welcome. In that context, the proposal to contract with interconnectors on the basis of Delivered Energy, rather than Declared Availability, should avoid further fragmentation of the market. Furthermore, as the consultation document identifies, a different product specification for interconnectors would require a different monitoring and enforcement regime, adding to the administrative burden of the policy. Therefore, we support DECC's proposal to offer the same single product to interconnectors as to other participants in the market.

We agree with DECC's proposal to offer 1-year capacity contracts to interconnectors. The argument in favour of long-term contracts for generators has rested on the need to provide them with relative revenue certainty. For interconnectors, Ofgem's newly introduced cap-and-floor regulation system will provide this certainty to interconnectors who opt into it. There is no need to double-up on this transfer of risk to the consumer by granting access to long-term capacity contracts.

The different terms on offer to potential new-build interconnectors and new-build generation plant is also justifiable because of the nature of the risks faced by the different sectors. Generators face greater technology redundancy risk because fossil and carbon prices may run against them. To the extent that interconnectors are discriminated against by the current proposals, it is due, rather than undue, discrimination, and serves consumers' interests.

## **Transitional Arrangements**

While there are clearly uncertainties about the volume of DSR that will be attracted to participate in the Capacity Market in future years, there are strong reasons to believe it has the potential to be a competitive provider of capacity services. In other capacity markets such as in PJM and New England in the USA, DSR accounts for more than 10% of capacity. In GB, meanwhile, it is anticipated by DECC to amount to roughly 5% of capacity (4.7% of total capacity will be auctioned in the T-1 auction which is presently reserved for DSR providers. Less than 1% of the pre-qualified T-4 capacity comes from DSR). While the American capacity markets are both more mature, and have some different characteristics, they do indicate the possible potential for DSR to grow in importance.

The Transitional Arrangements are designed to support new entrants in the DSR market. As a result, they exclude DSR bidders which have entered the T-4 auctions (i.e. the auctions in 2014 or 2015 for delivery in 2018/19 or 2019/2020) from also entering the one-year transitional auctions in 2015 or 2016. While this is designed to nurture new entrants who could become participants in the Capacity Market longer term, it means that the most established, and probably most competitive, sources of DSR would be kept out. Furthermore, the T-1 auctions in the enduring regime can be scaled back by ministers. This raises the possibility that by the time the T-1 auction is due to be run, ministers will have decided only a small amount of DSR capacity will be procured, with the consumer having already been committed to potentially more expensive options in the T-4 auction.

DSR is restricted to 1-year contracts and will be in competition with generation based projects aiming to acquire 3- or 15-year contracts. This is a particular concern because, as a young and growing sector, there is potential for more DSR to become available over time than might be available in the first auctions. However, if a substantial commitment of capacity has been made in the form of longer duration contracts for new build power stations, some DSR may be blocked from coming forward, even if it turns out cheaper on a year-by-year basis.

It seems perverse to attempt to incentivise new DSR while simultaneously limiting its ability to benefit from any improvement. Participation in the T-4 auctions and the transitional arrangements would not entail any double payments – DSR providers would be offering products for different delivery years. To maximise competitive pressure in both the T-4 auctions and the transitional arrangements we would encourage government to rethink whether it has struck the appropriate balance between encouraging new entrants with enabling the most efficient use of DSR capabilities.

Thank you for the opportunity to make this submission, please do not hesitate to make contact with me if you would like to discuss it further.

Yours sincerely

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