



Department
of Energy &
Climate Change

Capacity Market break-out group

EMR Stakeholder Event

11 February 2013



1: Overview



We face increasing security of supply challenges

The market faces new, long-term challenges...

Closure:
around a fifth
of existing
capacity
closing in the
next decade



Market failures: e.g.
reliability is
public good,
SO actions in
scarcity
situations not
fully priced in

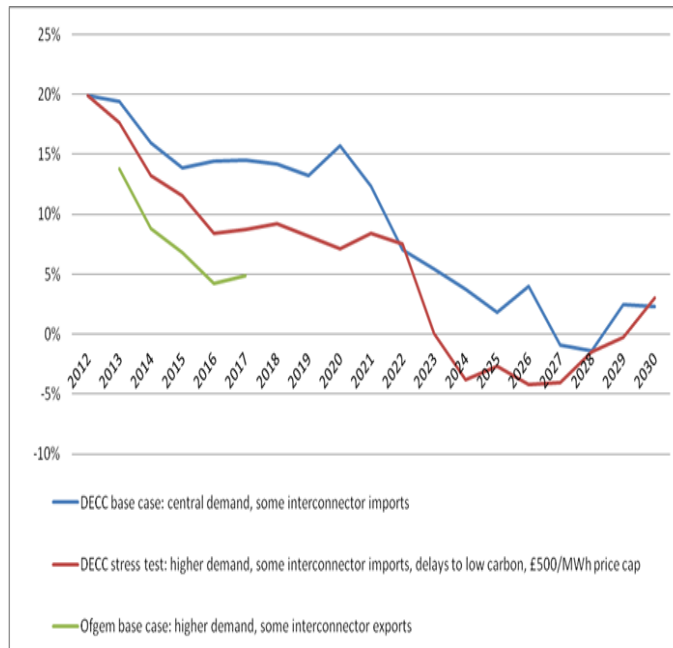


Intermittency and inflexibility:
large proportion
of new capacity
will be
intermittent or
less flexible

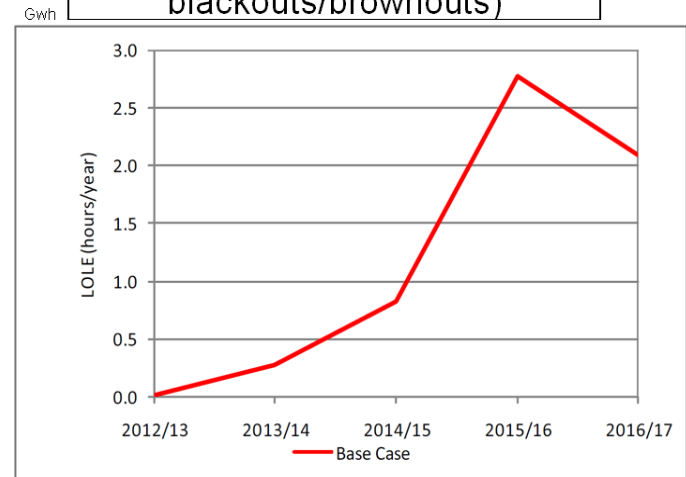


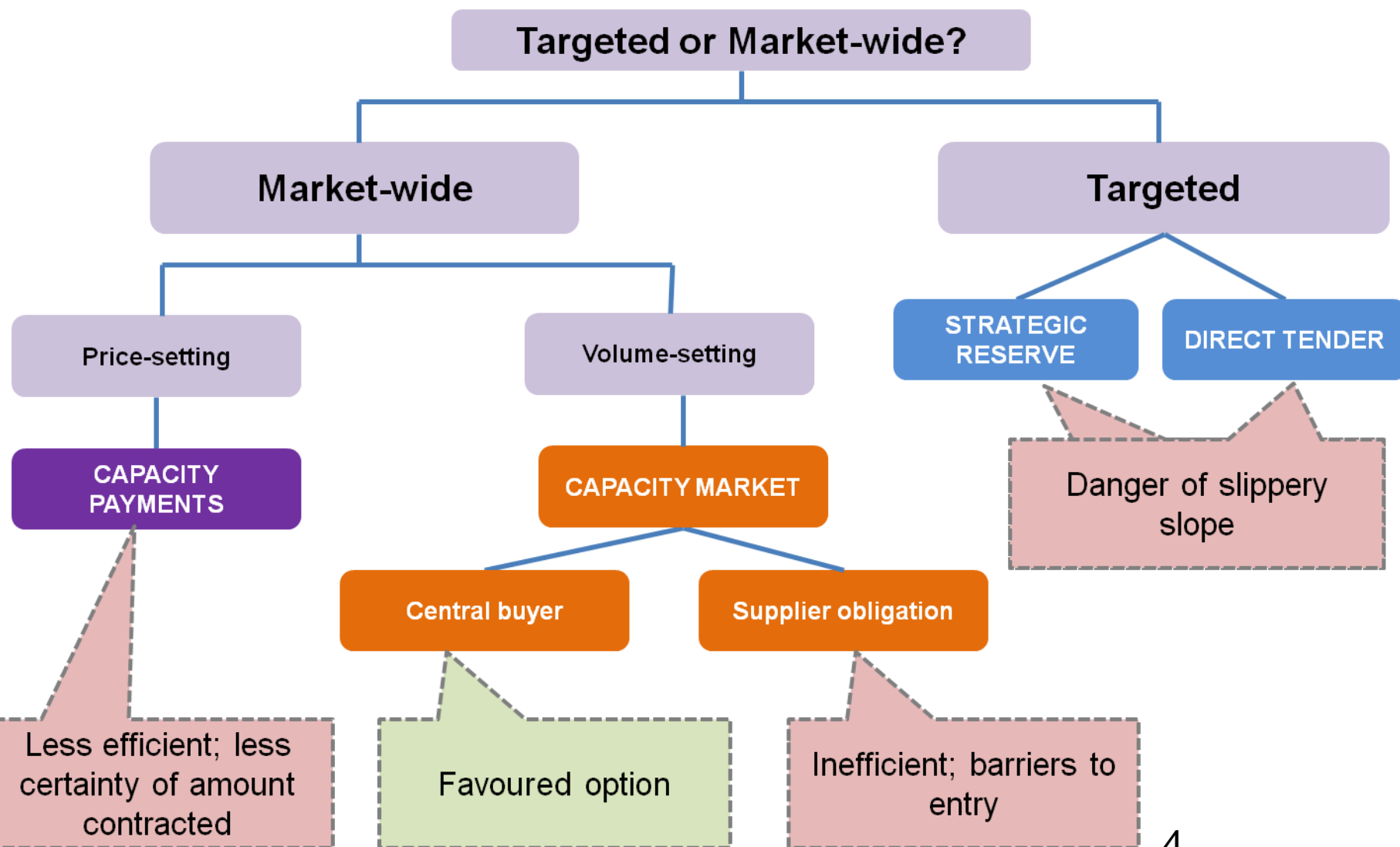
Insufficient incentives to invest in reliable capacity:
harder for reliable /
despatchable
capacity to capture
revenues, leading to
under- investment

... and there is consensus that margins will tighten, potentially to uncomfortable levels



Forecast loss of load (leading to blackouts/brownouts)



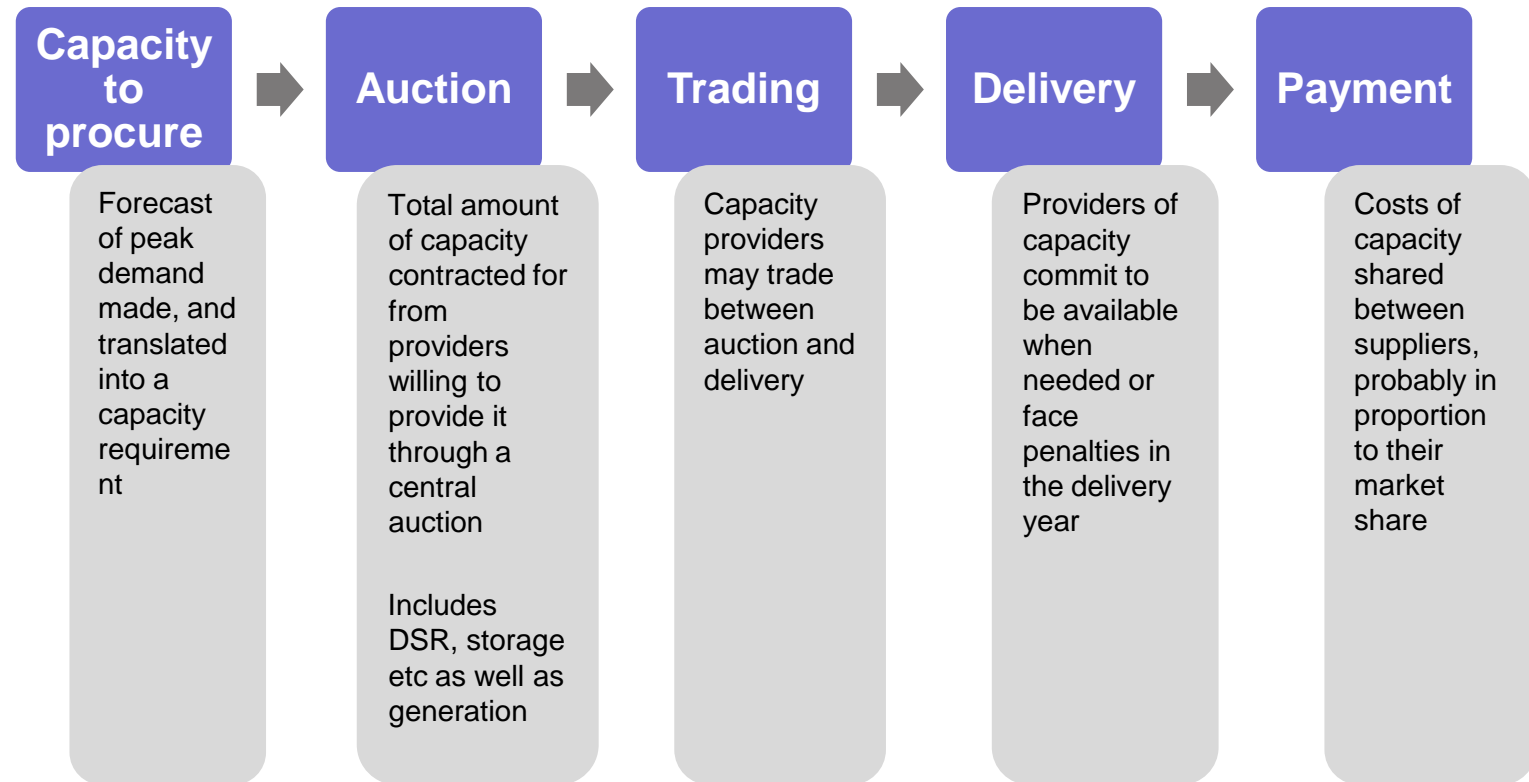




2: Capacity Market design



Capacity Market –high-level design



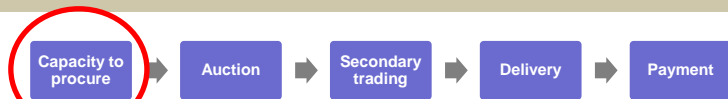
Implementation

- Bodies have clear roles and responsibilities
- Capacity Market can evolve as necessary

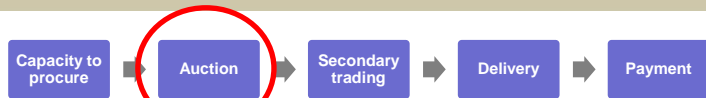
Process for deciding the volume of capacity to procure



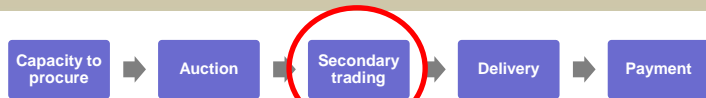
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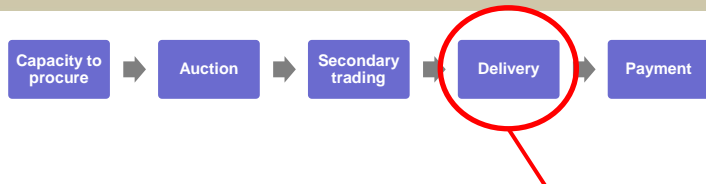
- **Minded to run the first Capacity Market auction in 2014, for delivery in 2018-19**
- Auctions will be held **c4 years ahead of delivery year**
- Net amount of capacity decided by Ministers **in advance of the auction**
- Volume of capacity **based on Reliability Standard**
- Auction participants **can participate in Balancing Services markets**
- DSR procured through **additional year ahead auction**



- Emerging preference for **pay-as-cleared auction** using sloping demand curve
- Participants:
 - **Included:** Generation (including CHP); Demand Side Response; Storage
 - **Excluded:** Plant receiving CfD
 - **To be decided:** Plant receiving Renewables Obligation; Demand Reduction; Interconnected capacity
- All participants **required to pre-qualify**
- **Different contract lengths available** – indicative 10 years for new, 3 years for refurbished, 1 year for existing



- **Private financial trading** permitted/encouraged
- Capacity contract can be **freely traded**
- Platform to be facilitated
- Considering liquidity issues in secondary markets given potential for different liability levels



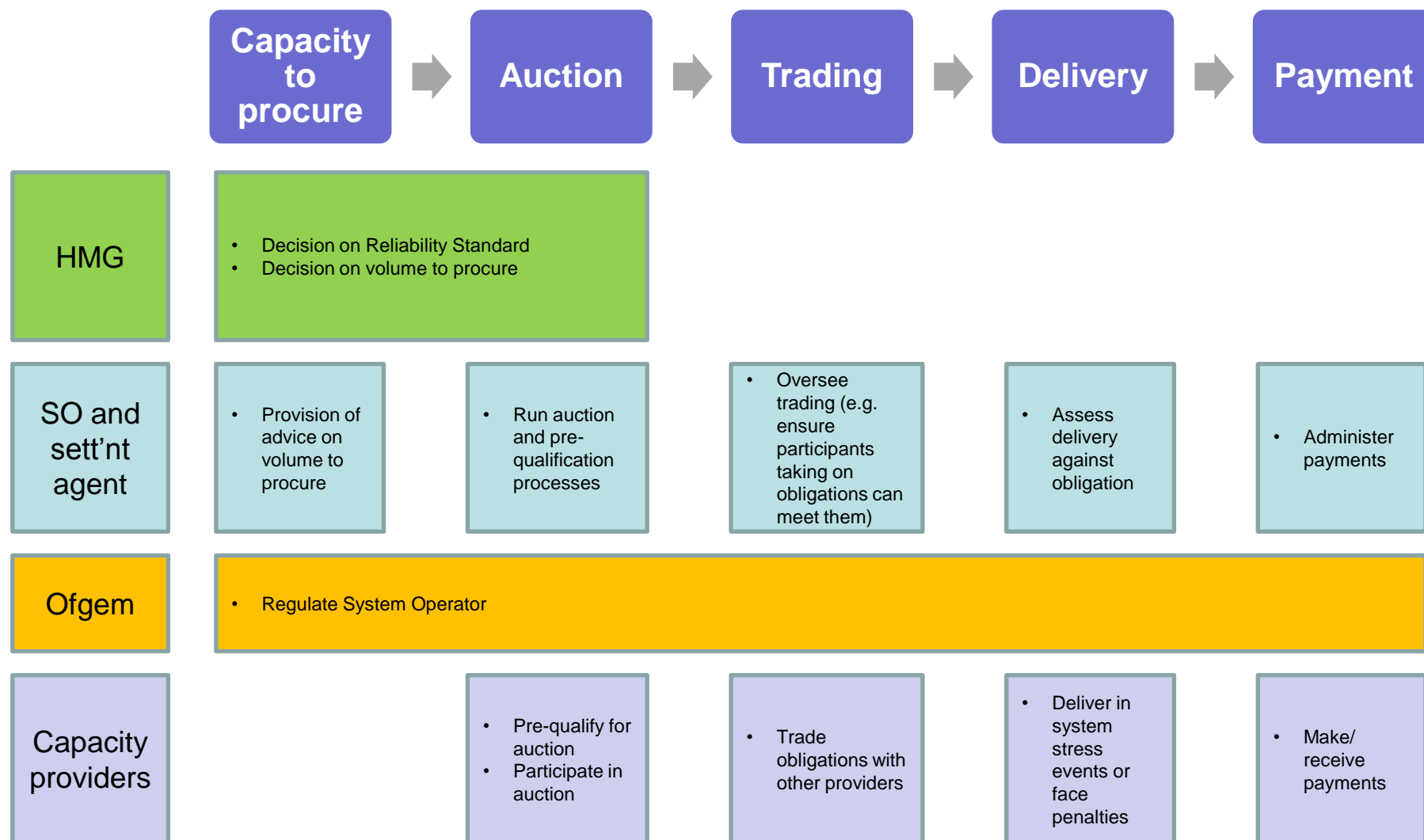
- **Up-front payment** – flat fee (£) paid monthly (£/12) in delivery year
- Obligation based on **delivery of energy at times of system stress**
- Considering proposals to **ensure liabilities are proportionate** – including:
 - Capping of liabilities
 - Penalties per event of up to 4 hours
 - Payment for over-performance

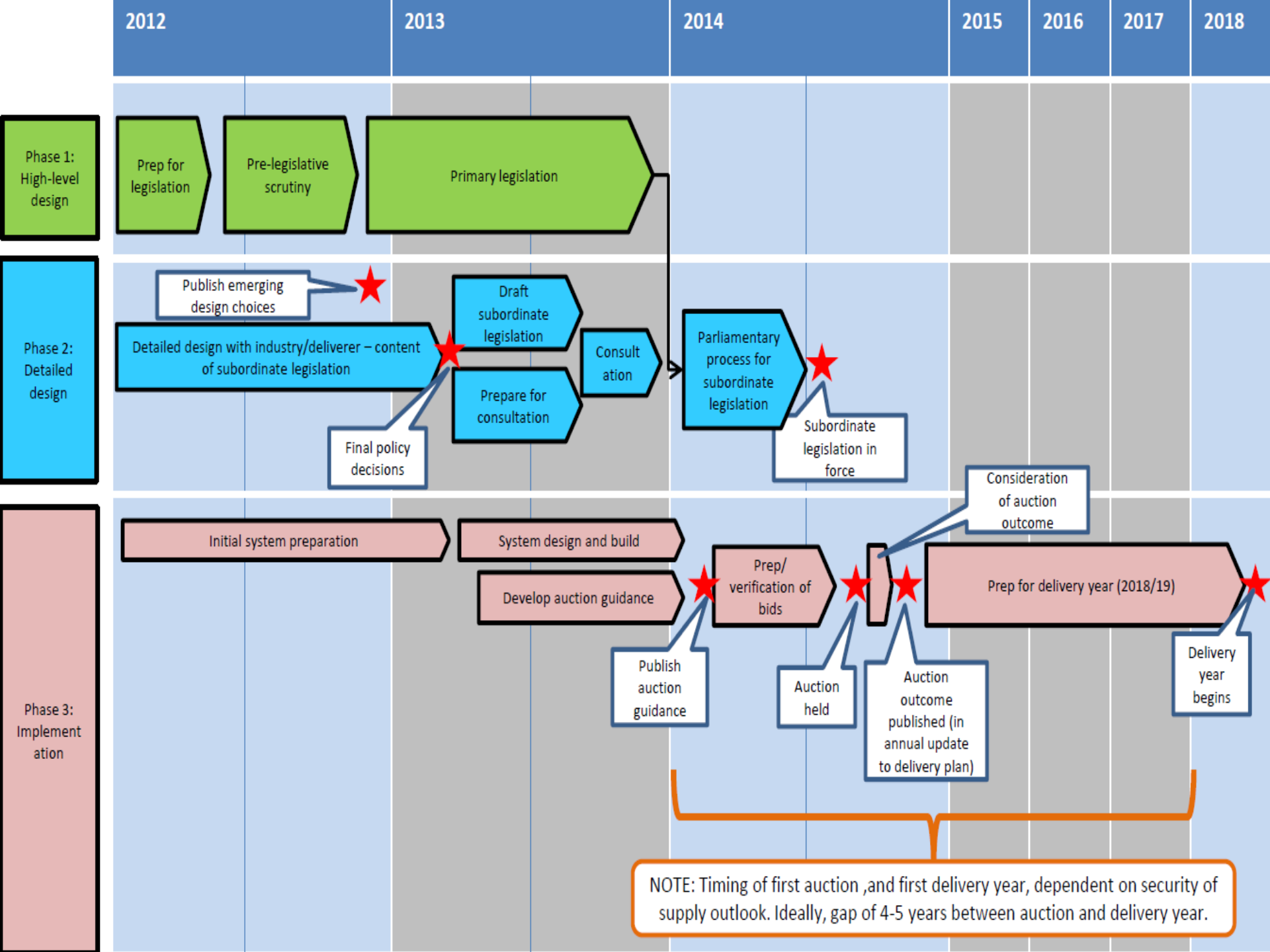


- Use of **settlement body**
- Requirement on industry participants to **meet financial commitments**
- Settlement agency has right of cost recovery – **from Capacity Market participants, probably on basis of market share**



Roles in steady state







3: How the Capacity Market delivers

The Capacity Market will help to provide the necessary investor certainty...



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Increasing investment certainty by:

Providing predictable payments for capacity: reducing dependence on unpredictable scarcity rents

Offering longer-term contracts for new plant: increasing long-term revenue certainty and reducing cost of capital

Reducing risk for capacity providers by ensuring a proportionate penalty regime in the event of non-delivery

Using an enduring Reliability Standard: providing greater certainty of how much capacity is needed, and reducing “boom and bust” investment risks

... while also protecting consumers' interests



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**Protecting
consumers
by:**

Reduced risk of service interruptions: Capacity Market helps to ensure adequate reliable capacity on the system

Minimising risk of over-procurement: use of Reliability Standard; reflecting the value provided by interconnection

Supporting participation of a wide range of technologies: specific arrangements for DSR

Allowing new plant to compete on comparable basis with incumbents: longer-term contracts for new plant

Competitive auction to set lowest price for capacity: providing incentives for efficient delivery and innovation; using sloping demand curve



Questions/discussion