Capacity Market Update
New Carbon Emissions Limits for Participants

5 August 2019

Overview

On 4 July 2019, the Recast EU Electricity Regulation[1] (the **Electricity Regulation**) came into effect as part of the EU's Clean Energy Package.[2] The Electricity Regulation has direct effect (takes full effect in law) in the UK, and Article 22 concerns "Design Principles for Capacity Mechanisms" and includes carbon emissions limits for new and existing generation seeking agreements in Capacity Market auctions.

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1 Regulation (EU) 2019/943 on the internal market for electricity

2 https://ec.europa.eu/energy/en/topics/energy-strategy-and-energy-union/clean-energy-all-europeans

What Are the New Emissions Limits?

Article 22 of the Electricity Regulation provides that:

New Plants – From 4 July 2019, plants that started commercial production on or after 4 July 2019 and emit more than 550g of CO2 of fossil-fuel origin per kWh cannot earn revenues from the Capacity Market.

Existing Plants – From 1 July 2025 at the latest, plants that started commercial production before 4 July 2019 and emit more than 550g of CO2 of fossil-fuel origin per kWh and more than 350kg of CO2 of fossil-fuel origin on average per year per installed kWe cannot earn revenues from the Capacity Market.

The emissions limit of 550g of CO2 of fossil-fuel origin per kWh of electricity and the limit of 350kg of CO2 of fossil-fuel origin on average per year per installed kWe referred to above is to be calculated on the basis of the design efficiency of the generation unit, meaning the net efficiency at nominal capacity under the relevant standards, which is likely only to be finalised through ACER technical guidance. ACER is due to publish a methodology for calculating emissions limits by 5 January 2020. It is anticipated that this will also include the methodology for calculating CHP emissions and that it will assume a heat-only boiler as the alternative heat source.

EU member states with existing Capacity Market mechanisms are required, pursuant to Article 22 (5) of the Electricity Regulation, to comply with these limits without prejudice to commitments or Capacity Market agreements concluded by 31 December 2019.

Capacity Market Rule Changes

New Plants

In order to comply with these emissions limits in respect of new-build capacity and unproven demand side response (DSR) seeking to prequalify for the capacity auctions in early 2020, amendments to the Capacity Market Rules came into force on 18 July 2019 (these changes were made through the Capacity Market (Amendment) (No. 5) Rules 2019). These changes include a new requirement for applicants for new-build Capacity Market Units (**CMUs**) that consists of, or will consist of, a generating unit that produces electricity from fossil fuels to provide a "Fossil Fuel Emissions Declaration" declaring that no unit has a Commercial Production Start Date that is on or after 4 July 2019 and will at any time during the delivery year (in respect of which a capacity obligation awarded to the CMU may apply) specified in the application emit more than 550g of CO2 of fossil-fuel origin per kWh of electricity generated.

Existing Plants

The Department of Business Energy & Industrial Strategy (**BEIS**) is now seeking views on how to most effectively implement the remainder of the provisions, in respect of existing capacity, and has issued a consultation[3] that closes on 6 September 2019 (the **BEIS Consultation**).

3 BEIS Proposals for Capacity Market Emissions Limit Consultation, accessed 4 August 2019.

What Generation Type Will Be Affected by These New Limits?

These new emissions limits will affect coal, diesel and possibly some old inefficient gas generation, including any such fossil-fuelled components included as part of DSR CMUs. Our expectation is that efficient gas, combined heat and power, and energy from waste will still be able to participate in the Capacity Market.

As per Article 22 (5), fossil-fuelled generation with long-term agreements from any Capacity Market auction held before 31 December 2019, and which run beyond 1 July 2025, will not be subject to these limits for the duration of their Capacity Market agreement.

Existing generation exceeding the 550g/kWh standard will have the option of taking advantage of the 350kg CO2/installed kW allowance contained within the Electricity Regulation, which would allow them to continue participating in the Capacity Market, provided they limit their emissions by operating for a limited number of annual running hours.

The BEIS Consultation Relating to Existing (Including Refurbishing) Generation

In order to give effect to the requirements in Article 22 in respect of Capacity Market auctions taking place after 1 January 2020, BEIS is consulting on:

- **Whether emissions limits for existing generation should take effect on 1 July 2025 or 1 October 2024**. The Electricity Regulation imposes a requirement that any existing generation that does not meet the emissions limits shall not, from 1 July 2025, receive any capacity payments. This date falls partway through the 2024/25 delivery year. As such, BEIS has asked for industry views on whether or not the implementation date should align with the start of that delivery year.
- **What length of Capacity Market agreements should be awarded in the upcoming T-3 and T-4 Capacity Market auctions to refurbishing fossil fuel generation that will not meet the emissions limits**. Refurbishing generation is currently eligible for three-year Capacity Market agreements, which, if awarded in the upcoming T-3 and T-4 Capacity Market auctions, would run beyond 1 July 2025 for emissions limits on existing generation. BEIS does not believe it is appropriate to support investment in refurbishing and extending the life of generation capacity that will exceed the emissions limits and so is in favour of altering the Capacity Market Rules such that refurbishing CMUs that will exceed emissions limits are only eligible for one-year agreements in the upcoming auctions.
- **How best to deal with false or inaccurate Fossil Fuel Emissions Declarations and the recovery of Capacity Market payments in such cases**. The Capacity Market Rules already establish arrangements for terminating Capacity Market agreements, and recovering capacity payments in circumstances in which capacity providers have made false or inaccurate declarations. Industry views are sought on whether it is necessary to amend these existing arrangements in respect of the Fossil Fuel Emissions Declarations, including whether a termination fee should be introduced and, if so, at what level.

BEIS intends to consider amendments to the Capacity Market Rules ahead of the upcoming Capacity Market auctions to be held in early 2020. The amendments could affect CMUs that submitted prequalification applications during summer 2019, particularly refurbishing CMUs.

BEIS currently intends the proposed changes will continue to apply after the UK's exit from the EU.[4]

4 Ibid 3.