

On 24 April 2020, the Department for Business, Energy & Industrial Strategy (BEIS) published a Consultation¹ seeking industry views to relax certain Capacity Market obligations and deadlines, reduce the burden and minimise terminations of Capacity Market Agreements arising from the COVID-19 pandemic or the restrictions imposed by the Government to tackle it.

The consultation closes at 11:45 p.m. on 30 April 2020. In this alert, Rob Broom (associate) and Paul Brennan (consultant) from our Energy & Natural Resources Practice take a closer look at the proposed changes.

The UK Capacity Market

The Capacity Market is a support scheme for electricity generation introduced as part of the UK Government's Electricity Market Reform (EMR) pursuant to the Energy Act 2013. It is the government's main tool for ensuring security of electricity supply in the UK.

The EMR Delivery Body (National Grid) runs Capacity Market auctions one (T-1) and four (T-4) years ahead of delivery years (DY) to secure an overall level of electricity capacity as determined by the Secretary of State. Successful generators in the Capacity Market auction receive a Capacity Agreement for a specific obligation and price per kW, and are to paid monthly payments based on the auction clearing price, their obligation and the time of the year.

Obligations Under a Capacity Agreement

In response to a System Stress Event, Capacity Providers (as holders of Capacity Agreements) are, on being given four hours' notice by the Delivery Body, required to ensure that their Capacity Market Unit (CMU) provides capacity, by way of actual generation or demand reduction, as the case may be, at a level adjusted to reflect the prevailing level of national demand, up to a maximum of the CMU's committed level of capacity under its Capacity Agreement. In the event that the CMU fails to generate, or reduce demand, to the required level during a System Stress Event, the Capacity Provider will then be liable to pay a penalty, capped at twice the monthly capacity payment for the CMU, with an annual cap and liabilities equal to the total amount of payments received by the CMU in the relevant Delivery Year.



In addition to the requirements to respond to System Stress Events, a Capacity Agreement requires the CMU to demonstrate to the Delivery Body a capacity at a level equal to its Capacity Market Agreement obligation on three separate days (each a Satisfactory Performance Day or SPD) during the winter (a period from 1 October to the following 30 April) of any relevant Delivery, and one SPD must occur during the period from 1 January to 30 April – failing which, the Capacity Agreement and the Capacity Provider's entitlement to payments for the relevant CMU will be suspended. In addition, metering test certificates must be provided where the Delivery Body determines these are required for a CMU's metering arrangements.

New and Refurbishing CMUs are subject to additional requirements, to demonstrate progress in their construction or refurbishment and their ability to perform to perform, including:

- Providing Independent Technical Expert (ITE) Reports on progress every six months (Rule 12.2.1)
- Meeting Minimum Completion Requirements or "MCR" – achieving an export MW capacity equivalent to 50% of the CMU's Capacity Market Agreement obligation by a designated Long Stop Date
- Meeting Substantial Completion Milestones or "SCM" – achieving an export MW capacity equivalent to 90% of the CMU's Capacity Market Agreement obligation by a designated long stop date

New Build CMUs awarded T-1 Capacity Market Agreement for capacity obligations which begin to have effect in DY 2020/21 face termination if they do not achieve their SCM or MCR by the start of the DY (i.e. the Long-Stop Date for this type of agreement is 1 October 2020).

¹ BEIS Consultation "Capacity Market Proposed Easements in Response to COVID-19 Pandemic"; published 24 April 2020, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/881101/capacity-market-proposed-easements-covid19.pdf, accessed 27 April 2020.

If Refurbishing CMUs awarded multi-year agreements in the 2016 T-4 auction for capacity obligations which begin to have effect in 2020/21 miss their SCM by their Long-Stop Date of 1 October 2020, then their multi-year agreement reverts to a one-year agreement

New Build CMUs awarded T-4 Capacity Market Agreements in the 2016 T-4 auction for capacity obligations which begin to have effect in DY 2020/21 have a Long-Stop Date which affords a 12-month grace period after the start of that delivery year within which they can meet the MCR and/or the SCM.

Can Capacity Providers Rely on Force Majeure, Frustration or Equivalent Legal Doctrine to Excuse Performance Under Their Capacity Agreements?

A Capacity Agreement is not in itself a private law contract, but a statutory contract under the Energy Act 2013. The Electricity Capacity Regulations 2014, made under the act, define a Capacity Agreement as "...comprising the rights and obligations accruing to a capacity provider under or by virtue of the Electricity Capacity Regulations 2014 and the Capacity Market Rules" (adopted under the Regulations) with respect to CMUs registered in the Capacity Market Register as a "capacity committed" CMUs for one or more Delivery Years. A Capacity Agreement is not intended to give rise to contractual rights for the benefit of the Capacity Provider. Consequently, neither the contractual relief afforded by the typical *force majeure* nor the Common Law doctrine of frustration apply. Putting the matter beyond doubt, the Capacity Market Rules specifically exclude the application of *force majeure*, frustration or equivalent legal doctrine.² Consequently, Capacity Providers are not entitled to relief where unforeseeable and unavoidable circumstances that are outside of their control prevent them from fulfilling their obligations under their Capacity Agreements.

² Rule 6.9.1.

There are, though, other mechanisms under Capacity Market Rules to avoid penalties if Capacity Providers are unable to meet their obligation to provide capacity in response to a system stress event:

- **Physical Secondary Trading** – A Capacity Provider may transfer all or part of a Capacity Agreement for a Capacity Committed CMU (the CMU Transferor) for all or a specified number of calendar days in a DY to an Acceptable Transferee in respect of another CMU (the CMU Transferee). The trade of the obligation must occur prior to the period for which the obligation is transferred (*ex ante*) and the CMU Transferee would then receive payments for the period for which they hold all or part of the obligation.
- **Volume Reallocation** – Following a System Stress Event, Capacity Providers who have over delivered can transfer excess output of a CMU to a separate CMU. Where a CMU has delivered more than its "Adjusted Load Following Capacity Obligation", ("the seller") would be permitted to reallocate the excess output to another CMU that did not deliver all of its "Adjusted Load Following Capacity Obligation" ("the buyer"). The obligation of either CMU is not changed by the trade. The buyer would be considered to have met its obligation via a combination of any output of its own and that nominated from other CMUs. The seller would not receive over delivery payments for any MW transferred to another CMU.

Existing Capacity Providers who anticipate being unable to respond to System Stress Events as a result of the COVID-19 pandemic may use either or both of these mechanisms to reduce their liability in the event that a System Stress Event does occur. Under the Capacity Market Rules as they stand, though, there is no relief against the consequences of failures to comply with rules regarding the testing of CMUs' performance and completion of works on New and Refurbished CMUs to achieve the relevant completion milestones.



What Is the Consultation Seeking to Change?

The first thing to note is what the government is **not** proposing to change. There will be no equivalent to *force majeure* relief for Capacity Providers who are unable to provide capacity during a System Stress Event. Capacity Providers with Existing CMUs will have to use the existing mechanisms if they wish to avoid penalty payments in the event that a System Stress Event occurs.

Recognising that the COVID-19 pandemic and measures being taken to delay its spread are likely to impact Capacity Providers' ability to satisfy testing requirements on CMUs generally and complete works on New and Refurbished CMUs in particular, BEIS is looking to modify the current rules in the following areas

Proposed Change	Rationale
General	
<p>Satisfactory Performance Days (SPDs) – There will be no suspension of capacity payments between 30 April 2020 and the termination deadline (in most cases, 31 July 2020) in instances where a CMU with a Capacity Agreement awarded in an auction held after 21 December 2017 fails to achieve three separate SPDs by 30 April 2020, provided it does so by 31 July 2020.</p>	<ul style="list-style-type: none"> • BEIS recognises that disruptions caused by the COVID-19 pandemic may have caused failures by Capacity Providers to achieve the SPDs by 30 April 2020. • If Capacity Providers will still be required to deliver three additional SPDs by the deadline in Rule 13.4.1ZA(a) (in most cases, 31 July 2020), or face loss of capacity payments and a Termination Event under Rule 6.10.1(r), with possible termination and associated termination fees as a consequence.
<p>Metering Tests – Extend the deadline from 17 September to 30 September 2020 for Existing CMUs and DSR CMUs with T-1 Capacity Agreements for the 2020/21 Delivery Year.</p>	<ul style="list-style-type: none"> • As metering tests can require access to sites, BEIS is proposing to provide some relief by extending the deadline by two weeks until the end of September 2020.
<p>Long-Stop Date – Extend the Long-Stop Date for New Build CMUs awarded T-1 agreements and Refurbishing CMUs with multi-year agreements, which, in both cases, have a 2020/21 Delivery Year, by 12 months. Capacity payments will not be made until the relevant milestone is met (the SCM or the MCR).</p> <p>To qualify for the extended Long-Stop Date (being the 30 September 2021), an ITE report must be provided to the Delivery Body by 1 October 2020, confirming that the project would have met its SCM as set out in rule 6.7.2 by that date had it not been for the impact of the COVID-19 pandemic, and explaining how the COVID-19 pandemic led to project delays.</p>	<ul style="list-style-type: none"> • BEIS recognises that New Build and Refurbishing CMUs holding agreements for capacity obligations that are due to commence in DY 2020/21 may be facing delays as a result of the COVID-19 pandemic and so may be unable to meet their MCR and/or SCM, as applicable. • If neither the SCM nor MCR are met by the extended Long-Stop Date, then the CMU will be terminated in accordance with current arrangements. • New Build CMUs with multi-year agreements due to start in the 2020/21 Delivery Year already benefit from a September 2021 Long Stop Date
<p>Independent Technical Expert (ITE) Reports – Remove the requirement for an ITE report in relation to any Six Monthly Progress Reports falling due during the 2020/21 financial year for New Build CMUs and Refurbishing CMUs (i.e. from 1 April 2020).</p>	<ul style="list-style-type: none"> • It may be impossible or very difficult for experts to access sites in order to prepare their reports. The change is also intended to relieve the administrative burden on Capacity Providers who are experiencing problems reaching key milestones. • BEIS is considering whether it might be necessary in the case of New Build and Refurbishing CMUs connected to a distribution system to relax the requirement for an ITE to certify that the DNO's commissioning tests have been satisfied.



Demand Side Response (DSR)

Metering Test and DSR Test – Unproven DSR CMUs holding Capacity Agreements commencing in the 2021 Delivery Year to have an additional 12 months to comply with these requirements.

These extended deadlines would only be available where an ITE report is provided by 31 August 2020, which confirms that the CMU would have been ready to deliver capacity by the start of the 2020/21 Delivery Year had it not been for the impact of the COVID-19 pandemic.

- DSR aggregators with Unproven DSR CMUs holding agreements for capacity obligations, which begin to have effect in the 2020/21 DY, may experience difficulties in acquiring or recruiting DSR capacity during the COVID-19 pandemic and, therefore, struggle to:

1. Provide a DSR Test Certificate by 31 August 2020 (Rule 8.3.2(a)), and
2. Complete a Metering Test (if required) by the deadline of 17 September 2020 (Rule 8.3.3(e)(i))

- The government, therefore, proposes to extend each of these deadlines by 12 months so that Unproven DSR can benefit from arrangements similar to the extension of the Long-Stop Date that applies to Prospective CMUs (as amended per the above proposals).

- BEIS expects the ITE's report to explain the Capacity Provider's progress in recruiting DSR components, and confirm that until the outbreak of the pandemic, it had been on track against the original Business Plan for the CMU (Rule 3.10.1) to deliver DSR capacity by 1 October 2020, and an explanation of how the effects of the COVID-19 pandemic led to delays.

DSR Baseline Demand – Reduce the amount of data required to be provided by capacity providers to establish baseline demand for Unproven DSR CMUs with Capacity Agreements commencing in 2020/21. Capacity Providers will be required to provide data from two rather than six of the working days in the six-week period preceding the day on which the DSR Test occurred.

For DSR CMUs with Capacity Agreements for the current Delivery Year (2019/20), historic baseline data (i.e. used in the CMU's DSR Test) may be used to demonstrate Satisfactory Performance Days.

A lack of demand, particularly from commercial and industrial sites, may make it more difficult to demonstrate an appropriate level of baseline demand to be used in the DSR tests.

Storage (Extended Performance Days)

N/A

No special provision has been made for storage CMUs that the pandemic has prevented from discharging their obligation to run an extended performance test prior to April 30 this Delivery Year.

In addition, BEIS proposes to make various modifications to the Market Rules and Electricity Capacity Regulations 2014 relating to the review and Appeals Processes.

The following changes proposed for existing Capacity Agreements:

- Where a termination notice is issued before 1 May 2021, the time in which a Capacity Provider may appeal to the Secretary of State to have the termination notice extended or withdrawn is increased from 20 to 30 working days
- The maximum amount of time by which the Secretary of State may extend a termination notice is increased from six months to a year, if the request is made in the first (or only) Delivery Year of the Capacity Agreement
- A new right for the Secretary of State to direct the termination of a Capacity Agreement without obligation to pay a termination fee if requested before the end of its first Delivery Year, and the Capacity Provider demonstrates that the relevant failure requirement was the direct and unavoidable result of the pandemic; the Capacity Provider would, though, have to repay any capacity payment it received under the relevant Capacity Agreement

Looking forward, with respect to reviewable decisions notified by the Delivery Body prior to 1 May 2021, such as prequalification decisions and the issue of termination notices, and appeals from those decisions to Ofgem:

- The time within which a request for reconsideration of the decision must be submitted to the Delivery Body is increased from five to 10 working days
- The time the Delivery Body has to reconsider a delivery body reviewable decision and notify the affected person of its reconsidered decision and the reasons for it is increased by five working days to 20 working days after the original decision
- The time within which an appeal against a reconsidered decision of the Delivery Body (or against its rejection of a request for a decision to be reconsidered) may be submitted to Ofgem is increased from five to 10 working days

Conclusion

Notwithstanding any changes brought about by the Consultation, BEIS encourages Capacity Providers who might be experiencing delays or other difficulties in meeting their Capacity Agreement obligations due to the COVID-19 pandemic or related restrictions to communicate these as early as possible to the Delivery Body and to continue to provide the Delivery Body with regular updates.

The changes to the Market Rules are relatively modest. There is no additional relief for Existing CMUs that are unable to discharge their obligations to provide capacity in response to a System Stress Event though, with the current reduction in demand, the risk of such events occurring may have diminished. Capacity Providers affected in this way may be able to reduce their exposure to penalties cost effectively by physical capacity trading or volume allocation.

The relief for CMUs unable to demonstrate their ability to provide capacity through Satisfactory Performance Days, etc., is welcome, although the relief is not comprehensive, and only temporary.

The extension of Long-Stop Dates up until September 2021 for all New Build and Refurbished Capacity Agreements with a first Delivery Year of 2020/21 is also welcome; although, it will only protect the CMUs against the consequences of termination – it will not result in an extension of their Capacity Agreements or compensate the Capacity Provider for the income resulting from delays in completing the relevant works.

Lastly, the extended time periods for challenging Reviewable Delivery Body Decisions are welcome; though, they remain very tight. Applicants who fear they may encounter difficulties in the pre-qualification process or who may be expecting termination notices would be well advised to ensure that they have the information necessary to support any such challenge at their fingertips.

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