DETERMINATION PURSUANT TO REGULATION 71(3)(b) OF THE ELECTRICITY CAPACITY REGULATIONS 2014 FOLLOWING AN APPEAL MADE TO THE AUTHORITY PURSUANT TO REGULATION 70(1)(a)

Introduction

1. This determination relates to appeals made by Green Frog Power Limited ("GFP") against decisions made by the delivery body (National Grid Electricity Transmission plc – "NGET") in respect of the following 12 capacity market units (CMUs):

    (1) 214DOW – Dowlais STOR CMU
    (2) 214GIR – Girlington STOR CMU
    (3) 214HIR – Hirwaun STOR CMU
    (4) 214NOR – Northwick STOR CMU
    (5) 214PLY – Plymouth STOR CMU
    (6) 214TIR – Tir John STOR CMU
    (7) 214TRE – Tregaron STOR CMU
    (8) 214WIL – Willoughby STOR CMU
    (9) 214BRI – Briton Ferry STOR CMU
    (10) 214FLA – Flatworth STOR CMU
    (11) 214HUL – Hull STOR CMU
    (12) 214SWA – Swansea STOR CMU

2. Pursuant to Regulation 71(3) of the Electricity Capacity Regulations 2014 (the "Regulations"), where the Authority receives an appeal notice under that regulation that complies with Regulation 70, the Authority must review a reconsidered decision made by NGET. In reviewing a reconsidered decision, the Authority must determine whether the decision was correct on the basis of the information which NGET had when it made that decision.

Appeal Background

3. GFP submitted applications to the T-4 auction for 12 CMUs (the "GFP Applications"). In a Notification of Prequalification Decision dated 3 October 2014 (the "NGET Prequalification Decision"), NGET prequalified four and rejected eight of the GFP Applications. The eight rejected CMUs were rejected on the grounds that the historic output figures did not demonstrate output above the de-rated capacity of the CMUs, as required by rule 4.4.2(f) of the Capacity Market Rules (the "Rules").

4. In a letter from GFP to NGET dated 10 October 2014 (the "GFP Reconsideration Request") GFP disputes the prequalification decision in respect of the eight CMUs that did not prequalify. Further, GFP states in that letter that, if NGET disagrees with GFP, then it should remove all 12 of GFP's CMUs from the CM Register – with the effect that they do not prequalify.

5. In a Notification of Reconsidered Decision dated 17 October 2014 (the "NGET Reconsidered Decision") NGET upheld the NGET Prequalification Decision to reject the eight CMUs on the following grounds:

   "*the historic output figures using the STOR data as requested did not demonstrate net output above the de-rated capacity in each of the Settlement Periods as required by Rule 4.4.2(f)*"

6. In addition, NGET rejected all 12 of the CMUs' for the following reason:

   "*the covering letter accompanying the Dispute Notice (and therefore considered part of that Notice) introduces a conditional element into the STOR status declaration [our emphasis] which was previously submitted by the applicant as required by Rule 3.4.8(b). We are therefore not able to accept this as a valid STOR status declaration and are so not able to prequalify the CMUs under Rule 4.4.2(a) as the application has, as a result, not been completed and submitted in accordance with the Rules*".

7. In two capacity market Appeal Notices (and accompanying letters) dated 23 October 2014 (the "GFP Appeal") GFP submitted an application for the Authority to review the NGET Reconsidered Decision, pursuant to Regulation 70(2) of the Regulations, for each of the 12 CMUs (listed in paragraph 1 above).

GFP's reasons for appeal

We set out below a summary of the main reasons for the appeal.

Issue 1: Settlement Periods

8. GFP states that it was rejected from prequalification for eight CMUs on the basis that it had not provided historical data showing that each of its CMUs had generated up to at least their de-rated capacity on three occasions over the last 24 months (CMUs 1 to 8 listed in paragraph 1 above). GFP states that it asked NGET to use minute-by-minute STOR performance to demonstrate its ability to reach de-rated capacity. GFP required the STOR

data to be used because it had not achieved full capacity for the entire duration of a settlement period.

9. GFP contends that neither the Rules nor the Regulations require a CMU to demonstrate that its net output exceeds the de-rated capacity for an entire half hour, only that it should be demonstrated within the three periods of its highest total output. GFP states that the STOR data demonstrates that it has operated to de-rated capacity on at least three occasions over the last 24 months in the periods identified by rule 3.6.1 and that, having done so, it meets the requirements of Rule 4.2.2(f). This requires NGET to prequalify its CMUs.

Issue 2: Conditionality

10. The NGET Reconsidered Decision rejected all 12 CMUs from prequalification on grounds that the GFP Reconsideration Request applied conditionality to GFP's withdrawal declaration. GFP deny this and contend that its withdrawal application – that it would withdraw for a fee if accepted into the CM auction – cannot be construed as conditional.

11. GFP states that there is a material difference between the wording of Regulation 18 and Rule 3.4.8(b) in the treatment of prequalification. GFP believes that the wording of Regulation 18 allows GFP to terminate its contract for an appropriate fee, whereas the wording of Rule 3.4.8(b) precludes this option. GFP believes that NGET wrongly applied the relevant law, in particular, that in the event of a conflict between the Rules and the Regulations, the Regulations must prevail. So, in GFP's view, the wording of Regulation 18 should be followed. GFP's interpretation of Regulation 18 means that the withdrawal declaration it made should be accepted and would require NGET to register all 12 CMUs as prequalified.

12. GFP has requested that the Authority, in considering its arguments, should take account of DECC's formal notification to the European Commission on state aid concerning treatment of long-term STOR contracts with NGET[1]. GFP states that this advice provides that no STOR provider should be worse off if it participates in a CM auction.

Process

13. In coming to our determination we have considered all the information provided by GFP and NGET, including the information provided in response to our request dated 3 November 2014 – a copy of NGET's response was copied to GFP on 11 November 2014.

[1] DECC's advice is summarised in paragraph 105 of Commission Decision C (2014) 5083 final.

Our Findings

Issue 1: Settlement Periods

14. Rule 3.6.1 states that each applicant for an existing generating CMU must identify in the application three settlement periods on separate days in the 24 months prior to the start of the prequalification window in which such existing generating CMU delivered its highest physically generated net outputs, and specify such physically generated outputs. A "settlement period" is defined in Regulation 2 as meaning a 30 minute period beginning on an hour or half hour.

15. The substance of the argument put forward by GFP is that it has not generated for the whole of a settlement period, but that minute by minute data is available, and should be sufficient. We do not accept this argument for the reasons set out below:

    a) In our view, if Rule 3.6.1 had intended for net output calculations to be against a moment (or a minute) i.e. the maximum net output on the three separate days, it would not have specified a settlement period of 30 minutes. In such circumstances Rule 3.6.1 would have just required the applicant to state the maximum net output of its CMUs on three separate days, with no mention of settlement periods. A proper interpretation of Rule 3.6.1 leads to the conclusion that an applicant must identify settlement periods, which according to Regulation 2 are of 30 minutes each.

    b) The definition of settlement period in Regulation 2, and how that is interpreted by NGET, is in line with that used across the industry, including within balancing mechanisms. The settlement period data supplied by GFP in its prequalification application, from Centrica, also included data based on average 30 minute settlement periods.

    c) The evidence before NGET when it made its decision, including interrogation of STOR data it held, did not provide evidence that GFP has generated for a period of 30 minutes in excess of the de-rated capacity. On that basis, GFP has not complied with the provisions of Rule 3.6.1.

16. GFP's claim that it only ever generates at the request of NGET under the long-term STOR contract, and that GFP has never been asked to generate for 30 minutes at its de-rated capacity, is an irrelevant matter for the purposes of the prequalification assessment NGET is required to conduct.

Issue 2: Conditionality

17. Rule 3.4.8(b) provides that GFP must, at the time of making its prequalification application, declare if its CMUs are currently subject to a long-term STOR contract and irrevocably declare that, if awarded a capacity agreement, it will withdraw from its long-term STOR contract.

18. The effect of Regulation 18(1) is that NGET must not prequalify a CMU that is the subject of a long-term STOR contract unless GFP has provided it, by the close of the prequalification window, a withdrawal declaration. Regulation 18(4) defines this "withdrawal declaration" as a declaration in writing by GFP that, if awarded a capacity obligation, it will offer to NGET to withdraw or terminate long-term STOR contracts with effect no later than the start of the delivery period.

19. The original application for prequalification for all 12 CMUs contained a withdrawal declaration that met the requirements of rule 3.4.8(b). This was made both on the electronic application form, and on a separate, signed declaration letter from GFP. The signed declaration letter did not mention any condition or term that would apply when the offer to withdraw from a STOR contract was made.

20. As part of the Reconsideration Request, GFP qualified these declarations by saying that:

"*Our interpretation of the Regulations and Rules is that we will not be excluded from the Capacity Mechanism provided that we offer to withdraw our long-term STOR contract with National Grid….the offer can demand consideration from National Grid for the withdrawal."*

21. The NGET Reconsidered Decision states that the reconsideration request introduces a conditional element into the STOR status declaration previously submitted. NGET states that it is not therefore able to accept this as a valid STOR status declaration and is not able to prequalify any of the 12 CMUs under Rule 4.4.2(a).

22. GFP contends that Regulation 18 and Rule 3.4.8(b) are inconsistent and that Rule 3.4.8(b) should be overridden by Regulation 18. Rule 3.4.8(b) states that GFP must declare that it will withdraw from its STOR contacts. Regulation 18 states that GFP must declare that it will *offer* to NGET to withdraw its STOR contracts.

23. Rule 1.5 provides that, if there is an inconsistency in terms then the Regulations take precedence over the Rules. While there is a difference in the drafting of Regulation 18

and Rule 3.4.8(b), we do not consider there to be any difference between the overall legal effect of these provisions, in terms of the intent they are seeking to achieve, and there is, therefore, no inconsistency which needs resolving by resorting to Rule 1.5.

24. The substance of the appeal under this ground, is whether the declaration that the provisions require, permits the future withdrawal from a STOR contract subject to the payment of a fee to GFP or not. The answer to this issue will determine whether GFP has provided valid declarations as part of its applications to the T-4 auction.

25. When interpreting the Rules and Regulations we must do so in context and in a way that implements, rather than defeats their legislative purpose. In this regard it is abundantly clear that as far as those applicants who have existing STOR contracts are concerned that the scheme is designed to ensure that a CMU cannot participate in the capacity market whilst concurrently receiving payment under a long term STOR contract. This is given legal effect by: firstly, requiring STOR providers to declare that they will withdraw from those existing commitments should they be awarded a capacity obligation for a CMU; secondly, such a withdrawal having no conditions attached to it; and lastly, by NGET having no discretion but to accept such a withdrawal where an applicant has been successful.

26. Accordingly we have reached the view that the provisions do not allow a declaration to be made in terms that the withdrawal from a STOR contract would be subject to the payment of a fee to GFP. GFP has not therefore made a valid declaration as required under Regulation 18 and Rule 3.4.8(b).

27. In reaching this view we have taken account of the following:

    a) There is no indication in the Rules or Regulations, either expressly or by implication that the withdrawal from a STOR contract can be on the basis that a fee is paid. The fact that Regulation 18 uses the words ‘to offer’ does not indicate that the offer to withdraw can be supplemented by the applicant in any way. If that had been the intention, then express words to allow that would have been drafted into relevant provisions.

    b) Neither the Rules nor the Regulations give any power to NGET to negotiate the basis of any offer to withdraw from a STOR contract. NGET is faced with a purely binary choice. It must decide whether the declaration is valid or not. Where it is valid and the applicant is successful in being awarded a capacity obligation then the withdrawal must take place in accordance with the declaration. In such circumstances, if the relevant provisions allowed for a fee to be paid as part of the terms of the withdrawal,

then provision would have been made for NGET to negotiate or calculate the fee, as in absence of such a power NGET would have to accept whatever fee was being set out. This is in contrast with other parts of the Regulations and the Rules, for example the detailed settlement calculations in Schedule 1 to the Regulations.

c) DECC's response to its consultation on proposals for the implementation of EMR[2] and in particular the following:

i. that any declaration to withdraw from a STOR contact must be irrevocable and unconditional (pages 72-75). Under the heading Long-term STOR, DECC states that long-term STOR may only participate in the capacity market where it irrevocably commits to the termination of the STOR contract if successful in the capacity auction.

ii. it would be overpayment for long-term STOR contracts to receive capacity payments in addition to STOR payments (see paragraphs 2 and 3 of page 73).

iii. that it has decided to allow long-term STOR capacity to participate in the CM if they choose, on condition they make an irrevocable declaration in respect of each CMU to allow their STOR contracts to be terminated ahead of the relevant capacity market delivery year if awarded a capacity agreement (see last paragraph of page 74). Further, that NGET has confirmed to STOR providers that it would be willing to accept an offer to terminate a long-term STOR contract without prejudice in the event that a provider holding such a contract wished to participate in the capacity market and was successful in the auction. Again there is no suggestion of allowing conditionality of terms or any mention that NGET should pay a fee to a CMU.

28. GFP, as part of its appeal has asked that regard be paid to the notification made by DECC to the Commission, pursuant to article 108(3) of the Treaty on the Functioning of the European Union, in respect of its proposals to support capacity providers in the GB electricity market. GFP asserts that the notification provides that STOR contracts with NGET could be terminated in a way that would not leave holders of such contracts 'commercially worse off' (reliance is placed upon paragraph 138 of the Commission's state aid approval decision). GFP states that if DECC's statement to the EU is to be relied on then it must be permitted to bid at auction and to make its offer to terminate its contract for a fixed fee.

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/324170/Government_Response_to_EMR_implementation_consultation.pdf

29. We do not accept this interpretation because there is no suggestion in the decision document that DECC was of the view that STOR providers should be compensated in any way when they give up existing contracts. In fact the discussion in the decision document about such providers being discriminated against, because they were being excluded from the capacity market unless they gave up existing contracts, would have been a non-issue and not needed the exploration evidenced in the document, if the intention had been for them to be able to participate in the capacity market and to receive payment for relinquishing existing contracts. Further, the decision makes particular reference to the probable need for those relinquishing contracts to consider re-financing (see paragraphs 105 and 138). There would have been no need to consider that issue if the intention had been to allow such providers to be paid a fee when withdrawing from existing agreements.

30. GFP has asserted that NGET does not have to accept an offer to withdraw made under Regulation 18 and as it would have met its obligations and in such circumstances it would be entitled to *"receive Capacity Mechanism payments in 2018, as well as continued payments under its long-term STOR contract"*. As mentioned earlier the regime for STOR providers is designed in a way that if they wish to participate in the capacity market it is on the basis that if they are successful they no longer gain the benefit of a long-term STOR contract. GFP's suggestion would render the requirement to provide a withdrawal declaration virtually meaningless: an applicant wishing to participate in the capacity market whilst retaining payment under a long term STOR contract would simply have to make an offer of such order that NGET would be bound to reject it.

Conclusion

Issue 1: Settlement Periods

31. In our view NGET has applied Rules 3.6.1 and 4.4.2(f) of the Rules correctly. It would be incorrect to interpret the legislation to mean that GFP only had to provide a maximum net output for a given moment (or a minute) on three separate days over the last 24 months.

Issue 2: Conditionality

32. In our view NGET has correctly interpreted Regulation 18. We do not believe that there is inconsistency between Rule 3.8.4(b) and Regulation 18. The correct interpretation of Regulation 18 requires a declaration which commits the applicant, that is a STOR provider, to ultimately withdrawing from that STOR contract without any terms attaching

to that withdrawal. On that basis, NGET was correct to reject GFP's applications to prequalify all 12 of its CMUs because GFP made invalid declarations.

Determination

33. For the reasons set out in this determination the Authority hereby determines pursuant to Regulation 71(3) that the NGET Reconsidered Decision be upheld in respect of each of the 12 CMUs listed at paragraph 1 of this determination.

David O'Neill

Head of Wholesale Markets Policy: Electricity Market Reform
For and on behalf of the Gas and Electricity Markets Authority

21 November 2014