

Proposal for a Capacity Market Rules Change



Making a positive difference
for energy consumers

Reference number (to be completed by
Ofgem): CP199

Name of Organisation(s) / individual(s):
National Grid Interconnector Holdings Ltd

Date Submitted:
11 November 2016

Type of Change:

- Amendment
- Addition
- Revoke
- Substitution

If applicable, whether you are aware of an alternative proposal already submitted which this proposal relates to:

The proposer is unaware of any similar amendment

Proposal summary (short summary, suitable for published description on our website)

Longer term capacity market agreements for interconnectors

What the proposal relates to and if applicable, what current provision of Rules the proposal relates to (please state provision number):

This proposal relates to Rule 3.7(d), 3.8.1, 4.11.3 and 7.5.1(a).

Description of the issue that the change proposal seeks to address:

In order for interconnectors to participate in the Capacity Market from 2015 onwards, and to contribute to security of supply, interconnectors were able to participate for one year capacity agreements. This was seen as an interim solution pending the developing of an EU wide regime. Interconnectors have previously argued that by allowing new build interconnectors longer capacity agreements this would ensure more certainty for investment. DECC/BEIS consulted on the proposal to increase the length of agreements but at the time concluded that longer term agreements would not make a significant difference to secure project financing in either the Cap and Floor or merchant models. A number of events have occurred, not least the vote to leave the EU, that could impact that original analysis. We continue to believe that longer term certainty over revenues make it easier to secure funding and investment for interconnector projects. DECC/BEIS also said that the one year agreements also align with the need to adjust de-rating factors on an annual basis as new evidence regarding interconnector reliability emerged and in light of de-rating methodology improvements. Access to multi-year agreements should be an option for interconnectors perhaps with a mechanism to reflect variations in de-rating from year to year for interconnectors. We believe that multi-year agreements will provide more certainty for future interconnector investment and propose that new build interconnectors are eligible for longer term capacity agreements, as per new build generators. This will create more of a level playing field between generators and

interconnectors. In addition, this will provide assurance to interconnectors who have made investment decisions based on their participation in the CM (as a potential revenue stream). For refurbishing CMUs capacity Agreements of up to three years are offered for existing plants that can demonstrate that they require major refurbishment (Refurbishing CMUs), except for interconnectors. The right to access an extended duration agreement is dependent on a provider exceeding the threshold of capital expenditure on the CMU which is prescribed for in each auction. For generators, capital expenditure must exceed; £255/kW de-rated capacity, to obtain a 15 year agreement; and £130/kW de-rated capacity, to obtain a three year agreement; however, this is not the case for interconnectors. We would argue that existing interconnectors which require significant refurbishment, who are not regulated through the cap and floor regime, also require longer term capacity agreements in the same way that generators do and therefore should have access to longer term contracts. The decision to extend the life of an interconnector is the same as that of a generator. Longer term revenue certainty will facilitate consumer benefits by extending the life of an interconnector as part of a refurbishment programme; therefore providing more substantial security of supply

If applicable, please state the proposed revised drafting (*please highlight the change*):

Amend Maximum Obligation Period definition (a) and (b) – include “...and Prospective Interconnector CMU” after “for a Prospective Generating CMU” Rule 3.7(d) Insert “and Interconnector CMU” after “for a Generating CMU” or amend section e to state:(e) for an Interconnector CMU, whether the Qualifying £/kW Capital Expenditure is: (i) equal to or greater than the Three Year Minimum £/kW Threshold Rule 3.8.1(c) – No Amendments to wording required As per Rule 4.11.3 and 7.5.1(a), the auction parameters should be adjusted and updated accordingly on the Capacity Market Register to reflect the change in the Maximum Obligation Period and to allow new build interconnectors to obtain longer term Capacity market contracts

Analysis and evidence on the impact on industry and/or consumers including any risks to note when making the revision - including, any potential implications for industry codes:

New Interconnectors are likely to be subject to cap and floor regulation, and whilst the floor does provide some protection against low revenues, it does not, in itself, provide sufficient incentive to invest. Any certainty over revenues is a driver for new investment, and revenue above the “floor” in particular. If prospective interconnector developers were incentivised by more certain revenue streams it is likely that more will be built, which in the long run will reduce cost to consumers and enhance security of supply, the premise behind the Capacity Market, as well as increasing competition. Although not applicable to National Grid interconnectors, as with interconnectors funded via project financing arrangements, the higher the level of guaranteed income, the lower the risk and the cheaper the finance cost of the investment. With respect to the need to continue to de-rate interconnector capability on an annual basis this provision can also be made in the terms agreed multi-year contracts. Refurbishment of Existing Interconnectors - For the refurbishing interconnectors, an interconnector reaching the end of its original lifespan so it needs to refurbish as any other generating asset would. There again is little need to exclude interconnector assets from this market, especially as cap and floor arrangements are not accessible to such assets.

Details of Proposer *(please include name, telephone number, email and organisation):*

Joshua Coomber / 07874-010-307 / Joshua.coomber@nationalgrid.com / National Grid