

Annual Report on the Operation of the Capacity Market in 2017/18

Report

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Overview:

The Electricity Capacity Regulations 2014 require us to provide the Secretary of State with an annual report on the operation of the Capacity Market.

This is the fourth of these annual reports, following the T-1 Auction in January 2018, and T-4 Auction in February 2018.

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Executive Summary

This is our fourth annual report on the operation of the Capacity Market (CM). There have been two Capacity Market auctions since our last report: the 2017/18 T-4 Auction securing capacity for delivery in 2021/22, and the 2017/18 T-1 Auction securing capacity for 2018/19. This report describes the outcomes from these auctions, including the prequalification processes, along with some observations from our analysis.

Prequalification

The Delivery Body received 1,950 Prequalification applications in 2017/18, an increase from around 1,700 applications in 2016/17. A large number of Applicants failed to Prequalify during the Prequalification Window, and around two-thirds succeeded in prequalifying during the first round of appeals. A regulatory change prevented the Delivery Body from being able to consider new information from Prequalification Applicants during the appeal process. While the Delivery Body resolved a large proportion of the issues raised at Tier 1, over 140 Capacity Market Units (CMUs) appealed their Reconsidered Decisions to us.

2017/18 T-4 Capacity Auction

The fourth T-4 Capacity Auction cleared at a price of £8.40/kW, this was much lower than all previous T-4 auctions. Those winning agreements included three of the currently operational interconnectors and three new build interconnectors planned to be operational for delivery in 2021/22.

2017/18 T-1 Capacity Auction

The first T-1 Capacity Auction cleared at a price of £6.00/kW/year, which was the lowest ever reached in a GB Capacity Auction. Around 68% of the acquired capacity obligations were provided by gas turbines (CCGT and OCGT), with success rates of over 85%.

The Delivery Year 2016/17

The 2015 Transitional Arrangements Auction for delivery in 2016/17 concluded in January 2016 clearing at £27.50 kW/year, and agreements were awarded for around 57 CMUs with 803 MW of de-rated capacity. In the beginning of the first Capacity Market Delivery Year 2016/17, there were 46 active CMUs with an estimated total de-rated capacity of 620 MW available to deliver capacity.

During the Delivery Year 2016/17, one CMU failed to demonstrate satisfactory performance by meeting the de-rated capacity of their Capacity Obligation resulting in a suspension of capacity payments. Another CMU was terminated for failing the delivery requirements outlined in the Capacity Market Rules.

1. Background

Purpose of this report

- 1.1. This report covers the operation of the Capacity Market since our last report published in June 2017, including a factual presentation of the prequalification process and the outcomes of two auctions.
- 1.2. The report is one of two reports that we are required to provide to the Secretary of State after each T-4 capacity auction, under the Electricity Capacity Regulations 2014 (the "Regulations")¹. The second report is on the performance of the National Grid Electricity Transmission's (NGET's) functions as the Delivery Body for the Capacity Market, and was published in June 2018.

Scope of this report

- 1.3. The report outlines the prequalification process and outcomes, and reports on the outcomes of two auctions²:
 - 2017/18 four year ahead auction, with capacity to be delivered in 2021/22 (2017/18 T-4 Auction);
 - 2017/18 one year ahead auction delivery in 2018/19³ (2017/18 T-1 Auction).
- 1.4. It also includes demand side response⁴ (DSR) and storage participation, analysis of bidding behaviour in the 2017/18 T-4 Auction and T-1 Auction, and an update of delivery against milestones of Capacity Agreements won in earlier auctions.
- 1.5. The Secretary of State may instruct us to report on any particular matter as part of this report. No such instruction was received this year.

¹ [The Electricity Capacity Regulations 2014](#).

² The timings for these auctions is available at [https://www.emrdeliverybody.com/SiteAssets/Lists/Latest%20News/NewForm/Capacity%20Market%20Operational%20Plan%202017%20version%203%20\(3\).pdf](https://www.emrdeliverybody.com/SiteAssets/Lists/Latest%20News/NewForm/Capacity%20Market%20Operational%20Plan%202017%20version%203%20(3).pdf)

³ National Grid has published final auction results for the [2017/18 T-4 Auction](#) and [2017/18 T-1 Auction](#). See www.emrdeliverybody.com.

⁴ Demand Side Response is provided by customers who lower or shift their electricity use at peak times, which may be done by those customers utilising backup generation.

Background to the Capacity Market

Overview of Capacity Market

- 1.6. The Capacity Market (CM) was introduced in 2014 to maintain sufficient levels of capacity to ensure security of electricity supply.
- 1.7. The CM provides revenue in the form of capacity payments to potential capacity providers. In return, participants must commit to delivering electricity at times of system stress and face penalties if they fail to do so.
- 1.8. Capacity payments are determined via competitive auctions, held four years (T-4 Auction) and one year (T-1 Auction) before each delivery period. The T-1 auctions are used to 'top-up' the target capacity for the delivery year, and spread the risk. Prospective capacity providers must meet certain eligibility requirements and prequalify before they can participate in the CM auctions.
- 1.9. CM auctions are technology neutral, and generation, DSR and interconnectors may all participate.⁵ However, any capacity receiving renewable subsidies, eg Contracts for Difference, is not eligible.

Overview of the prequalification process

A high level summary of the prequalification process

- 1.10. To participate in a CM auction, a Capacity Market Unit (CMU) must prequalify by meeting the requirements set out in the Capacity Market Rules (the "Rules") and Regulations.⁶ National Grid Electricity Transmission (NGET), the Delivery Body, runs the prequalification process, reviewing applications and determining whether CMUs are eligible to participate.
- 1.11. Applicants can ask the Delivery Body to review its initial decision (a 'Tier 1 appeal'). Following an unsuccessful Tier 1 appeal an applicant may submit an appeal to the Authority (a 'Tier 2 appeal').

Classification of CMUs

- 1.12. CMUs are classified as follows: generators and interconnectors that are currently operational ('Existing'), generators investing in an existing asset ('Refurbishing') and new generators and interconnectors ('New Build').

⁵ Except for the TAs which are only for DSR Capacity Market Units.

⁶ [The Electricity Capacity Regulations 2014](#) and [the Capacity Market Rules](#).

Demand side response (DSR) may also participate. They may have completed a DSR Test ('Proven DSR') or not ('Unproven DSR').

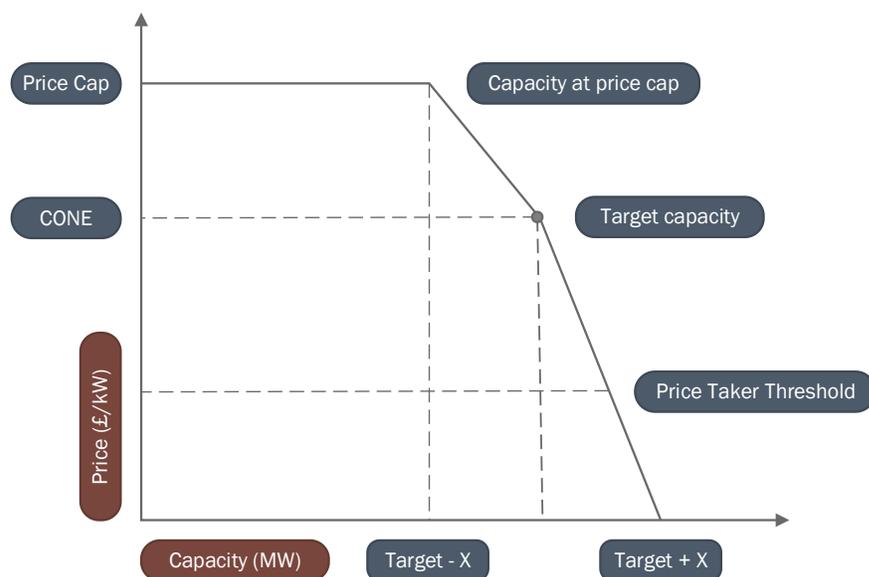
- 1.13. Existing CMUs and all DSR CMUs are eligible for agreements that last for one year. Refurbishing and New Build CMUs are eligible to receive agreements up to three and 15 years respectively in the T-4 auctions.

Overview of the auction process

Overarching auction design

- 1.14. The CM auctions have a descending clock format, with bidders exiting the auction when the price drops below the level at which they are willing to take on a Capacity Obligation. There are multiple 'rounds', starting at a price cap and reducing incrementally.
- 1.15. Existing CMUs are by default 'Price Takers', which means they can only place bids below a certain threshold (£25/kW/year in the 2017 T-4 Auction, and 2017 T-1). In order to bid above this threshold, they must become 'Price Makers' by submitting a Price Maker Memorandum, outlining why they may need to bid above the threshold. All other CMUs are Price Makers and can bid up to the Auction Price Cap (£75/kW/year in the 2017 T-4 auction, and 2017 T-1).
- 1.16. As well as placing bids to exit the auction, Refurbishing and New Build CMUs may place a bid at the price at which they would like to switch from a 3-year or 15-year agreement to a one-year agreement. Refurbishing CMUs can also specify a price at which they would like to switch to a 'Pre-refurbishing' state, where they would instead receive an Existing CMU contract for one year, with no obligation to invest in the asset.
- 1.17. The auction continues on this basis until the total capacity offered by remaining participants falls below the demanded capacity at that price (the 'clearing round'). CMUs still in the auction will receive a capacity agreement at this price.
- 1.18. The demand curve for the auction, as shown in Figure 1, is sloped downwards, reflecting the benefit in securing more capacity when the price is low. A variability from the target ("X") defines the slope of the curve.

Figure 1 – Auction demand curve



Recent policy developments

- 1.19. In 2017, there were several policy developments that affected particular fuel and technology types' participation in the CM.
- 1.20. In June 2017, Ofgem made a decision to amend the charging arrangements for embedded generators.⁷ It referred to concerns that charging arrangements for embedded generators over-reward embedded generation ('embedded benefits'), which distorts investment decisions and leads to inefficient outcomes in the CM. These amendments were implemented from April 2018.
- 1.21. In December 2017, the Government implemented the Medium Combustion Plant Directive which restricts emissions by generators that are less than 50 MW.⁸ This primarily affects diesel generators but also older and more polluting gas turbines who, unlike large-scale generators, are not currently subject to emissions limits. The Directive is aimed at addressing emissions of high levels of noxious air pollutants. Emissions limits will apply and permits will be required for new plants from December 2018. Existing plants will be affected from January 2024.
- 1.22. In December 2017, it was announced that the de-rating methodology for duration-limited storage changed for the 2017 T-1 and T-4 auctions. The de-

⁷

https://www.ofgem.gov.uk/system/files/docs/2017/06/impact_assessment_and_decision_on_industry_cmp264265.pdf

⁸ http://www.legislation.gov.uk/ukxi/2018/110/pdfs/ukxi0d_20180110_en.pdf

rating methodology now uses an Equivalent Firm Capacity (EFC) metric. This metric gives shorter duration storage CMUs lower de-rating factors than longer duration storage CMUs. These factors also differ between the T-1 and T-4 auctions, and shorter duration storage received a lower de-rating factor in the T-4 auction than the T-1 auction.⁹

⁹ National Grid, Duration-Limited Storage De-Rating Factor Assessment – Final Report: <https://www.emrdeliverybody.com/Lists/Latest%20News/Attachments/150/Duration%20Limited%20Storage%20De-Rating%20Factor%20Assessment%20-%20Final.pdf>

2. Appeal process for 2017/18 Auctions

Appeal process review

- 2.1. Many CMUs required the appeals process to prequalify. National Grid received 393 Tier 1 appeals for the 2017 T-4 Auction and 217 for the 2017 T-1 Capacity Auction. These disputes represented a total of 25.7 GW of de-rated capacity.
- 2.2. The five most common reasons for failure at prequalification were:
 - General Applicant details missing (e.g. Secondary Trading or Parent Company details missing), documents were either invalid or missing
 - Missing Exhibits on Despatch Controller Reference was invalid
 - Errors in the submitted Prequalification Certificate (Exhibit A)
 - Inconsistencies or missing Component Address information
 - Errors in the submitted Certificate of Conduct form (Exhibit C)
- 2.3. The time-limited derogation ended before the start of the 2017/18 Prequalification process, which meant that for the first time the Delivery Body was unable to consider new information from Prequalification Applicants during the appeal process ("Tier 1").
- 2.4. Following the Tier 1 disputes process, out of the 365 Applicants that were rejected at the prequalification stage for the 2017 T-4 Auction, 68% became prequalified or conditionally prequalified. Of the 210 Applicants for the T-1 Auction, 67% succeeded in becoming prequalified or conditionally prequalified.
- 2.5. Ofgem received Tier 2 disputes from over 140 CMUs from applicants who disagreed with the prequalification decision or the parameters of their prequalification.¹⁰ The breakdown of the reasons and numbers for both auctions are in Table 1 below.

¹⁰ Ofgem's determinations on Tier 2 CM disputes are available at www.ofgem.gov.uk.

Table 1 - Number of CMUs involved in Tier 2 disputes and the subject of those disputes

	2017/18 T-4 Auction	2017/18 T-1 Auction
Historic output/performance	4	8
Connection capacity	1	2
Connection agreement	4	1
Incorrect information	3	3
Missing information/documents	11	6
Exhibit errors	60	30
Mixed issues	9	6
Total	92	56

- 2.6. Of the Tier 2 disputes received, 68 decisions were overturned or the parameters of their prequalification were changed.

3. 2017/18 T-4 Auction

This section covers the prequalification and auction outcomes of the 2017/18 T-4 Auction, held between 6th February 2018 and 8th February 2018, for delivery of capacity in 2021/22.

- 3.1. In the 2017/18 T-4 Auction the price cap was £75/kW/year.¹¹ The price decrement per round was £5/kW/year, resulting in a maximum of 15 rounds over four consecutive days. The final target volume of capacity was 49.2 GW.¹²

Prequalification and participation outcomes for the 2017/18 T-4 Auction

Prequalification applications for the T-4 Auction

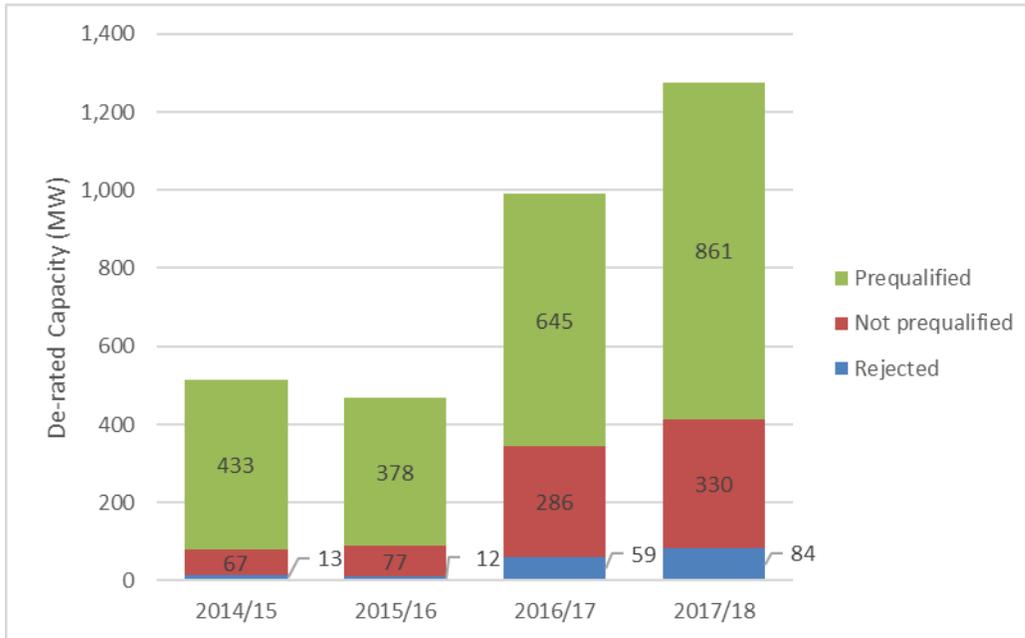
- 3.2. 1,275 CMU applications were made during the prequalification window, totalling 80.7 GW of de-rated capacity. The final number of prequalified CMUs for the T-4 Auction was 861, totalling 75.8 GW of de-rated capacity¹³.
- 3.3. Nine CMUs, totalling 6.2 GW of anticipated de-rated capacity, opted out. Of these, seven intend to be closed down, decommissioned or otherwise non-operational by the start of the Delivery Year. The other two opted out despite their intention to remain operational throughout the Delivery Year.
- 3.4. The 2017 T-4 Auction had 285 more prequalification applications than the 2016 T-4 Auction, which itself had over 500 more applications than the 2015 T-4 Auction. Figure 2 below shows that, despite this growth, the percentage of applications successfully prequalifying in 2017 (68%) is similar to 2016 (65%).

¹¹ Auction parameters are expressed in 2016/17 prices.

¹² Target capacity outlined in auction guidance before auction:
<https://www.emrdeliverybody.com/Capacity%20Markets%20Document%20Library/Capacity%20Market%20Auction%20Guidelines%20%2016th%20January%202018.pdf>

¹³ De-rated capacity includes the bidding capacity for DSR CMUs and the post-refurbishing de-rated capacity for Refurbishing CMUs.

Figure 2 - Breakdown by Prequalification decision in the T-4 auctions (number of CMUs)

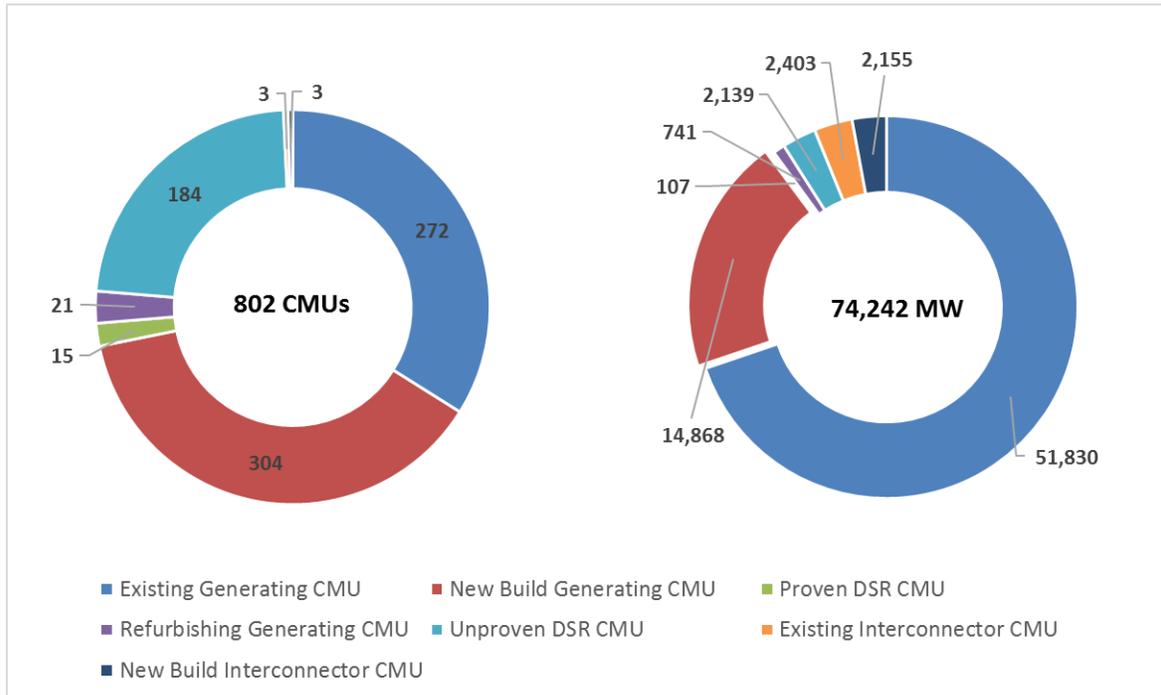


CMUs that entered the T-4 Auction

3.5. A total of 802 CMUs entered the auction¹⁴, totalling 74.2GW of de-rated capacity. This compares with the target capacity of 49.2 GW, implying there was considerable competition and liquidity going in to the auction (Figure 3).

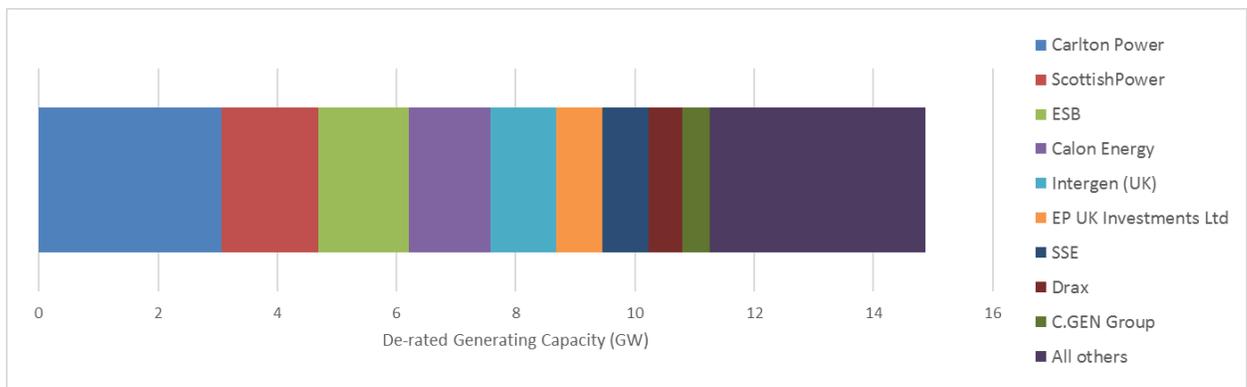
¹⁴ 861 CMUs prequalified for the auction but only 802 entered the auction. Of the 59 CMUs that prequalified but did not enter the auction, 26 made a successful Tier 2 dispute challenge but were settled after the deadline for auction entry confirmation. The other 33 CMUs were either New Build or Unproven DSR CMUS which did not confirm entry into the auction. It is a requirement for these CMU types to confirm entry into the auction in order to participate (Rule 5.5.14).

Figure 3 – Participating capacity by CMU Category



3.6. Approximately 130 different applicant companies entered at least one CMU in the 2017 T-4 Auction.¹⁵ Figure 4 shows the 14.7 GW of prequalified New Build Generating capacity by company. Eight companies participated with new large scale CCGT projects that made up 10.6 GW of this New Build capacity.

Figure 4 – Volume of prequalified New Build Generating capacity by company



3.7. All of the Refurbishing capacity that participated in the auction was offered by four different parent companies, consisting of 21 CMUs. This capacity totalled

¹⁵ We have estimated results for applicant companies on the Capacity Market Register by their parent company where appropriate using separate information provided by the Applicant.

741 MW. Just as in the 2016 T-4 Auction, Calon Energy's Baglan power station was the largest single asset to prequalify as a refurbishing asset (495 MW).

CMUs that did not prequalify for the T-4 Auction

- 3.8. A total of 414 CMUs failed to prequalify for the T-4 Auction, totalling around 4.6 GW of de-rated capacity.¹⁶ As in the previous three T-4 auctions, the majority of these CMUs were small, distribution-connected New Build units.
- 3.9. 313 of the unsuccessful CMUs were initially granted a conditional prequalification status following the Prequalification Results Day, but later failed to provide sufficient satisfactory information to become prequalified before the auction.

2017 T-4 Auction outcomes

Clearing price and volume

- 3.10. A total of 50.4 GW of capacity was awarded a Capacity Agreement through the auction, which cleared at £8.40/kW/year. This price was lower than the majority of analyst forecasts.¹⁷ An additional 5 MW of de-rated capacity was offered and accepted an agreement outside the auction process.¹⁸
- 3.11. The Auction did not clear with an exact match of offered capacity and target capacity so the Net Welfare Algorithm was used. The result of this calculation was negative so the marginal unit was not procured. 1.2 GW of extra capacity over the target level was procured due to the slope of the demand curve.
- 3.12. Further analysis using the bid information submitted during the T-4 Auction suggests that differences in the target auction volume could have had a significant impact on the clearing price and therefore the direct costs to consumers. Figure 5 shows the potential impact on the clearing price of increasing and decreasing the target volume by an increment of 0.5 GW.¹⁹

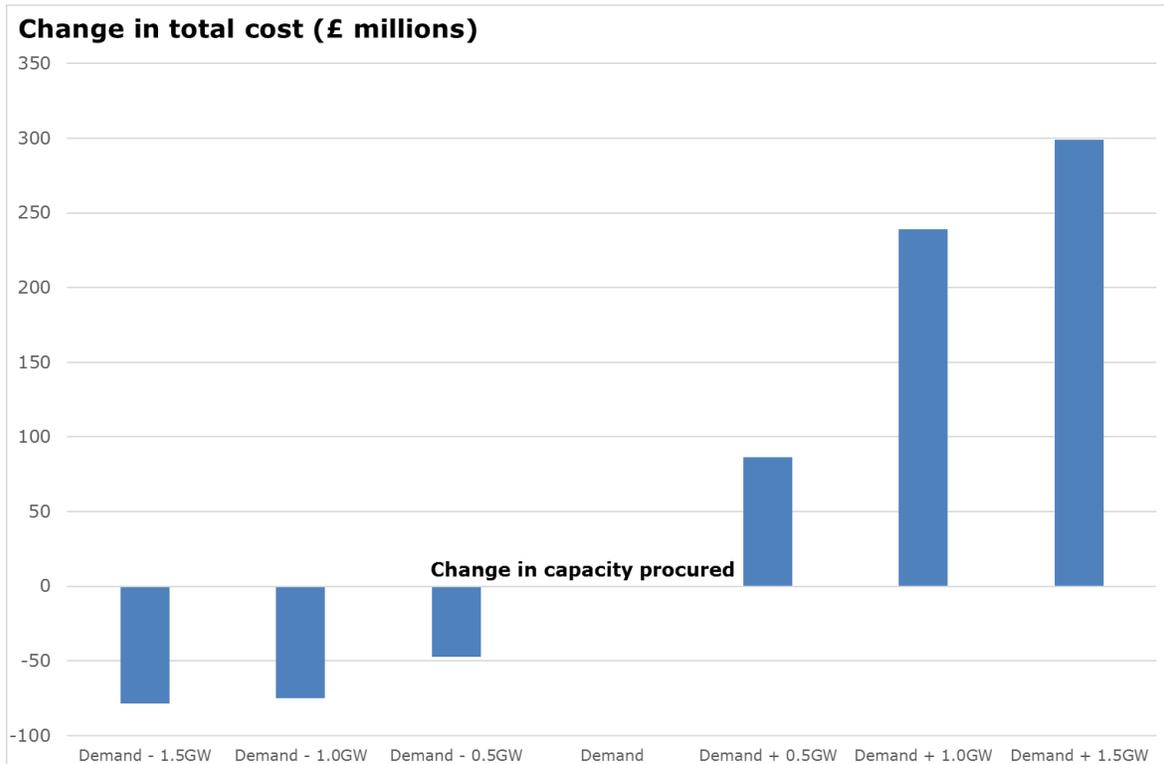
¹⁶ These are CMUs that didn't prequalify for the auction following the Prequalification window and are assets that were given either a 'Rejected' status, or units that failed to provide sufficient evidence to consolidate their conditional status into prequalified.

¹⁷ E.g. RBC Capital Markets estimated the auction clearing price would be £17.50-£20/kW/year.

¹⁸ 26 CMUs were offered an agreement at the market clearing price after the auction after a successful Tier 2 disputes decision. Of these, 3 CMUs (totalling 5 MW of capacity) accepted this offer.

¹⁹ This analysis is indicative only. It uses the T-4 supply curve and the target demand as set by government to produce indicative estimates of how changes in target demand may change

Figure 5 - Potential impact of target volume on the clearing price

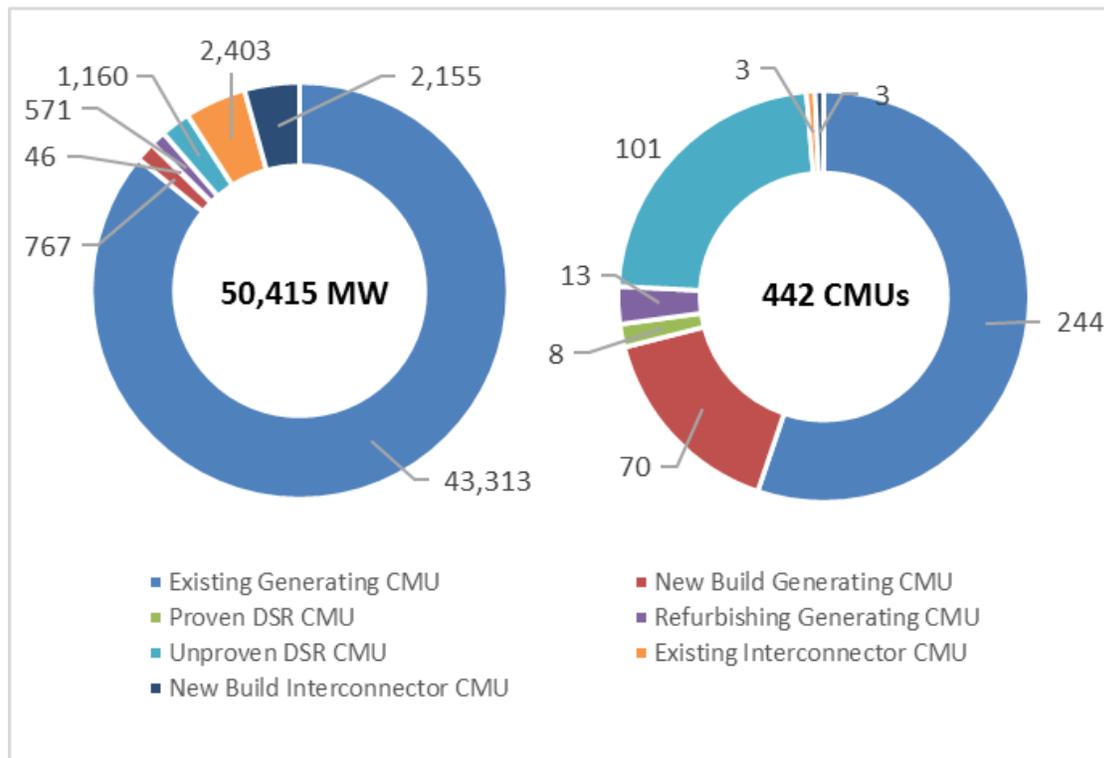


Results by CMU Category

3.13. The vast majority of cleared or successful capacity was Existing Generation (85.9%), as demonstrated in Figure 6. The next largest shares of winning capacity were Existing Interconnectors and New Build Interconnectors, achieving 4.8% and 4.3% respectively.

the cost to consumers. A key limitation with this analysis is that it does not account for changes to numbers of bidders and participant bidding behaviour under the different scenarios.

Figure 6 - Volume of cleared capacity by CMU Category



3.14. Only 767 MW of New Build Generating CMU capacity won capacity agreements, just over 1.5%. This is much lower than the 3.4 GW of capacity acquired by New Build Generating CMUs in the 2016 T-4 Auction. All of the 70 CMUs that make up this capacity plan to connect to the distribution network. Unlike the 2016 T-4 Auction, the 2017 T-4 Auction procured no new CCGT capacity.

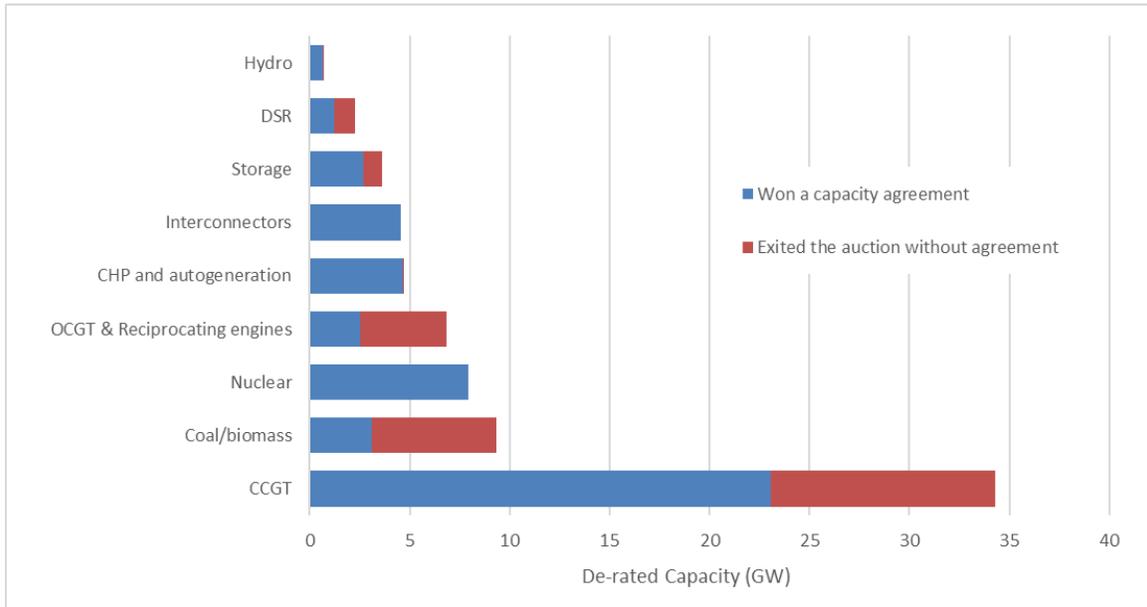
Results by technology and fuel type

3.15. Almost half (46%) of the 50.4 GW of acquired capacity market obligations were gained by CCGTs, 16% by Nuclear, and 9% by CHP and autogeneration (Figure 7).

3.16. Of the 74,242 MW of capacity that bid in the auction, 50,410 MW won capacity obligations. A further 5MW of capacity was awarded an agreement after the auction, following a successful Tier 2 dispute decision.²⁰

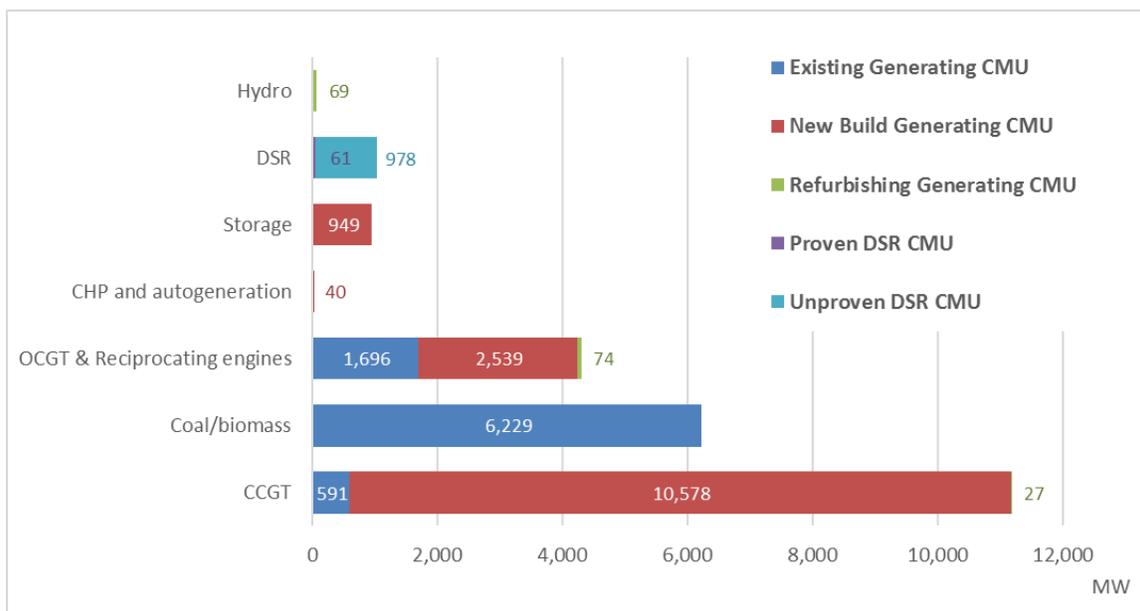
²⁰ 26 CMUs were offered an agreement at the market clearing price after the auction after a successful Tier 2 disputes decision. Of these, 3 CMUs (totalling 5 MW of capacity) accepted this offer.

Figure 7 - Winning and exited capacity by technology and fuel type (MW)



3.17. Figure 8, below, focuses on the capacity that exited the auction without an agreement (shown as the volume shaded in red in Figure 7). As in the 2015 and 2016 T-4 auctions, New Build Generating capacity accounted for most of the exited CCGT and OCGT capacity, 95% and 59% respectively. In comparison, all of the coal/biomass capacity that failed to win an agreement was Existing Generating capacity. Only two of the existing coal plants participating in the auction (Ratcliffe and two of Drax’s units) cleared the auction.

Figure 8 - Exited capacity by technology type (MW)



- 3.18. All three participating New Build Interconnector CMUs (Eleclink, IFA2 and NEMO), and all seven of the active nuclear power plants in GB won a capacity agreement in the auction.
- 3.19. Storage capacity was not as successful in 2017 as it was in the 2016 T-4 Auction, the first auction year it participated.
- 3.20. OCGT capacity was also not as successful in the 2017 T-4 Auction as it had been in previous auctions. By volume, it only acquired agreements for 27% of the capacity it acquired in the 2016 auction, 50% of the volume acquired in 2015, and 55% of that acquired in 2014.

Length of agreements

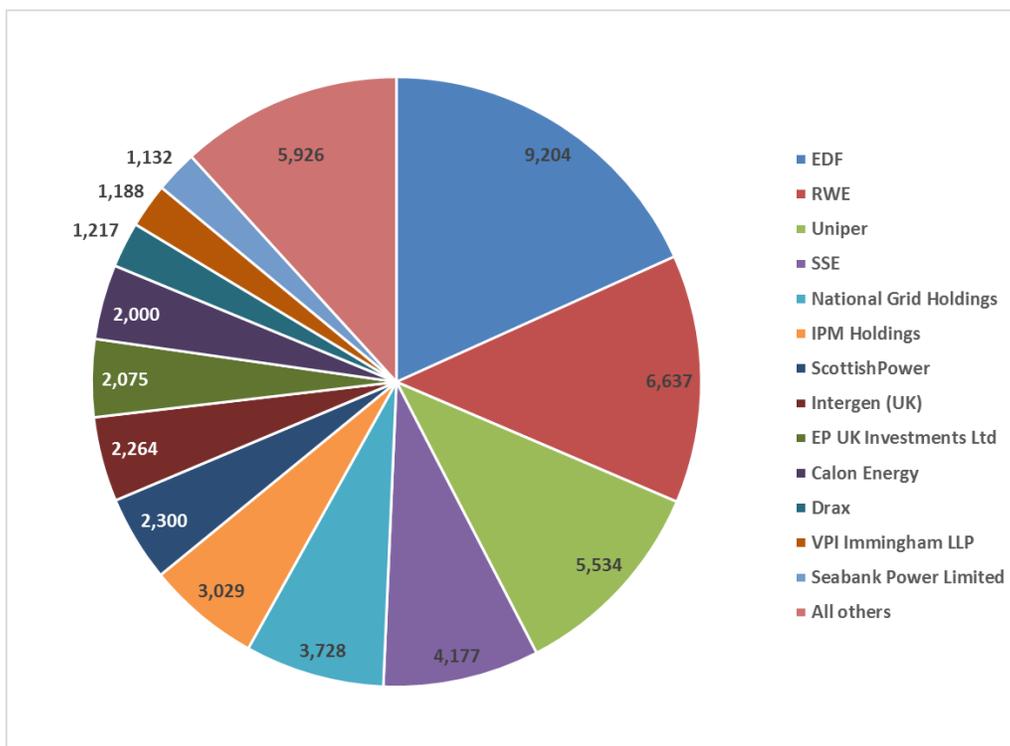
- 3.21. As in the previous T-4 Capacity Market Auctions, the majority of capacity in the 2017 T-4 Auction gained one-year agreements: 49.8 GW, just under 99%. 634 MW of capacity gained a 15-year agreement through the auction²¹ and 6 CMUs (18 MW) secured agreements of 2-14 years.
- 3.22. Only 653 MW of capacity was awarded agreements of more than one year in the 2017/18 T-4 Auction, down 75% on the 2016 T-4 auction.

²¹ 3 other CMUs (around 5 MW) were awarded 15-year Capacity Obligations following the auction.

Results by company

- 3.23. Just under 65% of the companies that entered the auction won agreements for at least one CMU.²² The acquired capacity through the 2017 T-4 Auction is broadly similar to the current market structure in power generation.
- 3.24. In volume terms, EDF, RWE, and Uniper secured the most de-rated capacity, just as in the 2016 T-4 Auction. Collectively they gained over 42% of the total successful auction capacity – 21.4 GW (Figure 9).

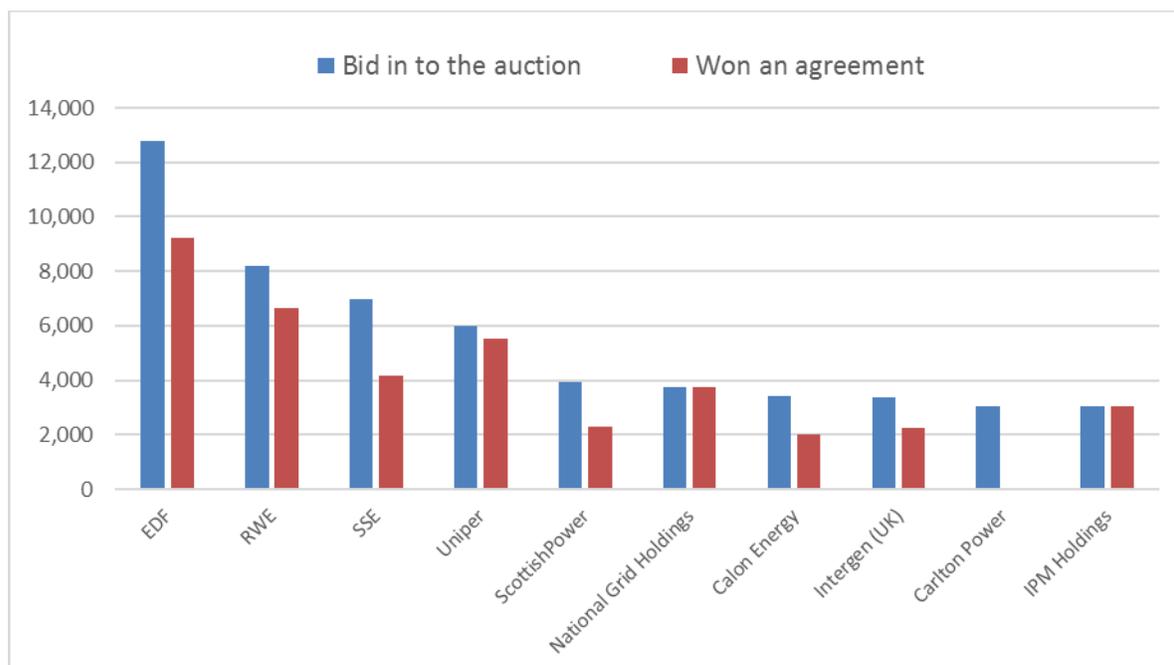
Figure 9 - Volume of cleared capacity by company (MW)



- 3.25. All but one of the ten largest auction participants by de-rated capacity had an auction success rate of over 50% (Figure 10), similar to the results of the 2016 T-4 Auction. Carlton Power are the single exception having failed to acquire a capacity agreement for the 3.1 GW of capacity they entered in to the auction.

²² We have grouped named companies by our assessment of what parent company they belong to as of 18/07/2018. This showed 129 different parent company groups, 83 of which gained an agreement for at least one of its constituent CMUs.

Figure 10 - Success rates of the largest 10 companies by capacity participating in the auction

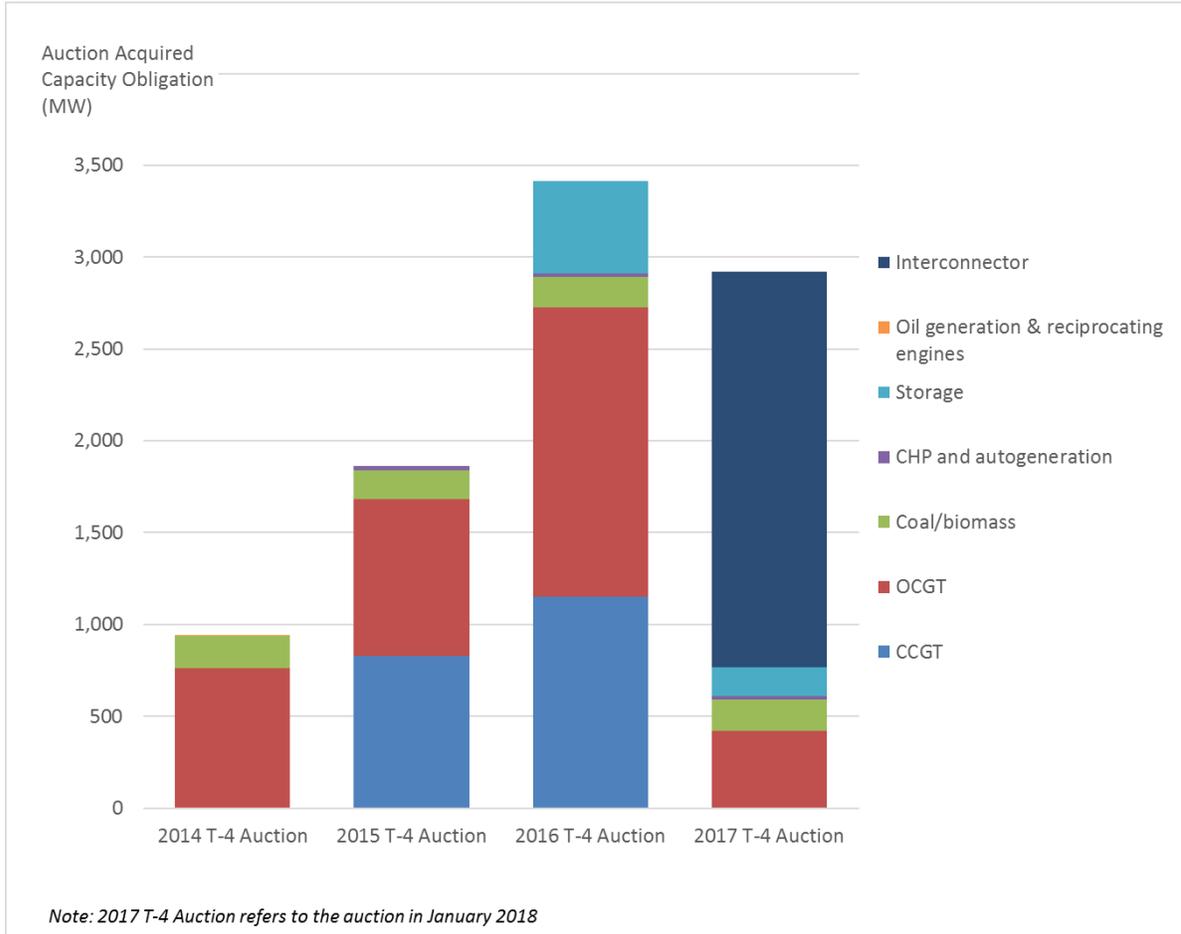


Further observations

Clearing price lower than in the 2016 T-4 auction

- 3.26. The auction cleared at a lower price than all of the previous T-4 auctions. The clearing price was £8.40/kW/year, compared to £22.50 in 2016, £18.00 in 2015 and £19.40 in 2014.
- 3.27. A total of 23.8GW of de-rated capacity in the 2017 T-4 Auction failed to clear. This was a higher proportion of the total de-rated capacity that entered the auction (32%) than either the 2016 (25%) or 2015 (20%) T-4 Auction. This reflects the greater volume of capacity that entered the auction.
- 3.28. The New Build interconnectors Eleclink, IFA2, and NEMO constituted the majority (73.8%) of successful New Build capacity in the 2017 T-4 Auction (Figure 11). Unlike the previous T-4 auctions, no new CCGT capacity was procured in 2017. In all four T-4 auctions to date, New Build Generating coal/biomass generators have secured agreements for a very similar amount of capacity.
- 3.29. The upward trend from previous years of total New Build capacity being procured did not continue in the 2017 T-4 Auction. This change might have been influenced by the lower target volume or clearing price.

Figure 11 - Successful New Build capacity by fuel and technology type in the T-4 auctions



4. 2017/18 T-1 Capacity Auction

This section covers the prequalification and auction outcomes for the 2017/18 T-1 Capacity Auction, for delivery of capacity in 2018/19.

- 4.1. In the T-1 Capacity Auction, the price cap was £75/kW/year. The price decrement per round was £5/kW/year, resulting in a maximum of 15 rounds over four consecutive days. The final target volume of capacity was 4.9GW.
- 4.2. The T-1 auction complements the capacity procured through the 2014 T-4 auction, and only one-year agreements were available in the T-1 Capacity Auction.

Prequalification and participation outcomes for the 2017/18 T-1 Capacity Auction

- 4.3. In total 672 CMU applications were made during the prequalification window, an equivalent of 13.6 GW of de-rated capacity.²³ Of these, 474 CMUs, equivalent to 11.8 GW of de-rated capacity, prequalified for the 2017/18 T-1 Capacity Auction.
- 4.4. Seven CMUs, totalling 4.8 GW of anticipated de-rated capacity, opted out. Of these seven CMUs, five intended to be closed down, decommissioned or otherwise non-operational by the start of the Delivery Year. Two CMUs (588 MW) opted out due to being temporarily non-operational for the winter of 2018/19 but operational thereafter.

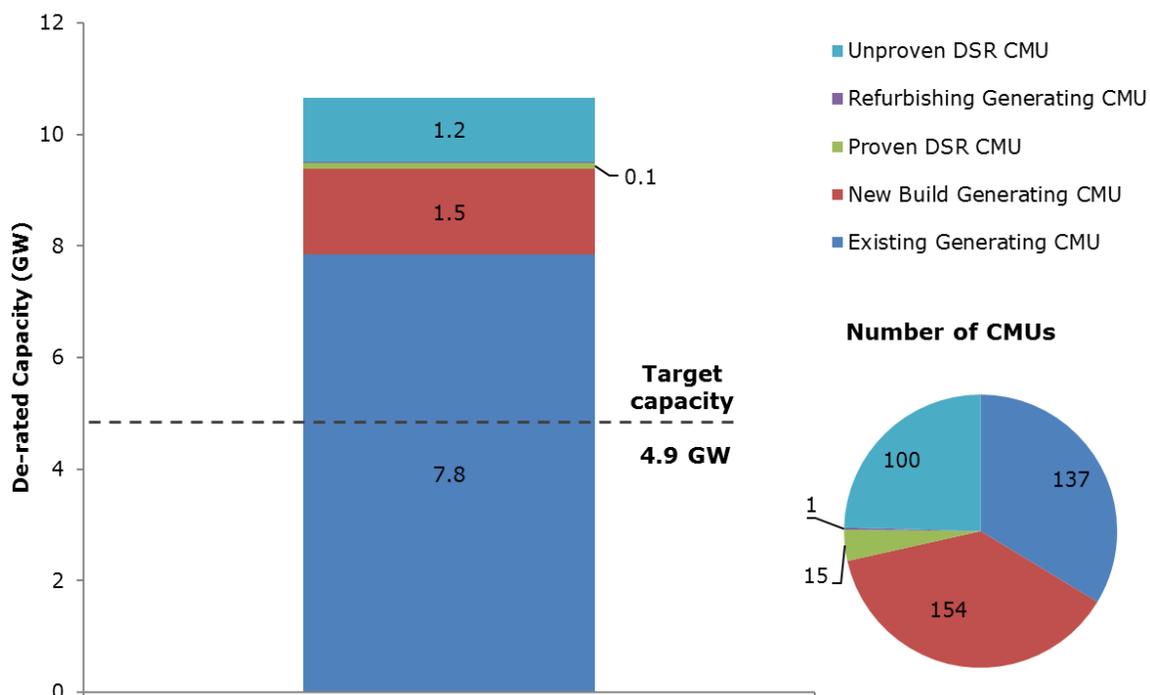
CMUs that entered the T-1 Capacity Auction

- 4.5. A total of 407 CMUs entered or participated in the auction²⁴, the equivalent of 10.7 GW of de-rated capacity. This compares with the target capacity of 4.9 GW, implying there was considerable competition and liquidity going into the auction (Figure 12).

²³ De-rated capacity combines the de-rated capacity column in the CM Register and and the pre-refurbishing de-rated capacity for Refurbishing CMUs.

²⁴ 474 CMUs prequalified for the auction but only 407 entered the auction. Of the 67 CMUs that prequalified but did not enter the auction, 12 made a successful Tier 2 dispute challenge but were settled after the deadline for auction entry confirmation. The other 55 CMUs were either New Build or Unproven DSR CMUS which did not confirm entry into the auction. It is a requirement for these CMU types to confirm entry into the auction in order to participate (Rule 5.5.14).

Figure 12 - Participating capacity by CMU Category



4.6. Approximately 100 different companies entered at least one CMU for the 2017/18 T-1 Capacity Auction.²⁵

CMUs that didn't prequalify for T-1 Auction

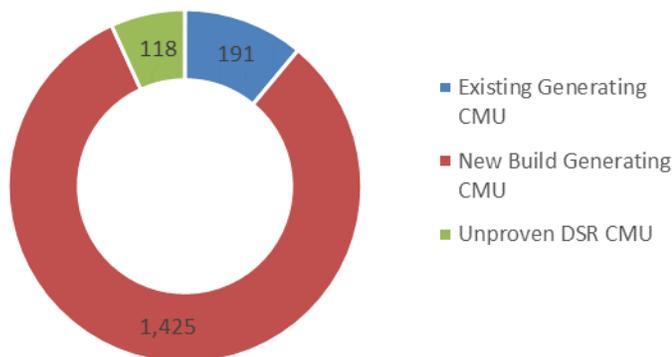
4.7. A total of 198 CMUs failed to prequalify for the T-1 Capacity Auction, totalling around of 1.7 GW of de-rated capacity (Figure 13).²⁶

4.8. 132 of the unsuccessful CMUs were initially granted a conditional prequalification status following the Prequalification Results Day, but later failed to provide sufficient credit cover or did not confirm entry into the auction in time. Thirteen CMUs that were initially rejected went on to gain prequalification status after appealing to Ofgem as part of the dispute resolution process.

²⁵ We have estimated results for applicant companies on the Capacity Market Register by their parent company where appropriate using separate information provided by the Applicant.

²⁶ These are CMUs that didn't prequalify for auction following the Prequalification Window and are assets that were given either a 'Rejected' status, or units that failed to provide sufficient evidence to consolidate their conditional status into prequalified. Additionally, seven CMUs opted-out from the auction.

Figure 13 - Unsuccessful volume by CMU category (MW)



2017/18 T-1 Capacity Auction outcomes

Auction clearing and agreements

- 4.9. A total of 5.8 GW of capacity was awarded in the 2017 T-1 Auction at a clearing price of £6.00/kW/year.²⁷ This was at the lower end of market expectations²⁸, the lowest ever reached in a capacity market auction. The Auction did not clear with an exact match of Offered Capacity and target capacity so the Net Welfare Algorithm was used to determine clearing price and volume. The result of this calculation was positive, and the marginal unit was procured.
- 4.10. Approximately 0.9 GW of extra capacity was awarded over the target level due to the slope of the demand curve and the use of the Net Welfare Algorithm.
- 4.11. Some CMUs that won agreements in the 2017 T-1 Capacity Auction already hold agreements from earlier T-4 auctions and may have been able to accelerate their delivery, allowing them to bid competitively.

Results by CMU Category

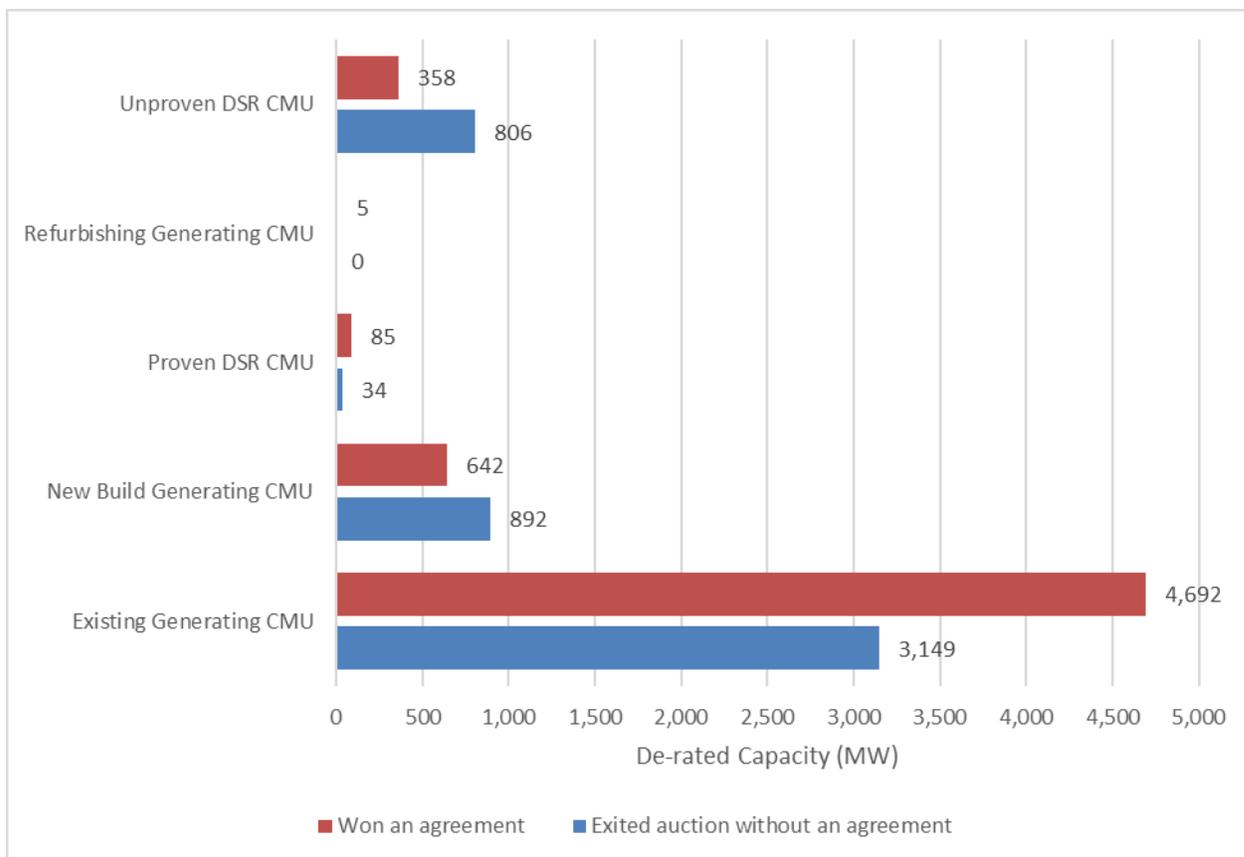
- 4.12. Existing Generating capacity accounted for just under 81% of cleared or successful capacity (4.7 GW), as demonstrated in Figure 14. This is likely to

²⁷ Out of 5.8 GW, 5.78 GW was awarded through the auction process, and an additional 0.015 GW of capacity was awarded outside the auction.

²⁸ The Financial Times reported that this clearing price was half what market analysts had expected: <https://www.ft.com/content/1e3d6e34-ea84-11e6-893c-082c54a7f539>.

be in part due to the short time between the end of the auction and the start of the delivery year.

Figure 14 - Winning and exited capacity by CMU Category (GW)



4.13. Around 0.6 GW of New Build Generating capacity won capacity agreements.²⁹ OCGT and Reciprocating Engines made up 85% of this total. Gas was the predominant fuel type accounting for just under 70% of all won New Build capacity agreements.

Results by technology and fuel type

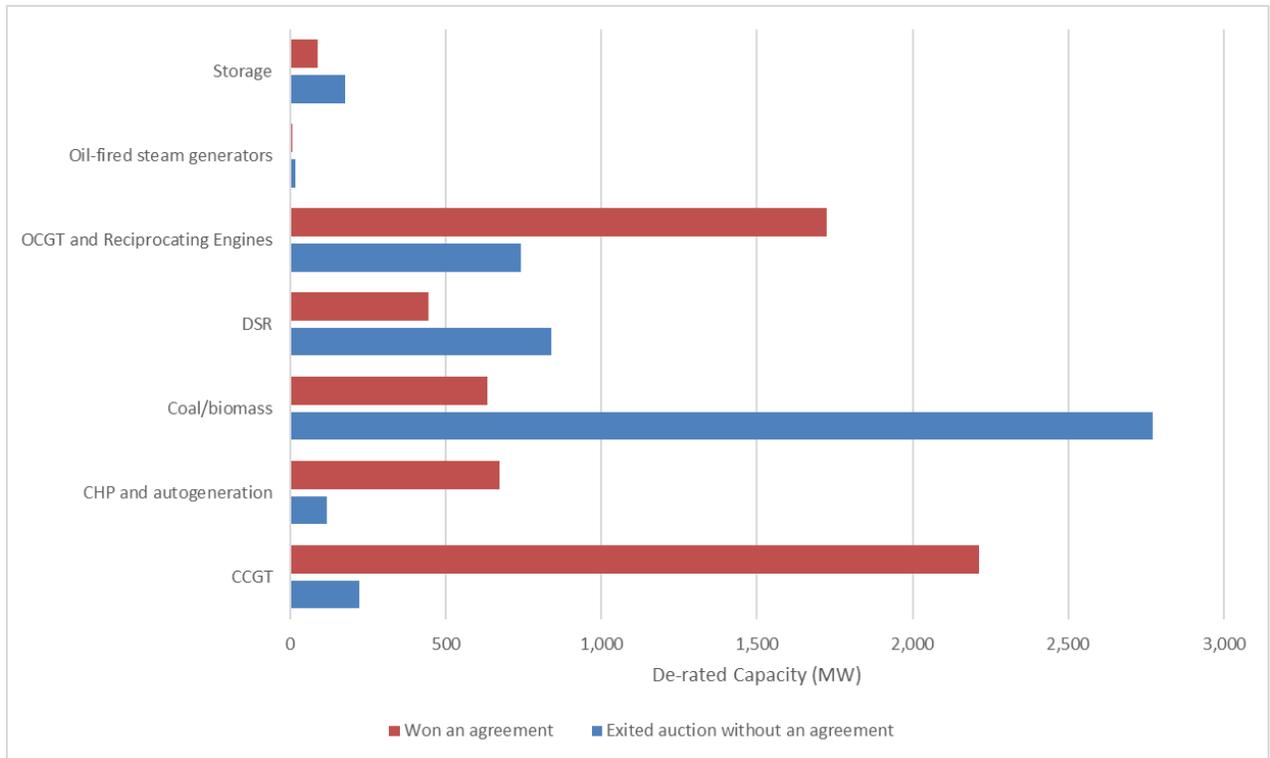
4.14. Around 38% of the acquired capacity obligations were provided by CCGTs, 30% by OCGT and Reciprocating Engines³⁰, 12% by CHP and autogeneration and 11% by generators using coal or biomass as a fuel (Figure 15). CCGT,

²⁹ This does not include the CMUs given outside of the auction process.

³⁰ This includes both diesel and gas OCGTs.

CHP and autogeneration, and OCGT and reciprocating engines had success rates of 91%, 85%, and 75% respectively.

Figure 15 - Cleared and exited capacity by technology type³¹

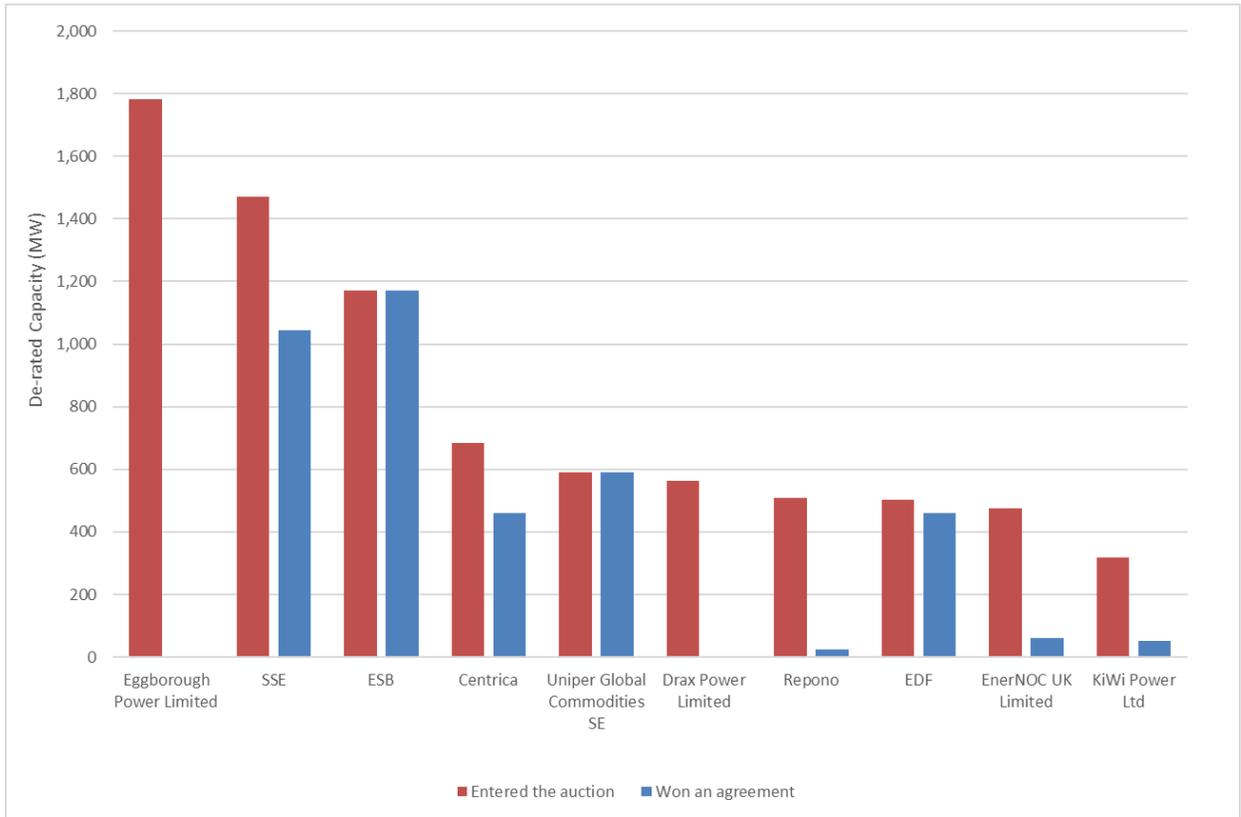


Results by company

4.15. 78% of the companies that entered the auction won agreements for at least one CMU. Figure 16 demonstrates the success rates in the T-1 Auction of the ten largest auction participants by de-rated capacity. Two auction participants had a success rate of 100% and two had a success rate of 0%.

³¹ OCGT and Reciprocating Engines includes fuel types Gas, Diesel and Bio-fuel.

Figure 16 – Top 10 companies by prequalified and successful capacity



5. DSR, storage, and interconnector participation

- 5.1. This section covers Demand Side Response (DSR) participation in the 2017/18 T-4 Auction and 2017/18 T-1 Auction, and some historical analysis. The section also covers some analysis on interconnector participation in the auctions over time and recent increased interest by storage providers.

Background

- 5.2. The original design of the Capacity Market included a number of arrangements to encourage DSR participation and in 2015 and 2016 the Delivery Body ran Transitional Arrangements auctions for DSR and small-scale generation to facilitate and support DSR participation in the two years preceding full Capacity Market delivery.
- 5.3. Changes to government policy in 2015 enabled interconnector participation in the T-4 auctions. In the 2017 T-4 auction both existing and new build interconnectors secured agreements.
- 5.4. In July 2017, BEIS launched a consultation into storage derating factors.³² Following this, in December 2017, the de-rating factor for storage CMUs for the 2017 T-1 and T-4 auctions were revised. The de-rating methodology now uses an Equivalent Firm Capacity (EFC) methodology. This methodology gives shorter duration storage CMUs lower de-rating factors than longer duration storage CMUs. These factors also differ between the T-1 and T-4 auctions, with shorter duration batteries receiving a smaller de-rated capacity in the T-4 auction than the T-1 auction.³³ The difference in de-rating for T-4 and T-1 auctions is due to EFC taking into account total volume of storage on the system.

DSR prequalification and auction outcomes

2017/18 T-4 Auction

- 5.5. A total of 1.2 GW of DSR capacity secured an agreement, out of the 2.2 GW that entered the auction. This accounted for 2.4% of total secured capacity.

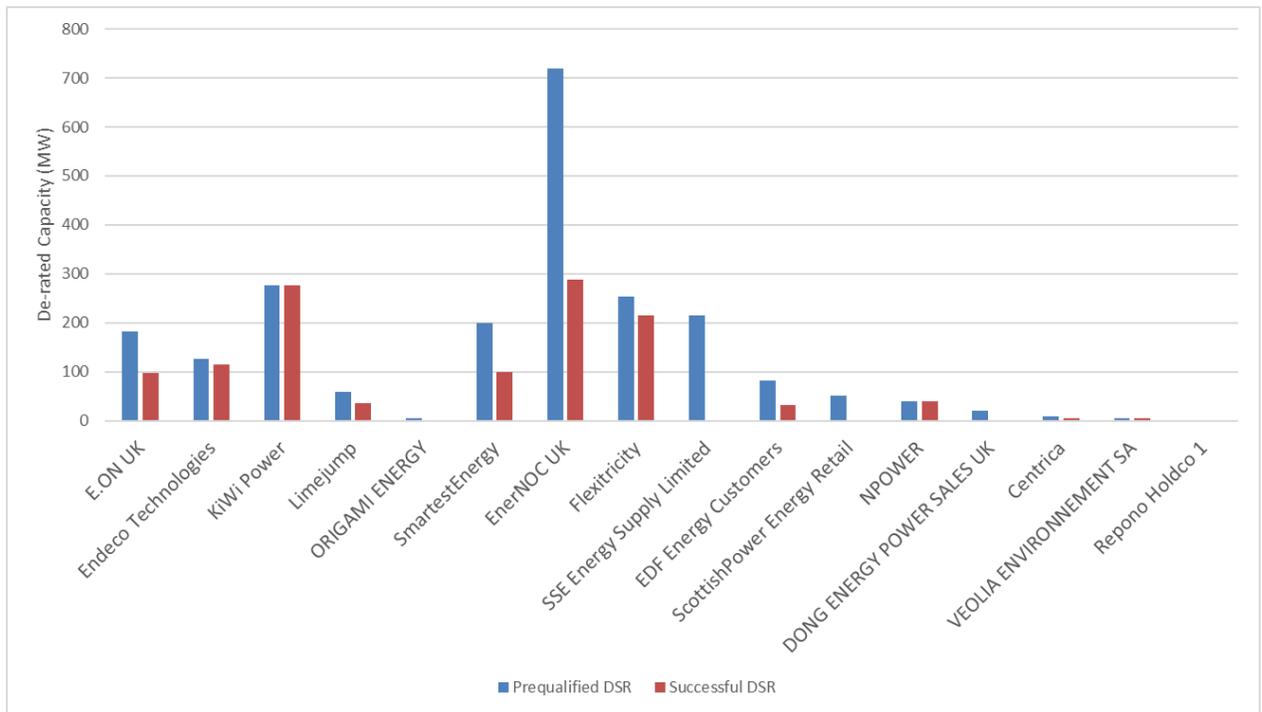
³² BEIS, Capacity Market Consultation – Improving the Framework: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/631842/CM_consultation_-_detailed_proposals-template.pdf

³³ National Grid, Duration-Limited Storage De-Rating Factor Assessment – Final Report: <https://www.emrdeliverybody.com/Lists/Latest%20News/Attachments/150/Duration%20Limit%20Storage%20De-Rating%20Factor%20Assessment%20-%20Final.pdf>

This DSR capacity is subject to change as DSR components will have to undergo testing one month before the start of the Delivery Year in October 2021.

- 5.6. The DSR that prequalified for the 2017 T-4 auction had a success rate of just under 54%, slightly below the average success rate of 67% in the auction.
- 5.7. EnerNOC secured the most capacity (24%) with a success rate of 40%. Four companies had a success rate of 100% but two of these were for obligations of under 5 MW (Figure 17).

Figure 17 – Prequalified and successful DSR capacity by company in the 2017 T-4 Auction



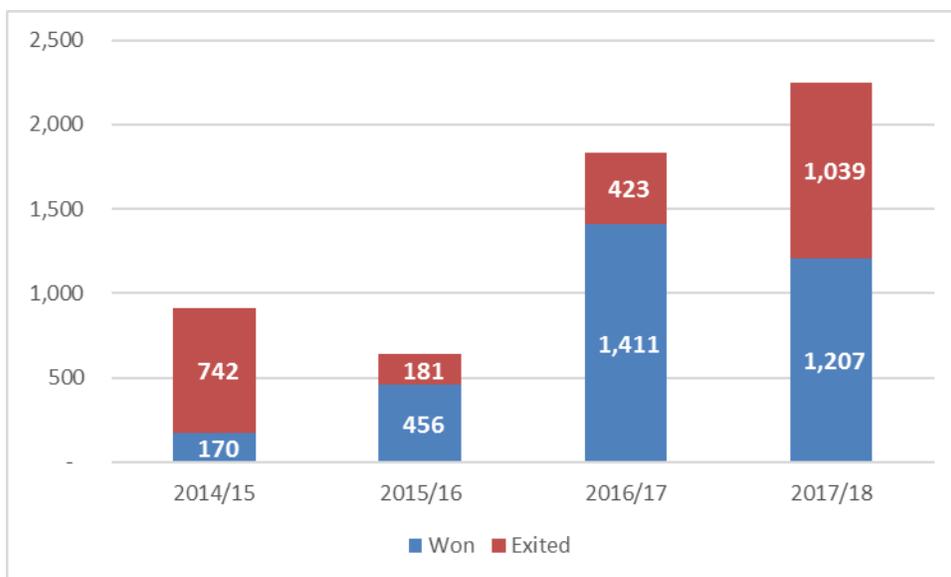
2017/18 T-1 Auction

- 5.8. A total of 115 DSR CMUs entered the 2017 T-1 Auction, with a total bidding capacity of 1,283 MW, which accounted for 12% of total bidding capacity.
- 5.9. Out of the total participating in the 2017/18 T-1 Auction, 41 DSR CMUs secured an agreement, totalling around 443 MW of capacity. This amounts to just under 8% of all successful capacity. The DSR success rate for units entering the auction was 35%, compared with the auction’s average success rate of 73%.
- 5.10. Out of the total DSR CMUs that secured an agreement, 35 CMUs were proven and 358 were unproven. The proven CMUs had a significantly larger success rate at 71% compared to unproven CMUs success rate at 31%.

Historical analysis of DSR participation in T-4 auctions

- 5.11. The amount of successful DSR in the 2017/18 auction has not continued the trend seen across the previous years (Figure 18). The clearing price is likely to be a significant driver of the lower volume of successful DSR.
- 5.12. The volume of DSR participating capacity increased by 22% compared to the previous year. However, the success rates of this capacity has been decreasing from 82% in the 2015/16 auction to 78% in the 2016/17 auction and finally just under 54% in the 2017/18 auction.

Figure 18 - DSR participation and success in T-4 auctions

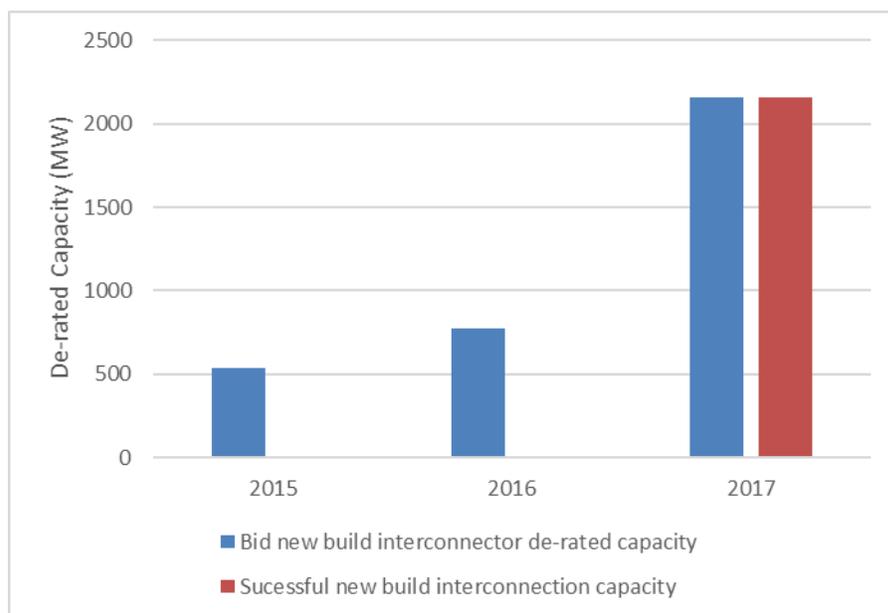


Interconnector prequalification and auction outcomes

2017/18 T-4 Auction

5.13. 2017/18 was the first auction where New Build Interconnector CMU secured an agreement (Figure 19). All 4.6 GW of interconnector capacity that prequalified entered the auction and secured an agreement. The three New Build Interconnector CMUs accounted for 2.2 GW of this capacity.

Figure 19 - New build interconnector participation and success



Storage prequalification and auction outcomes

Historical storage auction participation and performance

5.14. There were no participating storage projects in the 2014/15 and 2015/16 capacity auctions.

5.15. The 2016 T-4 auction, storage CMUs won agreements for the first time³⁴. The majority of successful capacity (2.5 GW) was existing transmission-connected

³⁴ Storage Generating Technology Class was first introduced ahead of the 2017/18 auctions. Our historic analysis is based on the Location & Description of CMU Components field in the Capacity Market Registers.

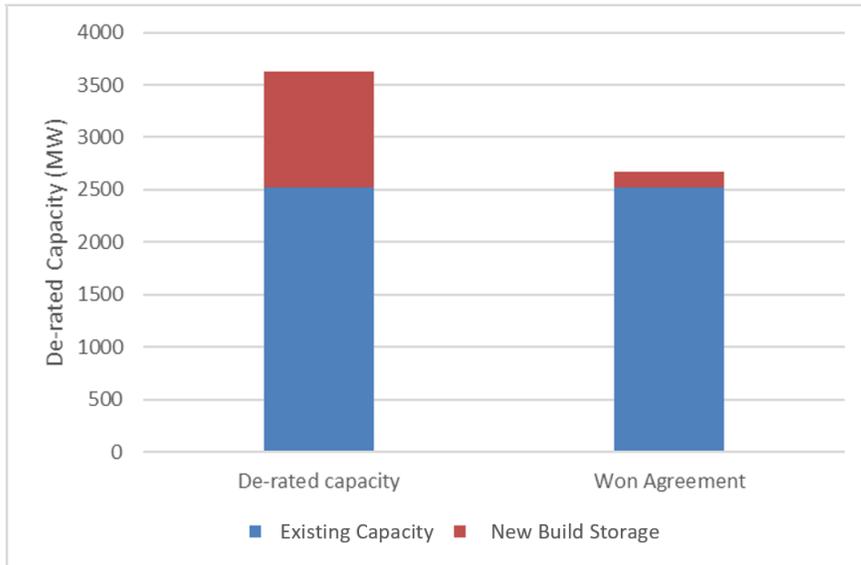
storage, 454 MW of New Build distribution-connected storage secured agreements.

- 5.16. In the 2017 Early Capacity Auction, storage capacity had a success rate of 98%.

2017/18 T-4 Auction

- 5.17. 2.1 GW of New Build storage de-rated capacity applied for prequalification in the 2017 T-4 Auction. In the 2016 auction, 2.3 GW of New Build de-rated capacity prequalified, with 0.6 GW securing an agreement in the auction (25%).
- 5.18. In November 2017, 228 New Build battery storage CMUs conditionally prequalified for the auction, with an estimated de-rated capacity of 1.7 GW. Another 11 existing battery storage CMUs successfully prequalified (2.5 GW).
- 5.19. In December 2017, BEIS published its decision on the new de-rating factors. In addition, New Build CMUs are required to post credit cover to attain a prequalification status. Following these events, the number of successfully prequalified New Build storage CMUs fell to 146 (1.3 GW). In total, 3.8 GW of de-rated storage capacity successfully prequalified.
- 5.20. Overall, storage success rates remained relatively high. 3.6 GW of this storage capacity entered the auction. 2.7 GW secured an agreement, including all of the existing storage that entered the auction.
- 5.21. However, only 151 MW (14%) out of the 1.1 GW of new build storage that entered the auction gained a capacity agreement (Figure 20). In comparison, in 2016, 501MW of the 566MW that entered the T-4 auction won an agreement (89%).

Figure 20 – Capacity secured agreements for new build and existing storage in the 2017/18 T-4 auction.



6. Bidding behaviour

This section provides an overview of the bidding approaches of participants in the 2017/18 T-4 and T-1 Capacity Auctions

Background

Bidding actions in 2017/18 T-4 and T-1 Capacity Auctions

- 6.1. In each round, the following actions are available to auction participants:
 - **Exit Bid** – all Capacity Market Units (CMUs) can specify the price at which they exit the auction
 - **Duration Bid Amendment (DBA)** – New Build and Refurbishing CMUs that qualify for longer agreements can specify the price at which they want to reduce the length of their agreement
 - **Continue as Pre-refurbishing** – Refurbishing CMUs can specify a price to switch to an Existing contract (and as a result only receive a one-year agreement)
- 6.2. In each round, bidders also have the option of placing 'Proxy Bids' for any of the above actions. These are bids which take effect in a later round.
- 6.3. CMUs that qualified as Price Makers could place Exit Bids up to the auction cap of £75/kW/year. This included all New Build, Refurbishing and DSR CMUs, and Existing CMUs that submitted Price Maker Memorandums. Price Takers could only place bids at less than or equal to £25/kW/year.

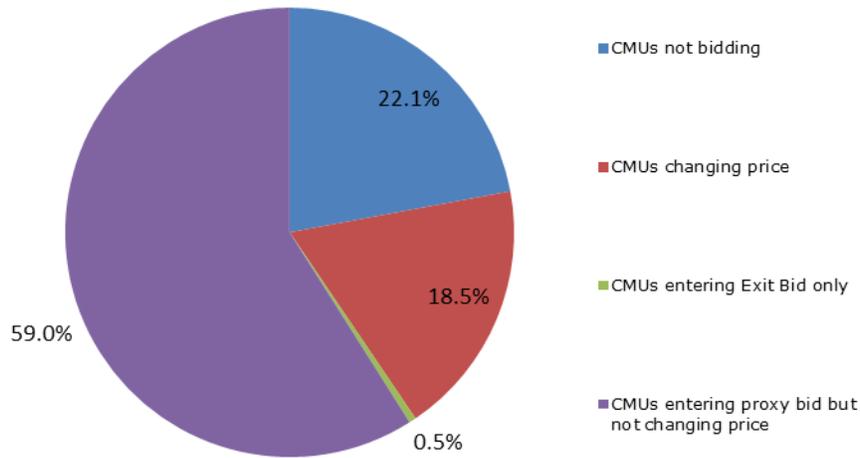
Our monitoring

- 6.4. We monitor bidding patterns and behaviour following the CM auctions for several reasons, including our role as a Competition Authority and a National Regulatory Authority, and to monitor compliance with the CM Rules. We also monitor to inform decisions on whether to make changes to the CM Rules.

Summary of bidding behaviour in the 2017/18 T-4 Auction

- 6.5. Looking at the 2017/18 T-4 Auction data (Figure 21), around a fifth of the CMUs changed their bidding price during the auction. This was an increase from the 2016/17 T-4 Auction (8%). The majority of the changes in price were decreases, which could reflect the competitive nature of the auction.

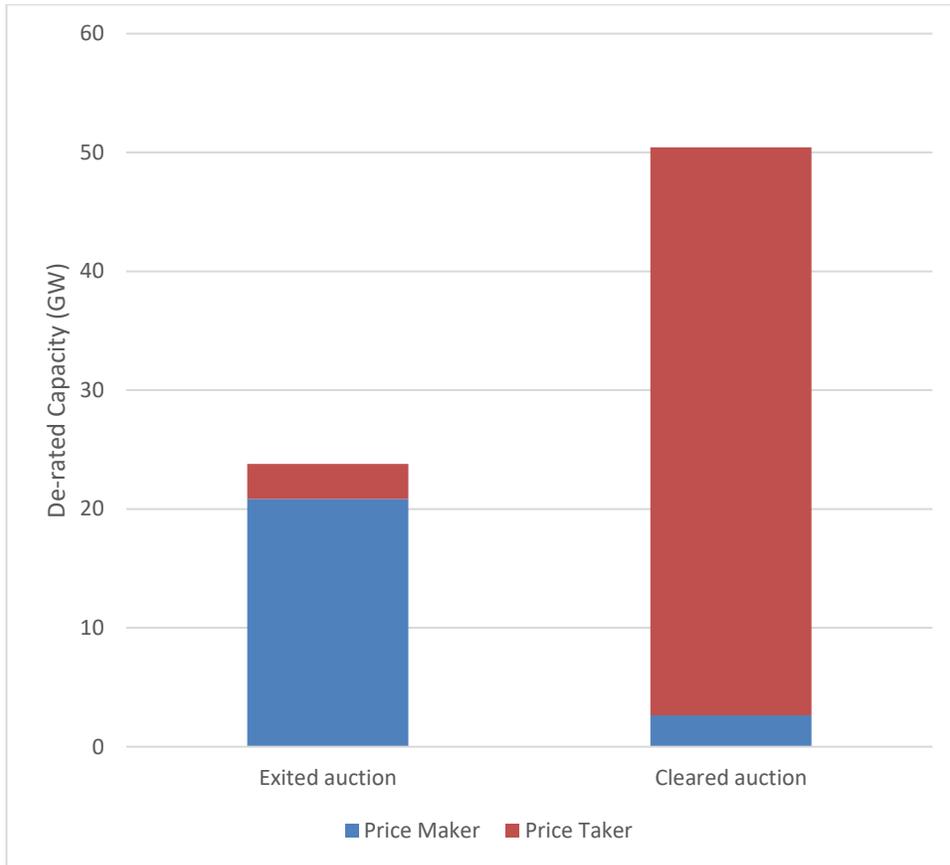
Figure 21 – Bidding behaviour for CMUs in the 2017/18 T-4 Auction



Price Makers and Takers

6.6. In the 2017 T-4 Auction, the majority of Price Maker capacity (approximately 89%) exited the auction without an agreement (Figure 22). Around 2% of existing CMUs that had signed a Price Maker Memorandum (enabling them to bid above £25/kW) cleared the auction. Overall, the bidding behaviour in the 2017 T-4 Capacity Market Auction did not significantly differ from the 2016 T-4 Auction. The majority of Price Makers that entered the auction failed to secure an agreement, whilst most Price Takers secured an agreement.

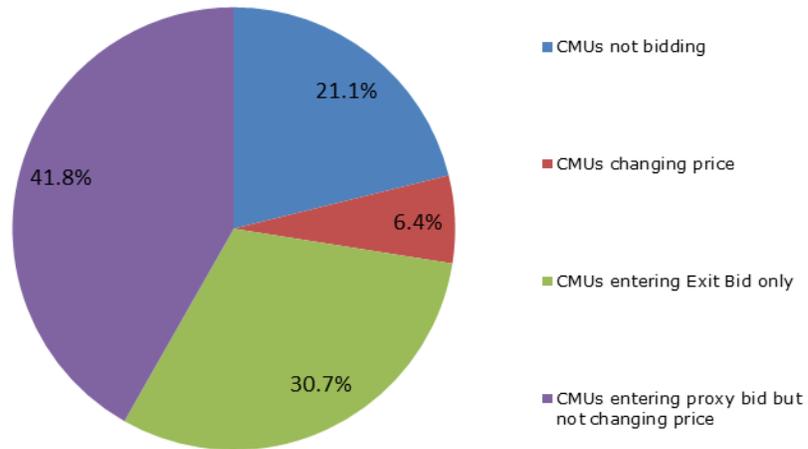
Figure 22 – Cleared and exited capacity by Existing Price Makers and Price Takers in the 2017/18 T-4 Capacity Market Auction



Summary of bidding behaviour in the 2017/18 T-1 Auction

6.7. 42% of participants entered proxy bids without changing price and almost a third entered only exit bids (31%). 21% of CMUs did not place any bids during the auction. 6.4% of all CMUs participating in the T-1 actively bid during the auction.

Figure 23 – Bidding actions for CMUs in the 2017/18 T-1 Capacity Auction



Price Makers and Takers

6.8. 54% of Price Maker capacity participating in the 2017 T-1 Auction cleared the auction with an agreement (Figure 24). No existing CMUs that had signed a Price Maker Memorandum (enabling them to bid above £25/kW) cleared the auction.

Figure 24 – Cleared and exited capacity by Existing Price Makers and Price Takers in the 2017/18 T-1 Capacity Auction



7. Delivery milestones for earlier auctions

- 7.1. 2017/18 is the fourth year of Capacity Market (CM) auctions. There have been three previous CM auction rounds in 2014, 2015 and 2016. This section covers the performance of CMUs against their obligations including investment, construction, and testing.

Delivery milestones for T-4 Auctions (2014-2017)

- 7.2. Successful New Build and Refurbishing Generating, and New Build Interconnector CMUs must meet a number of pre-delivery year milestones.
- 7.3. New Build CMUs are required to achieve the Financial Commitment Milestone³⁵, Minimum Completion Requirement and Substantial Completion Milestone by deadlines specified in the CM Rules.³⁶ A failure to do so can result in a loss of CM payments, and/or a termination of their CM agreement.³⁷
- 7.4. DSR providers are required to carry out a DSR test to prove that their CMU can achieve the capacity stated in the Capacity Obligation. A failure to meet this requirement may result in a termination of their agreement.³⁸

³⁵ Financial Commitment Milestone is a requirement on the Capacity Provider to demonstrate that 10% of total project spend for that CMUs has incurred.

³⁶ Minimum Completion Requirement obligates the Capacity Provider to have an aggregate physical generating capacity de-rated exceeding 50% of its Capacity Obligation. Substantial Completion Milestone requires the CMU to demonstrate an aggregate physical generating capacity de-rated equal or exceeding 90% of its Capacity Obligation. A failure to achieve these milestones by a specified date may result in a loss of CM payments, or a termination of the Capacity Obligation.

³⁷ Progress towards meeting these milestones is monitored by a requirement on Prospective Capacity Provider to submit construction reports to the Delivery Body until the SCM is achieved.

³⁸ See Rule 6.8.2 and 6.10.1. DSR Test Certificate is due one month before the start of the Delivery Year as outlined in Rule 3.10.2(a).

Table 2 - Successful New Build CMUs, milestones achieved and terminated de-rated capacity to date (March 2018)³⁹

	Successful New Build capacity	Successful New Build CMUs	Capacity met FCM (%)	Capacity met SCM/MCM (%)	Terminated capacity (GW)	Terminated capacity (CMUs)
2014 T-4 (DY 2018)	2.6 GW	78	100%	65%	1.7 GW	7
2015 T-4 (DY 2019)	1.9 GW	74	100%	45%	118 MW	7
2016 T-4 (DY 2020)	3.4 GW	129	43%	28%	12 MW	1
2017 T-4 (DY 2021)	2.9 GW	73	Due in 2019	Due in 2021	n/a	n/a

2014 T-4 Auction

- 7.5. The 2014 T-4 auctions procured 49.3 GW of de-rated capacity at a clearing price of £19.40/kW/year. 2.6 GW of cleared de-rated capacity was new generating capacity (Table 2).
- 7.6. In March 2018, 65% of the active New Build CMUs for delivery in 2018/19 had met their Substantial Completion Milestone (SCM). Another quarter of all CMUs expected to achieve it by the start of the 2018/19 Delivery Year.⁴⁰
- 7.7. Seven CMUs have been terminated to date. Six of these CMUs are New Build, totalling around 1.7 GW de-rated capacity (of which 1,656 MW is due to the Trafford power station⁴¹).

³⁹ These figures include de-rated capacity terminated in previous calendar years. References to milestones are based on data last updated in March. Terminated capacity figures are based on information available in the CMR.

⁴⁰ Delivery Years run from 1 October until the end of September the following calendar year.

⁴¹ The Trafford power station failed to reach its financial commitment milestone in December 2016 after receiving a three-month extension.

2015 T-4 Auction

- 7.8. The 2015 T-4 auction procured 46.4 GW of de-rated capacity at a clearing price of £18.00/kW/year. This included around 1.9 GW of new generating capacity.
- 7.9. In March 2018, around 45% of New Build de-rated capacity for delivery in 2019/20 had met their SCM. According to the submitted construction reports, 47% of Capacity Obligations yet to achieve SCM expected to do so before the start of the delivery year (Table 2).
- 7.10. The Capacity Market Register for the 2015 T-4 auction⁴² show that seven CMUs (out of which six are New Build Generating CMUs) have been terminated since the auction, equivalent to around 118 MW de-rated distribution-connected capacity.

2016 T-4 Auction

- 7.11. The 2016 T-4 Capacity Auction procured a total of 52.4 GW of de-rated capacity at a clearing price of £22.50/kW/year. 3.4 GW of this was New Build Generating capacity.
- 7.12. The SCM for successful Prospective CMUs from the 2016 T-4 Auction is the start of 2020/21 Delivery Year. In March 2018, eight of the New Build CMUs (equivalent to around 944 MW of de-rated capacity) had achieved their SCM.
- 7.13. By July 2018, one 12 MW CMU procured through the 2016 T-4 auction had been terminated.

2017 T-4 Auction

- 7.14. The 2017 T-4 auction procured 50.4 GW of de-rated capacity at a clearing price of £8.40/kW/year. Around 2.9GW of cleared capacity was New Build Generating and Interconnector capacity.
- 7.15. Prospective CMUs which won a Capacity Agreement in the 2017/18 T-4 Auction must reach the Financial Commitment Milestone (FCM) by 21 June 2019.
- 7.16. Six months after the 2017/18 T-4 auction none of the auction acquired capacity obligations have thus far been terminated.

⁴² Published in June 2018.

The 2017/18 Delivery Year

7.17. The Early Capacity Auction (ECA) and the second Transitional Arrangements Auction (TA) procured 54.4 GW and 312 MW de-rated capacity respectively for the 2017/18 Delivery Year currently under way (Table 3).

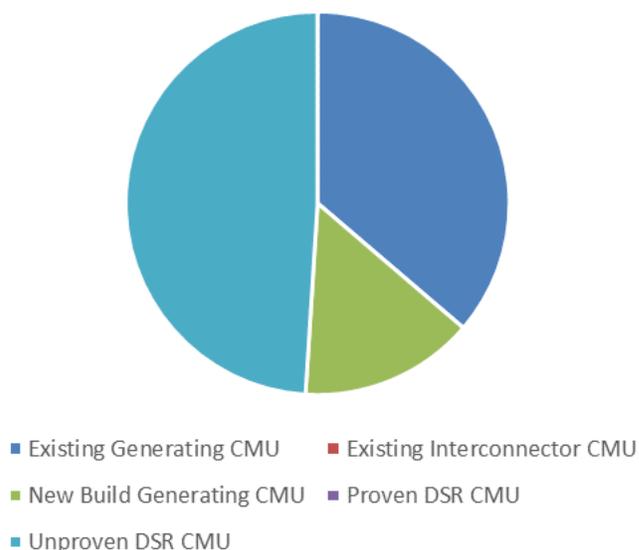
Table 3 – Successful New Build/DSR CMUs, milestones achieved and terminated de-rated capacity to date (March 2018)

	Successful New Build/DSR Capacity	Successful New Build/DSR Capacity	Capacity met FCM (%)	Capacity met SCM/MCM (%)	Terminated capacity (MW)	Terminated capacity (CMUs)
2016 TA (DY 2017)	312 MW	32	n/a	n/a	15 MW	4
2017 EA (DY 2017)	1.7 GW	70	100%	98%	20 MW	6

7.18. 1.7 GW of ECA successful capacity was New Build, whilst the 2016 TA only procured DSR capacity.

7.19. Based on the CMR data published in July 2018, 20 MW of capacity procured through the ECA has been terminated to date, and another 15MW through the TA. The majority of this terminated de-rated capacity (Figure 25) is Unproven DSR (18MW), 13 MW Existing Generating and 2 MW New Build Generating CMU capacity.

Figure 25 – Terminated capacity by CMU category for the 2017 Delivery Year (at July 18)



8. 2015 Transitional Arrangements Auction and 2016/17 Delivery Year

- 8.1. The 2015 Transitional Arrangements Auction for delivery in 2016/17 concluded in January 2016 clearing at £27.50/kW/year, and agreements were awarded for around 57 CMUs with 803 MW of de-rated capacity.

Testing and Pre-Delivery Year Capacity Providers

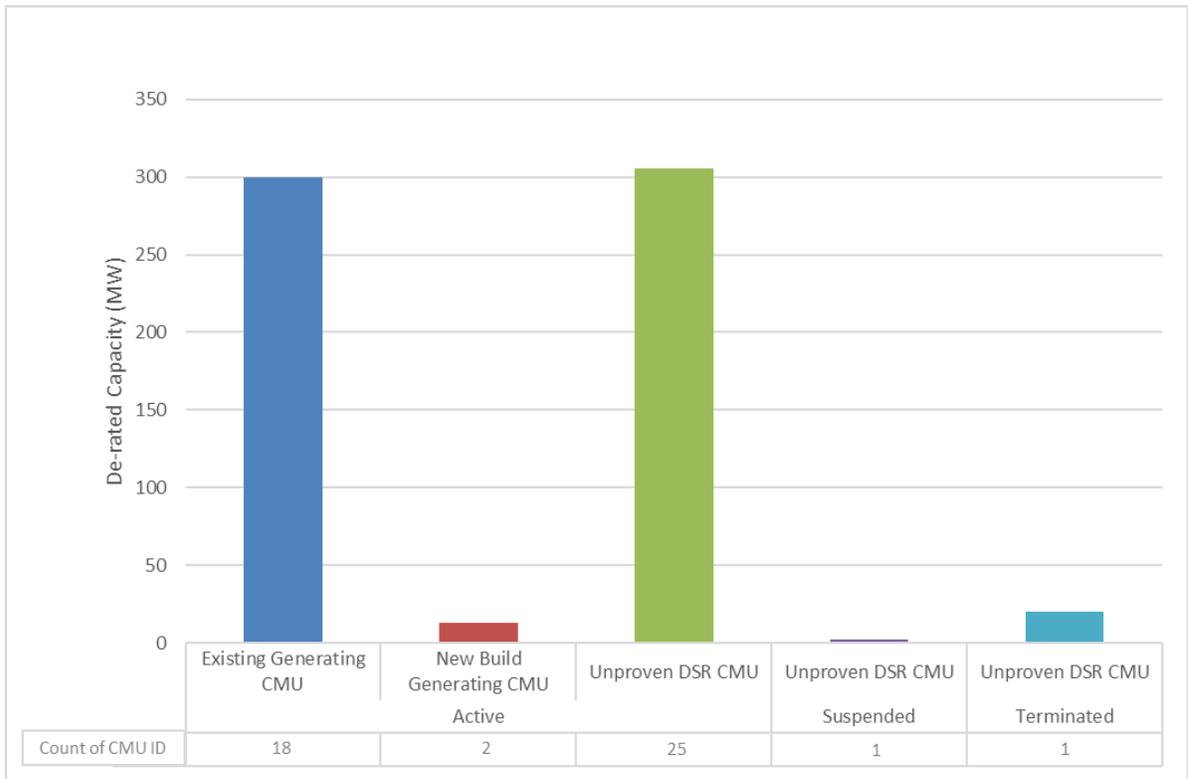
- 8.2. Following DSR and Metering tests due in September 2016, Capacity Obligations for eight providers were revised down (in total by 75 MW) for failing to demonstrate the complete Capacity Market Obligation during testing. The majority of this capacity was Unproven DSR.⁴³
- 8.3. 46 CMUs remained active after the DSR test deadline with an estimated total de-rated capacity of 620 MW available to deliver capacity. The majority of this is Unproven DSR (329 MW), followed by Existing Generating CMU de-rated capacity (300 MW) and only around 13 MW of New Build Generating CMU capacity.

Delivery Year obligations

- 8.4. Capacity Providers are required to show satisfactory performance by demonstrating their de-rated capacity in accordance with the arrangements set out in Chapter 13 of the Rules.
- 8.5. During the Delivery Year 2016/17, one CMU failed to demonstrate satisfactory performance resulting in a suspension of capacity payments. Another CMU was terminated for failing to demonstrate satisfactory performance (Figure 26).

⁴³ For further analysis of the 2015 Transitional Arrangements see BEIS' 'Evaluation of the Transitional Arrangements for Demand Side Response', available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/671595/Evaluation_of_the_Transitional_Arrangements_for_Demand-Side_Response_-_Phase_2_Main_Report.pdf

Figure 26 – Satisfactory Performance Days by CMU category for 2015 Transitional Auction (at the end of Delivery Year 2016/17)



9. Next steps

- 9.1. On 9 July 2018, the government announced the Capacity Market (CM) auction parameters for the auctions to be held in 2018/19. In 2018/19 the Delivery Body will run two auctions:⁴⁴
- T-1 auction for delivery in 2019/20 with a target capacity of 4.6 GW (minimum and maximum capacities of 3.6 GW and 5.6 GW, respectively);
 - T-4 auction for delivery in 2022/23 with a target capacity of 46.3 GW (minimum and maximum capacities of 44.8 GW and 47.8 GW, respectively).
- 9.2. Ofgem will continue to play a key role in the CM, which includes:
- responsibility for the Rules;
 - oversight and enforcement powers over how NGET, suppliers and generators are complying with the Electricity Capacity Regulations 2014 (the Regulations) and the Rules;
 - determine disputes where participants disagree with a decision made by NGET;
 - monitor the CM policy;
 - enforce competition law and compliance with the Rules and the Regulations; and
 - report on the effectiveness of the CM generally and on NGET's performance.
- 9.3. We will also be issuing an update on our Five Year Review of the CM Rules in early autumn. This review is distinct from the review to be conducted by Government, which will consider the wider CM framework. We intend to co-ordinate the timing and content of our review with Government, to ensure consistency and effective engagement with stakeholders.
- 9.4. Our review will consider, among other areas, our Rules change process. In light of the review, we consider that it may be confusing and counterproductive to run a full Rules change process for 2018/19. Instead, we will focus on those changes that have already been consulted and decided on.

⁴⁴ <https://www.gov.uk/government/collections/capacity-market-parameters-for-auctions-2019-to-2020-and-2022-to-2023>