**The Regulatory Assistance Project's (RAP) and ClientEarth's Concerns with UK Capacity Mechanism's State Aid Conformity – Follow-up**

In our previous contribution, we questioned the method employed by the UK to analysis its alleged adequacy problem. One of the issues we pointed out, was that National Grid and DECC made very conservative assumptions with regard to the contribution of interconnector capacity to achieve resource adequacy. The Final Report of the EMR's Panel of Technical Experts on National Grid's Electricity Capacity Report [1], which was also published on Tuesday , supports our view. It stresses that interconnectors should be treated in the same way as generation, and that doing so would make a difference of at least 2.6 GW It also does not find evidence for the UK's concerns about the "considerable uncertainty (...) around the potential flows (including direction) through GB interconnectors into the future …".

As mentioned in our earlier statement, we are very concerned about the disregard of interconnector capacity. There seems to be no valid reasons to not include interconnector capacity into resource adequacy assumptions. Yet, DECC sticks to its very conservative analysis. This leads to an over-estimation of the UK's resource adequacy problem, and in turn to an exaggerated amount of electricity generation capacity that will be procured through the capacity mechanism.

Since state aid should only be permitted if it is, among other things, necessary, proportional, and if it does not unduly distorts competition and trade between Member States, we believe that the proposed mechanism should be seriously questioned by the Commission. The case for a market-wide capacity market is that the market is not brining forward investment in capacity needed to meet resource adequacy requirements. But if the case for doing so is based on a significant understatement of the resources currently available, the rationale for a market wide-capacity market needs to be called into question.

Also, the mechanism as it stands today will benefit national resources more than necessary for achieving resource adequacy because it will lead to an over-procurement of national resources. Moreover, while it has been recognized that interconnection can play a serious role in achieving adequacy, the mechanism excludes interconnector capacity from participation in the mechanism and thereby threatens much needed future investments in interconnection.

Strengthening interconnectivity between Member States is a well-established EU policy. The UK capacity mechanism has the potential of undermining this goal in two ways. First, as mentioned, the mechanism

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/324976/EMR_Panel_s_Final_Report_on_National_Grid_s_ECR.pdf

might deter investment from interconnector capacity because the signal from the capacity mechanism is that interconnection does not play a role. Second, a Commission Decision approving that capacity mechanism as it looks today will set a precedent for other Member States that would like to exclude interconnection from their capacity mechanisms. This will make it very difficult to achieve the EU goal of strengthening EU interconnectivity."

Turning now to the issue of generator availability assumptions, our previous submission raised concerns about the overly-conservative approach adopted by both National Grid and Ofgem. These concerns have proved justified with National Grid's analysis and Ofgem's Electricity Capacity Report for 2014 both continuing to underestimate the availability of conventional generation reasonably be expected in a reasonably-well incentivised energy market. Even without a capacity market, Ofgem's announced balancing mechanism reforms will provide very strong incentives for market participants to balance their positions, with imbalances potentially exposed to cash out prices approaching VOLL when the risk of demand disconnection is high. DECC's own EMR Expert Panel (reference the EMR Expert Technical Panel final report) provides strong arguments for assuming that conventional generation can be expected to achieve availabilities in the mid to low 90% range when capacity is scarce and strong incentives exist, rather than the lower availabilities assumed by National Grid, Ofgem and DECC.

Taken together with the underestimate of interconnector contribution during scarcity events, these pessimistic assumptions probably remove at least 4 GW of capacity from the capacity stack thereby, either intentionally or otherwise, significantly overstating the case for capacity incentives over and above those already announced by Ofgem in the form of balancing mechanism reform.

While the political rational for some insurance policy to reduce the risk of insufficient capacity being available to meet demand can be understood, the decision to opt for a market-wide capacity market is difficult to justify given the available evidence. Even Ofgem's analysis, set out in their recently published Electricity Capacity report for 2014 (reference) which makes the same pessimistic assumptions on interconnector contribution and generator availability as does National Grid, concludes that supply security will remain above DECC's reliability standard even under the most pessimistic assumptions. Ofgem's 2014 report includes the effect of National Grid's DRBS and other initiatives for the coming winters and shows that reliability will not fall below a disconnection risk of 1 in 31 years, which compares which DECC's equivalent standard of 1 in 8 years. Clearly, the use of more appropriate interconnection and plant availability assumptions would result in even higher levels of predicted reliability. As suggested in our earlier submission, if additional insurance that sufficient capacity will be available is required, a targeted capacity mechanism that did not impact on energy prices or threaten the efficient operation of market coupling, would be far more appropriate.

Finally, continuing with the theme of demand response, it is disappointing to note that the arrangements for the participation of DSR in the forthcoming capacity auctions have worsened to some extent. Even though DECC appear to recognise the need to encourage the participation of DSR and the advantages to customers that would bring, lobbying by generators to ensure a "level playing field" seems to have resulted in harsher collateral requirements being imposed. In fact the playing field is now patently not level, as DSR is not able to access the longer contracts that new or refurbished generation can.