SPOTLIGHT ON:
THE CAPACITY MARKET

December 2016

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understanding energy

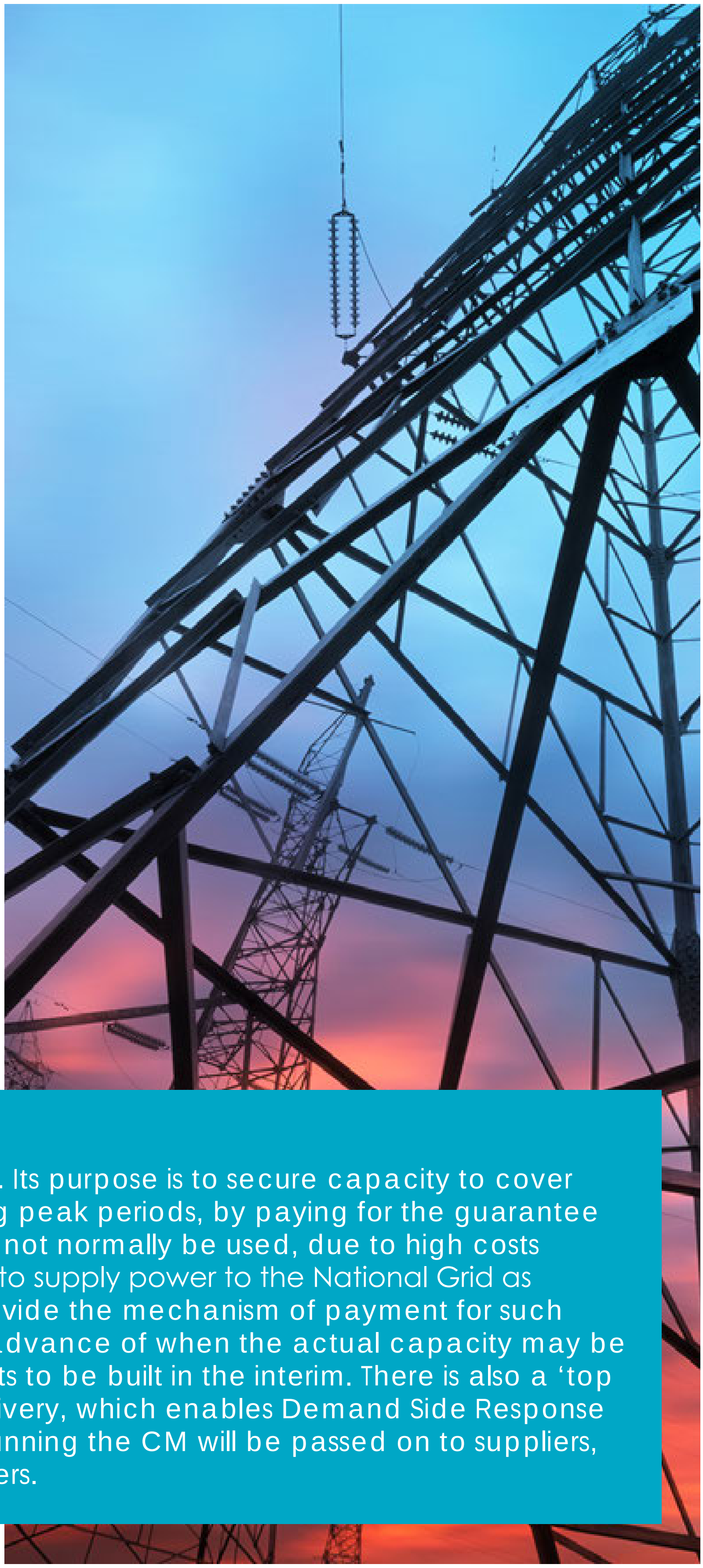
Quick guide to the Capacity Market:

The Capacity Market is a major part of the Government's wider Electricity Market Reform (EMR) program; designed to attract £110 billion of investment into the UK's electricity infrastructure by 2020. The EMR was introduced with three main aims, sometimes referred to as the 'energy trilemma':

1: Keep the lights on - Secure a reliable power supply for future years.

2: Meet environmental targets – Ensure the UK's meets its carbon reduction targets.

3: Keep costs down – Make sure energy remains affordable for consumers.



How the Capacity Market works:

CM operates as an annual auction (T4). Its purpose is to secure capacity to cover any potential shortfall in demand during peak periods, by paying for the guarantee that a generation source (which would not normally be used, due to high costs or inefficiencies) could be called upon to supply power to the National Grid as and when required. The T4 auctions provide the mechanism of payment for such guarantees and are held four years in advance of when the actual capacity may be required – allowing for new power plants to be built in the interim. There is also a 'top up' auction (T1) one year ahead of delivery, which enables Demand Side Response generators to participate. The cost of running the CM will be passed on to suppliers, who in turn will pass on costs to customers.

Capacity Market charges explained:

There are two types of charges for suppliers associated with CM:

1: A new company called “The Electricity Settlement Company” has been formed to run the scheme and their annual running costs are calculated each year and translated to suppliers as the **CM Operational Levy**. This will generally be passed on to the end user as a fixed unit rate per kWh – currently around 0.0015p/kWh.

2: The cost of the CM auctions (both DSR and generation) will translate into a second charge known as the **CM Obligation Levy**.
The two different types of levy are National Grid’s way of covering the costs of the Capacity Market. Suppliers will be charged according to their market share during periods of highest demand: between **4pm to 7pm, Monday to Friday during November to February**.

As these costs have grown significantly since the inception of the CM, suppliers are now beginning to pass them on to their customers.

Will your business pay extra to ‘make sure the lights stay on’?

Earlier this year, the decision was made by the Department of Business Energy and Industrial Strategy (BEIS), formerly DECC, to bring forward the start of the Capacity Market (CM) by one year, to October 2017.

Whilst this may still seem some time away, preparations for the introduction of the new mechanism are already well underway. The first T4 auctions took place during 2014 and 2015 – to prepare for winter 2018/19 and 2019/20 - whilst the first T1 auction is set to take place in January 2017, with the aim of securing ‘top up’ generation volume for winter 2017/2018. In addition, transitional arrangement (TA) auctions have already taken place to bring Demand Side Response firmly into the picture, and business energy consumers will begin to see changes on their next energy bill.

What to expect:

Some suppliers may pass on costs via a monthly charge for the financial year (April to March), which will be reconciled after February.

Others will set a price per kWh for consumption during peak periods, similar to Winter Peak charges used in the past. This will also be reconciled after February.

A third option will be for suppliers to forecast the charge and fix this at the outset of a new contract. It will not be seen as a separate charge on your bill, but will be included in your tariff rates. No reconciliation will be possible and suppliers may therefore choose to build in some additional cost to cover their risk.

The cost predictions so far look like this:

Winter 16-17	Winter 17-18*	Winter 18-19	Winter 19-20	Winter 20-21
Approx. 0.015p/ kWh or 0.17p/Peak kWh	Ranging from 0.44p to 0.73/ kWh or 10p to 16p/ Peak kWh	Approx. 0.34 p/ kWh for all kWh or 7.35p/Peak kWh	Approx. 0.35 p/ kWh or 7.41p/Peak kWh	Approx. 0.42 p/ kWh or 8.81p/Peak kWh

NB: NHH suppliers will either see the CM charges presented on billing as part of a new “EMR Charge” – the new CM costs (and Contracts for Difference charges) will be contained in this EMR charge and will be fixed for the duration of the offer period. Alternatively, the CM charges will be uplifted within the unit rates (e.g. Day Rate and Night Rate).

*T-1 auction for delivery in Winter 17-18 will begin 31st January 2017, meaning the impact on the bill will be understood by early February 2017.

Understand more

As businesses face new costs associated with the CM, it makes sense to put plans in place to reduce consumption at peak times, make necessary adjustments to budgets and be sure of how your supplier will approach the changes.

Find out more:

If you would like to find out more about the Capacity Market, how your business can reduce consumption, or how to benefit from Demand Side Response schemes, please get in touch.

Call us on: 08451 46 36 26
Email: enquiries@inenco.com
Visit: www.inenco.com