

UK GOVERNMENT PLANS TOP UP CAPACITY MARKET AUCTION THIS SUMMER

The UK Government has introduced Regulations to provide for a "top-up" T-1 capacity market (CM) auction in summer 2019 for delivery in winter 2019/2020. Through the changes to the CM arrangements, the Government aims to provide as much legal certainty as possible during the standstill period.

NEW CM REGULATIONS

Story so far

Following a successful passage through Parliament on 9 April 2019, the Government passed new Regulations to implement significant changes to the UK CM arrangements to apply during the standstill period. The standstill has been in place since the ruling of the General Court of the Court of Justice of the European Union (GC) in November 2018, which suspended the UK capacity market until a re-clearance of the decision is issued by the European Commission (EC) (see our November 2018 briefing for more detail on the GC's ruling [here](#)). Since then there has been a flurry of activity in both Westminster and Brussels:

- on 19 December 2018 the Government published a consultation on "technical changes" to the CM;
- on 25 January 2019 the EC filed an appeal against the GC's November 2018 decision;
- on 21 February 2019 the EC opened a formal (Phase 2) investigation into the design of the CM;
- on 28 February 2019 the Government published its response to the December 2018 consultation and laid draft Regulations in Parliament;
- on 5 March 2019 Tempus Energy launched a legal challenge against the Government's decision to introduce the Regulations; and
- on 7 March 2019 the Government published a further consultation on the CM, which among other things, proposes a T-3 auction in early 2020; and
- on 9 April 2019, Parliament passed the Regulations (and accompanying Rules), which entered into force on 10 April 2019.

Government rationale

The suspension of the CM prevented the Government from holding a planned capacity auction in February 2019 and from making any further capacity

Key issues

- The Government has introduced Regulations which implement the operational CM arrangements during the standstill period.
- The Regulations make provision for a replacement T-1 capacity auction in summer 2019 with capacity agreements being conditional on future State aid approval, and make provision for suppliers to continue making capacity market payments.
- Tempus Energy has challenged the Government's decisions since the GC's ruling by lodging a claim for judicial review at the High Court.

payments under existing agreements. This caused a significant amount of disruption and uncertainty in the GB electricity market by interrupting transactions and investment decisions. In addition, holders of capacity agreements were unsure of their rights and obligations during the standstill period. Equally electricity suppliers, who are required to collect capacity payments from their customers to pay holders of capacity agreements, did not know whether they were legally obliged to keep collecting payments from customers.

As set out by the Government in the explanatory memorandum, the Electricity Capacity (No.1) Regulations 2019 (the Regulations) attempt to provide as much legal certainty as possible to the market about the CM arrangements during the standstill period.

Changes introduced by the Regulations

The Regulations implement the Government's policy proposals for the standstill period, which it published in a consultation in December 2018, by modifying the application of the 2014 Regulations. Along with the Regulations, the Government laid the Capacity Market (Amendment)(No.1) Rules 2019 and the Capacity Market (Amendment)(No.2) Rules 2019 (Rules), which deal with technical aspects of the CM and have already come into force. As the title of the Regulations suggests, there will be further Regulations, which the Government has confirmed will be published later this spring.

The Regulations' main objective is to provide for a "top-up" T-1 auction in summer 2019 for delivery in winter 2019/20, thereby replacing the February 2019 auction that was cancelled as a result of the GC's ruling. As it is unlikely that the Government will have secured State aid approval by the summer, and in order to comply with the GC's ruling, the capacity agreements which will be awarded will be conditional on subsequent State aid approval.

When the State aid approval is forthcoming, the conditional agreements will be automatically converted into standard capacity agreements (provided this happens before 1 October 2020). If State aid approval is received by 1 October 2019, successful bidders will receive capacity payments in the "usual way", i.e. via monthly payments starting from 1 October 2019, and if approval is delayed, successful bidders will receive back payments.

The other two key changes to the existing arrangements provided by the Regulations are for:

- deferred payments to be made to capacity providers who have met their obligations during the standstill period; and
- suppliers to be invoiced in full for the duration of the standstill (assuming the EC grants State aid approval) and for suppliers to be able to make voluntary payments to the Electricity Settlements Company in the interim period.

Separately, the Rules also introduce fairly significant changes to the CM arrangements such as providing greater flexibility to existing capacity agreement holders during the standstill period. For example, capacity providers with contracts for new-build power stations will have extended periods within which to comply with certain financial milestones, and in which to obtain a distribution grid connection agreement.

NEW TEMPUS ENERGY LEGAL CHALLENGE

Tempus Energy, the company that successfully challenged the EC's decision not to raise State aid objections to the establishment of the CM, has sought to enforce the GC's judgment by lodging a claim for judicial review at the High Court.

While Tempus Energy's legal arguments have not yet been made public, it is understood from a press release¹ that its central argument is that the Government has not complied with the GC's ruling. Most notably, Tempus is expected to argue that the introduction of the Regulations amounts to continuing the operation of the CM in breach of the "standstill" obligation under EU law, which prohibits the implementation of State aid prior to a valid EC clearance decision. Tempus Energy also appears to have interpreted the GC's ruling to mean that the Government has a legal duty to recover the capacity payments already made to capacity agreement holders and to repay supplier charges that were collected to fund those payments.

There are, however, a number of reasons why Tempus Energy's challenge to the new Regulations is unlikely to succeed. Case law of the EU Courts is clear that aid can be granted with payment subject to State aid clearance without breaching the standstill obligation. Moreover, even if the High Court does conclude that it is required to order recoupment of capacity payments already made under two small "transitional" auctions (a separate "supplementary" auction was approved by a different State aid decision that was not annulled by the GC's judgment), the UK Government would be entitled to repay those amounts if the EC subsequently approves the capacity market scheme.

UNCERTAINTY PERSISTS

The Government has sought to introduce as much certainty as possible within the constraints of the GC's ruling. While the Regulations offer some clarity as to the Government's intentions for the operation of the CM going forward, the proposed measures are contingent on decisions which are outside of the Government's control. Until the legal challenge and Phase 2 investigation are resolved uncertainty around the future of the CM will persist.

The Government is anticipating that the EC's Phase 2 investigation will end by 1 October 2019. While it cannot be guaranteed that the EC will approve the CM scheme, the text of the EC's decision to open a Phase 2 investigation suggests that it is not minded to prohibit the scheme outright. What is less clear, however, is whether it will require changes to the scheme to address certain issues identified in that decision, and how material those changes might be.

It will therefore be interesting to see the market's appetite to participate in the planned T-1 auction this summer as both the Phase 2 investigations and UK legal challenge will most likely still be ongoing. Potential bidders should also consider that the obligation period (during which they must be available if called on during a stress event) might also commence without resolution of either or both the Phase 2 investigation and Tempus Energy's legal challenge.

¹ <https://blog.tempusenergy.com/blog/2019/3/5/tempus-enforces-judgment-to-remove-all-unlawful-capacity-payments>

While the Government is confident that the EC's approval will be forthcoming and timely, successful bidders in the replacement T-1 auction will still have to consider the possibility of being obliged to fulfil their obligations (and incurring costs) without knowing whether or when they will receive capacity payments.

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