

T-3 Capacity market results

The auction delivered a record low clearing price of all T-3/T-4 auctions to date

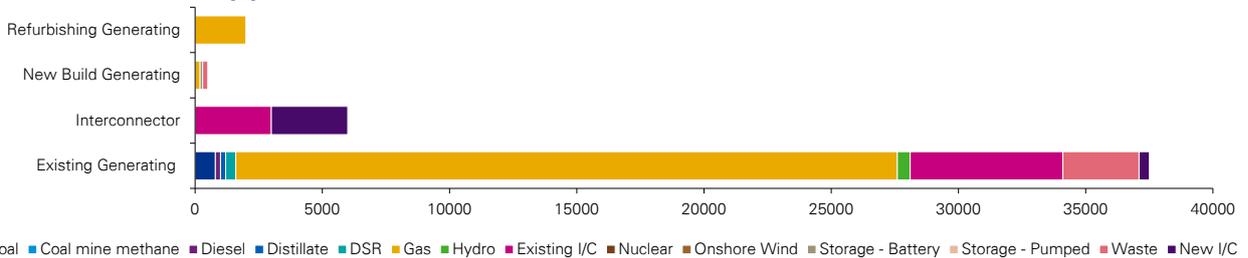
5 February 2020



Headline results

- The T-3 Capacity Market (CM) procured 45GW at a record low price (for T-3/T-4) of £6.44/kW translating into a gross cost of £290m for consumers.
- Despite a year-on-year decline, coal looks set to endure for another delivery year as two units at Ratcliffe (880MW) secure agreements.
- Other large existing units exited including several large CCGTs and Hinkley Point B.
- Interconnectors made up 13 percent of total procured de-rated capacity as a new 1.23GW project to Norway secured an agreement.
- Only 319 MWs of new build generation were successful.
- We saw the first sign of success for subsidy free renewables in the CM as five onshore wind projects secured agreements.
- The auction results, with oversupply of capacity, imply that the challenge for GB security of supply is no longer capacity but potentially flexibility, resilience and system stability.

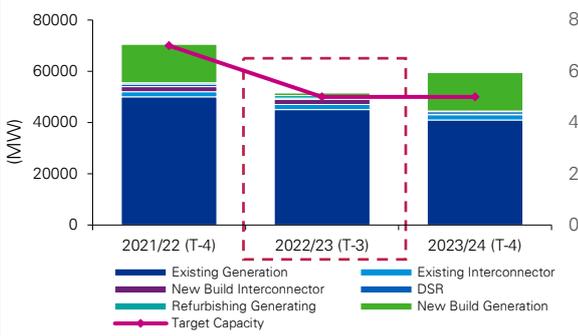
CM T-3 Auction, delivery year 2022/23 (MW)



Oversupply, oversupply, oversupply...

Whilst the auction was run under new state aid approval, the story of a market which is oversupplied endures. Although the auction was not as oversupplied as the 2021/22 and 2023/24 equivalents, there was still 59GW of capacity competing for 45GW of demand.

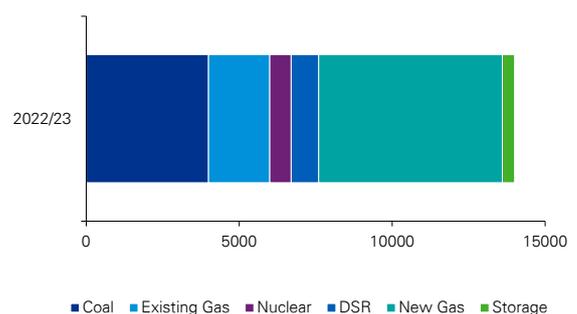
Prequalified Capacity in T3/T4 auctions



...which means existing domestic generators miss out...

This oversupply is responsible for driving out further coal capacity as Drax units 5 and 6 were unable to secure agreements for the first time. Uniper won agreements for two of their four coal units at Ratcliffe, but several large CCGTs, Ffestiniog and Hinkley Point B were all unsuccessful.

Capacity without agreements



With COP26 on the horizon and the increasing emphasis on climate risk ([see recent KPMG view](#)), are investors now driving change around unabated thermal units and could we start seeing a premium in CM bid prices to reflect this risk?

On the back of an auction which cleared at a record low, this risk appears theoretical for now, but it's a factor worth considering as decarbonisation continues to dominate the agenda.

...but interconnector capacity continues to grow...

On the day the UK left the European Union, all eight participating interconnector projects won agreements accounting for over 13 percent of the total procured de-rated capacity. This includes for the first time, National Grid's 1.4GW North Sea Link (NSL) project to Norway, which takes the total de-rated interconnection capacity to a record 5.9GW.

The UK will remain part of the Internal Energy Market (IEM) through the transition period meaning cross-border power will continue to be traded on a tariff-free basis. However, there is uncertainty for new interconnector projects created by the undefined future relationship with the EU, and this may impact the participation of further projects in future auctions. Furthermore, BEIS have committed to publish a call for evidence in "due course" to address the foreign participation issue which could have implications for I/C participation.

...with little room for new build generation...

New build generation capacity accounted for 0.71 percent of the total procured capacity and is made up of reciprocating engines, EfW, battery storage and subsidy free onshore wind.

Given the low clearing price and the shorter lead time for construction associated with a T-3 auction, it was unsurprising to see no new large gas projects won an agreement. These will now likely look to the T-4 auction in March to secure long-term agreements.

Storage and DSR both struggled when compared to the 2021/22 delivery year. This can be attributed to the lower clearing price, embedded reform and in the case of battery storage, low de-rating factors. The results imply that the business case for battery storage may no longer be reliant on the CM with investors looking to alternative markets for new revenue streams.

Five onshore wind projects took 15-year agreements, making the most of the revised eligibility criteria which now allows subsidy free renewables to participate in the CM. The headline of subsidy free wind taking FID, whilst significant, translates into 177MW of installed capacity but just 14.5MW of de-rated capacity as de-rating factors are set at 8.2 percent. However, it does represent a new, albeit small, incremental revenue for subsidy-free renewable projects.

Contact us



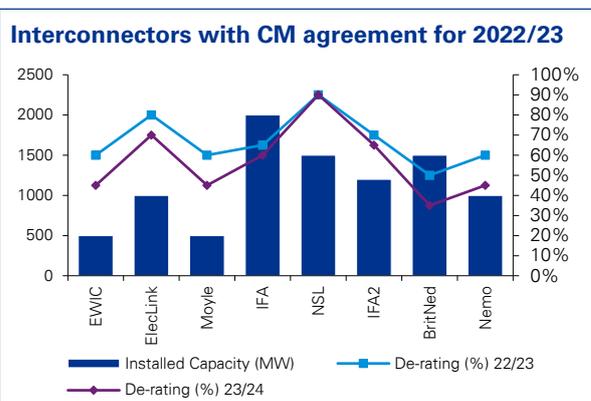
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Conclusions

The results of this auction have reiterated the level of over-capacity on the GB system in the early 2020s. This theme is likely to continue until coal, nuclear and old gas assets exit the market which is expected to take place through the mid/late 2020s.

The more interesting question is whether the lack of new build in this T-3 auction acts as a driver for the price in the T-4 which is due to take place on 5 March. However, this has to be considered alongside owners of the remaining coal and old gas assets coming to end-of-life decisions. A key factor will also be if, or by how much, BEIS and the Delivery Body decide to adjust the target capacity for the T-4 auction to reflect the change in supply/demand balance resulting from the T-3 auction.

If we see another sub-£10/kW clearing price in the T-4 auction, BEIS will continue to face difficult questions about the necessity of the CM and whether there is a requirement for capacity to ensure security of supply or potentially flexibility, resilience and system stability. The T-1 auction for delivery year 2020/21 takes place on Thursday and we can expect another low clearing price.

The medium-term challenge for BEIS will be whether the CM, in its current form, is aligned with our decarbonisation ambitions or whether more fundamental reform is required to reflect the growing prioritisation of delivering Net Zero by 2050.

The current consultation published on 3 Feb 2020 proposes numerous potential improvements, including establishing emission limit reporting and verification mechanism within the CM.

This could open the door for BEIS to introduce more ambitious emissions limits into the CM as they see fit which would be seen as a fundamental change to the existing mechanism.

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