EXPLANATORY MEMORANDUM TO

THE ELECTRICITY CAPACITY (AMENDMENT ETC.) (CORONAVIRUS) REGULATIONS 2020

2020 No. XXXX

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 Following a State aid standstill period during which the European Commission re-investigated the GB Capacity Market and approved it (Decision SA.35980-2019/C; "the State aid decision")[1], this instrument implements UK commitments recorded in the State aid decision by amending the Electricity Capacity Regulations 2014 (S.I. 2014/2043) ("the Principal Regulations"). In order to support capacity providers to deal with the effects of coronavirus on their operations, so they can continue to contribute to the Capacity Market's aim of ensuring security of electricity supply for GB consumers, this instrument also amends the Electricity Capacity (No. 1) Regulations 2019 (S.I. 2019/862) and modifies the application of the Principal Regulations.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument includes Scotland.

3.3 The powers under which this instrument is made cover Great Britain (see section 155 (extent) and section 27 (electricity capacity regulations) of the Energy Act 2013 (c. 32)).

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is Great Britain.

4.2 The territorial application of this instrument is Great Britain.

5. European Convention on Human Rights

5.1 The Minister of State for the Department for Business, Energy and Industrial Strategy Kwasi Kwarteng has made the following statement regarding Human Rights:

"In my view the provisions of the Electricity Capacity (Amendment etc.) (Coronavirus) Regulations 2020 are compatible with the Convention rights."

[1] https://ec.europa.eu/rapid/pressReleasesAction.do?reference=IP/19/6152

6. Legislative Context

6.1 Chapter 3 of Part 2 of the Energy Act 2013 ("the Act") provides the Secretary of State with powers to make electricity capacity regulations for the purpose of providing capacity to meet consumer demand for the supply of electricity in Great Britain.

6.2 On 15 November 2018, the Capacity Market's original State aid approval ("the original State aid decision") was annulled by the General Court of the Court of Justice of the European Union (Case T-793/14). As a consequence, the European Commission investigated the Capacity Market and, on 24 October 2019, found that the Capacity Market, as operated since 2014 and including during the period of the Commission's investigation, complied with European Union State aid rules (Decision SA.35980-2019/C; "the State aid decision")[2].

6.3 The State aid decision recorded UK commitments to implement improvements to the Capacity Market's design to reflect recent market and regulatory developments, including several measures identified through the Five-year Review of the Capacity Market published in July 2019[3].

6.4 This instrument and the Capacity Market (Amendment) (No. 2) Rules 2020 (to be laid shortly after this instrument to amend the Capacity Market Rules 2014 ("the Rules")) implement the majority of the commitments recorded in the State aid Decision, described in paragraphs 7.3 to 7.7 below.

6.5 This instrument and the Capacity Market (Amendment) (No. 2) Rules 2020 also make temporary changes to the Principal Regulations and the Rules respectively to support capacity providers to deal with the effects of the coronavirus. These changes are described in paragraphs 7.8 to 7.11 below.

7. Policy background

What is being done and why?

7.1 The Capacity Market is at the heart of the Government's arrangements for maintaining a secure and reliable electricity system. The Capacity Market provides all forms of electricity capacity capable of contributing to security of supply with the right incentives to be on the system and to deliver during periods of electricity system shortage and stress, for example during cold, still periods where demand is high and wind generation is low. This includes traditional technologies, such as gas-fired generation and nuclear, as well as intermittent renewables (wind and solar), demand side response (DSR) which delivers capacity by reducing demand, and interconnection with other countries.

7.2 The Capacity Market works by allowing eligible bidders to compete in auctions – either four years ("T-4 auction") or one year ("T-1 auction") ahead of when they must deliver capacity. Auction bids are made by capacity market units (CMUs) – the unit of generation, interconnection or demand side response in respect of which a capacity agreement is awarded. Successful bidders ("capacity providers") are awarded capacity agreements which oblige them to deliver capacity (by generating electricity or, in the case of DSR CMUs, reducing demand) at times of system stress. They face financial penalties if they fail to deliver. They receive capacity payments, which incentivise the

[2] https://ec.europa.eu/rapid/pressReleasesAction.do?reference=IP/19/6152
[3] https://www.gov.uk/government/publications/capacity-market-5-year-review-2014-to-2019

necessary investment to maintain and refurbish existing capacity, and to finance new build capacity.

Implementation of commitments recorded in the State aid decision

7.3 *Definition of DSR – Exclusion of Standalone Batteries*: a DSR CMU may provide capacity by temporarily reducing the amount of electricity it (or its customers) imports from the electricity distribution system. This instrument amends the definition of a DSR CMU to exclude such a CMU from using 'standalone' batteries to reduce import of electricity (by not charging the batteries).

This change prevents standalone batteries from competing as DSR CMUs to benefit from DSR's higher de-rating factor (the de-rating of each technology competing in the Capacity Market according to its contribution to security of supply determines the auction clearing price (£/MW) a capacity provider receives). The change ensures standalone batteries enter auctions as duration-limited storage generating CMUs, which have a lower de-rating factor more reflective of the contribution to security of supply they can provide, and thereby reduces the risk that the auctions under-procure capacity.

7.4 *DSR Multi-Year Agreements and Credit Cover*: This instrument supports changes to the Rules which allow Unproven DSR CMUs (DSR CMUs which have not yet proven they can deliver the capacity) to bid for capacity agreements of up to fifteen years. Currently, DSR CMUs can only access one-year agreements, while generating CMUs can access multi-year agreements. This instrument sets capital expenditure thresholds which must be met by such CMUs to obtain an agreement longer than one year. It also requires DSR CMUs bidding for longer agreements to provide the same level of financial collateral before auctions (£10,000/MW) as generating CMUs bidding for longer agreements. This collateral (called 'credit cover') is drawn down if the capacity is not delivered on time. The instrument also reduces the amount of credit cover to £5,000/MW if the "DSR partial credit cover release" requirements in the Rules are met.

7.5 *Reduction in the Minimum Capacity Threshold*: This instrument reduces the threshold of connected capacity ("the Minimum Capacity Threshold") at which CMUs can enter the Capacity Market in the future from 2MW to 1MW. This reduction will align the Capacity Market with other energy markets, making it easier for providers to compete in multiple markets. The reduction may also improve liquidity in the Capacity Market as more capacity providers will be eligible to compete which could lower the auction clearing price and provide greater value for electricity consumers.

7.6 *Long-term STOR (Short Term Operating Reserve) Contract Holders May Compete*: This instrument removes the exclusion on Long Term STOR contract holders from competing in the Capacity Market. STOR is an electricity balancing service procured by the National Grid Electricity System Operator to ensure moment-to-moment balancing of the electricity system. These contracts were expected to pay out very high revenues, and contract holders were therefore excluded from the Capacity Market when it was established in 2014 to prevent what were expected to be windfall profits, in line with the European Commission's guidelines on State aid for environmental protection and energy. Since 2014, the GB energy landscape has changed significantly and revenues from Long Term STOR contracts have been much lower than expected and in line with revenue from other electricity balancing services, none of which are excluded from the Capacity Market. The exclusion should therefore be removed.

7.7 *Target capacity for T-1 Auctions – T-1 Set Aside*: In each T-1 auction to date, the GB Capacity Market has procured at least 50% of the capacity which was 'set aside' for that T-1 auction at the time of the T-4 auction for the same delivery year. This practice provides certainty for those technologies, such as DSR, whose business models mean they are more likely to be able to participate in a T-1 auction than a T-4 auction. This instrument provides a legislative basis for this long-standing commitment.

Easements in response to the effects of coronavirus

7.8 The effects of coronavirus have adversely impacted the ability of capacity providers to meet some obligations in capacity agreements, e.g. because of delays to construction, financial decisions or network connections, or difficulties experienced by DSR CMUs recruiting clients and components given the significantly reduced demand at many commercial and industrial sites. This instrument temporarily removes or relaxes certain obligations and deadlines to support them to deal with the effects of coronavirus on their operations so they can continue to contribute to the Capacity Market's aim of ensuring security of electricity supply for GB consumers.

7.9 *Satisfactory Performance Requirements – Suspended Capacity Payments:* recognising the effects of coronavirus may have disrupted completion of satisfactory performance requirements (which test a CMU's readiness to deliver capacity), for the current delivery year (1 October 2019 to 30 September 2020) only, capacity payments that have been suspended for failure to meet the requirements will be paid if and when the requirements are met by a specified date.

7.10 *Secretary of State's Discretion:* as the effects of coronavirus adversely impact on capacity providers' ability to meet their obligations under capacity agreements, more termination notices in respect of capacity agreements may be issued. This instrument extends the Secretary of State's discretion in dealing with appeals of termination notices given by the Capacity Market Delivery Body (National Grid Electricity System Operator), and provides a longer period for a person to appeal to the Secretary of State to exercise that discretion, during this period.

7.11 *Requesting Reconsideration or Review of Decisions:* as the effects of coronavirus impact prospective and existing capacity providers' resources to request reconsideration or review of decisions made by the Delivery Body and the Gas and Electricity Markets Authority which affect them, this instrument provides a longer period for them to do so.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 There are no plans to consolidate the legislation amended by the instrument. The Department will publish an informal 'Keeling Schedule' showing how the relevant regulations in the Principal Regulations would be read as modified by this instrument.

10. Consultation outcome

10.1 Two public consultations were conducted in relation to the measures in this instrument. A joint Government Response, including a summary of consultation responses and details of the measures, was published on 20 May 2020[4].

10.2 The first was conducted between 3 February 2020 and 2 March 2020 and sought views on implementing the commitments in the State aid decision and some minor changes to the Capacity Market identified in our Five-year Review of the Capacity Market[5]. Thirty three responses were received from a range of stakeholders, including capacity providers and trade associations. Respondents were broadly supportive of the proposals. Some objections were raised by respondents to removing the exclusion on Long Term STOR contract holders from competing in the Capacity Market. The Government has addressed these objections in the response to the consultation, noting that the risk of contract holders benefitting from windfall profits by competing in the Capacity Market is no longer sufficient to justify excluding them.

10.3 A second expedited consultation was conducted between 23 April 2020 and 30 April 2020 and sought views on the proposed measures to support capacity providers adversely impacted by the effects of coronavirus[6]. Twenty nine responses were received from a range of stakeholders, including capacity providers and trade associations. The majority of respondents were supportive of the proposals. Where there was disagreement, this was generally in regard to further expanding the scope of the easements, in terms of which operators qualify, which deadlines they apply to and how long they will be in place for. We have included certain expansions of scope that were raised in the consultation in our legislative changes, where appropriate.

11. Guidance

11.1 Guidance on the Capacity Market is produced by National Grid and Electricity Settlements Company. It is published on their websites and is available here:
https://www.emrdeliverybody.com/cm/home.aspx
https://www.emrsettlement.co.uk/publications/guidance/

11.2 Guidance on how the changes made by this instrument will impact on participation in the Capacity Market will be published by the Delivery Body.

11.3 Guidance on the Capacity Market termination notice appeals process is produced by the Government. It is published on the Government's website and is available here:

https://www.gov.uk/government/publications/capacity-market-appeals-process

11.4 This guidance will be updated to reflect the changes made by this instrument to the appeals process.

12. Impact

12.1 The impact on business is small. There is no impact on charities or voluntary bodies.

12.2 There is no, or no significant impact on the public sector.

[4] https://www.gov.uk/government/consultations/capacity-market-proposals-for-future-improvements
[5] https://www.gov.uk/government/publications/capacity-market-5-year-review-2014-to-2019
[6] https://www.gov.uk/government/consultations/capacity-market-proposal-to-relax-the-rules-temporarily-in-response-to-covid-19

12.3 A separate Impact Assessment has not been prepared for this instrument because this instrument relates to maintenance of the Capacity Market and the existing regulatory standard to maintain three hours' loss of load expectation (LOLE). LOLE is the expected number of hours when demand is higher than available generation during the year before any mitigating or emergency actions are taken, but after all system warnings and System Operator balancing contracts have been exhausted.

12.4 The Capacity Market was subject to a full Impact Assessment when it was first introduced.

12.5 Further details on the impacts are set out in analysis within the Government Response referred to in section 10.1.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise regulatory burdens on small businesses.

13.3 Some small businesses will be affected by this instrument, for example DSR providers, small generators, and battery developers. These operators may benefit from the implementation of some of the State aid commitments. Notably, the reduction of the Minimum Capacity Threshold will create an entry to market for smaller capacity providers. Allowing Unproven DSR CMUs to access multi-year agreements may also provide a longer-term revenue stream to certain small capacity providers. The easements in response to the effects of coronavirus will benefit all capacity providers and may particularly benefit smaller capacity providers as they may be less resilient or able to cope with the adverse impacts of coronavirus on their operations.

14. Monitoring & review

14.1 The provisions of the Act which underpin the Capacity Market are required (by section 66 of the Act) to be reviewed every five years. Regulation 81 of the Principal Regulations requires a five-yearly review of the Principal Regulations. The first five-year review was published 22 July 2019[7]. The review found that the Capacity Market performance against its objectives has been good. The review did not recommend major changes, but identified incremental improvements which the Government will implement in due course. As some measures introduced by this instrument will have effect at the time of the next five-year review in 2024, this instrument modifies regulation 81 to include this instrument in the scope of the next five-year review.

15. Contact

15.1 Simon Dawes at the Department for Business, Energy and Industrial Strategy, email: simon.dawes@beis.gov.uk can be contacted with any queries regarding the instrument.

15.2 Angela Patel, Deputy Director for the Capacity Market, at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 Kwasi Kwarteng at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

[7] https://www.gov.uk/government/publications/capacity-market-5-year-review-2014-to-2019