EXPLANATORY MEMORANDUM TO

THE ELECTRICITY CAPACITY (AMENDMENT) (NO. 2) REGULATIONS 2025

2025 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Energy Security and Net Zero and is laid before Parliament by Command of His Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Declaration

2.1 Michael Shanks, Parliamentary Under-Secretary of State (Minister for Energy) at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

2.2 Bill Jones, Deputy Director for Future Electricity Security, at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Victoria Muir or Matt Harriman-Brady at the Department for Energy Security and Net Zero, or FutureElectricitySecurity@energysecurity.gov.uk, can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 The instrument amends the Electricity Capacity Regulations 2014 (S.I. 2014/2043) (the "CM Regulations") in order to make technical amendments to the Capacity Market ("CM") aimed at introducing a decarbonisation pathway for unabated gas. Unabated gas plants with Capacity Market agreements of up to 15 years will be allowed to exit from their agreements before its scheduled end date without penalty and transfer to a bespoke support mechanism under a Dispatchable Power Agreement (DPA) (which, outside of the CM, the government intends to enter as a type of contract for difference (CfD)). The DPA will enable unabated gas to decarbonise by retrofitting carbon capture equipment, aligning with the government's objectives of enabling a transition to clean power. This instrument also makes miscellaneous revocations to provisions in the CM Regulations, the Electricity Capacity (No.1) Regulations 2019 (S.I. 2019/862) and the Electricity Capacity (Amendment etc.) (Coronavirus) Regulations 2020 (S.I. 2020/697).

Where does the legislation extend to, and apply?

4.2 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is Great Britain.

4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is Great Britain.

5. Policy Context

What is being done and why?

5.1 The CM is at the heart of the government's arrangements for maintaining a secure and reliable electricity system. The CM provides all forms of electricity capacity capable of contributing to security of supply with the right incentives to be available 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 (e.g., wind and solar), Demand Side Response (which delivers capacity by reducing demand), storage assets and interconnection with other countries.

5.2 The CM 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 of Capacity Market Units ("CMUs") – the unit of generation, interconnection, or Demand Side Response in respect of which a capacity agreed is awarded. Successful bidders ("Capacity Providers") are awarded capacity agreements, from one year to fifteen years in duration, which oblige them to deliver capacity (by generating electricity or in the case of Demand Side Response CMUs, reducing demand) at a time of system stress. They face financial penalties if they fail to deliver. They receive capacity payments, which incentivise the necessary investment to maintain and refurbish capacity, and to finance new build capacity.

5.3 The Dispatchable Power Agreement ("DPA") is the business model developed for gas generation with carbon capture and storage ("power CCUS"). Power CCUS is a source of dispatchable low carbon generation. Conversion of unabated gas to power CCUS could support the deployment of low carbon flexible technologies in the transition to clean power.

5.4 This instrument aims to accelerate the decarbonisation of unabated gas. The government is committed to setting out clear and viable routes for unabated gas to decarbonise as part of the transition to Clean Power by 2030. The instrument makes changes to the CM to introduce an exit pathway for unabated gas. Unabated gas will be allowed to exit the CM without penalty and transfer to a power CCUS DPA, enabling the plant to retrofit carbon capture equipment and convert to low carbon. The instrument is required to change the CM Regulations to lead this policy change. The volume of capacity that would be eligible to use this exit pathway is currently 4.4GW and the usage is dependent on the generators becoming party to a DPA through bilateral negotiations with government outside of the CM. The responses on the consultation on these changes were broadly supportive, including responses from industry, commercial representation and delivery partners.

5.5 The CM Regulations contain provision which are now redundant in respect of specific auctions which took place when the CM was first established. Separately, the Electricity Capacity (No.1) Regulations 2019 and the Electricity Capacity (Amendment etc.) (Coronavirus) Regulations make situation specific modifications to the CM Regulations to account for, respectively, the impact of the State aid standstill which the CM was subject to in 2019, and the effects of the coronavirus pandemic. These provisions can now be revoked as they are no longer relevant.

What was the previous policy, how is this different?

5.6 Under the CM Regulations and Capacity Market Rules ("the Rules"), CM agreements may generally only come to an end at the scheduled expiry of their term or if the agreement is terminated before that for failure by a capacity provider to satisfy obligations, with termination fees imposed. This penalty on those who leave long term agreements early acts as a disincentive for unabated gas to decarbonise prior to the completion of their agreements, which could be as late as the 2040s. Stakeholder feedback received in response to a Call for Evidence in January 2023 highlighted the need for clarity on decarbonisation pathways and specifically for allowing unabated gas generators to exit their CM agreements without penalty before their scheduled expiry in order to access bespoke support or to secure new CM agreements after converting to low carbon.

5.7 Regulation 34 of the CM Regulations allows Capacity Providers with CM Agreements secured through a T-4 auction to exit their agreements to become eligible to participate in Contracts for Difference ("CfD") allocation rounds through a request for an immediate termination of a CM Agreement by the Delivery Body. The new policy is different to Regulation 34 as unabated gas plant will, instead of exiting to operate in the wholesale market, become party to a DPA before exiting from the CM. Further, in order to ensure security of supply, the exit will be managed to a specified timeline, set out in the CM Regulations and the CM Rules so that the capacity provider whose CM agreement has commenced continues to participate in the CM until they are due to commence support under their DPA. Legislation is therefore required to make the changes to the CM Regulations to introduce a new Regulation 34A, which sets out the process by which the CM's Delivery Body (National Energy System Operator (NESO)) can terminate a CM Agreement once a capacity provider has properly notified the Delivery Body so that it can exit the CM and access support under a Power CCUS DPA.

6. Legislative and Legal Context

How has the law changed?

6.1 The CM Regulations make provision for the purpose of meeting consumers' demand for electricity in Great Britain by establishing the CM, under which capacity providers, who make capacity available, can obtain capacity agreements which give them the right to receive capacity payments, and which also impose obligations on capacity providers to use their CMUs to provide capacity when required to do so. Further detailed provision implementing the CM is made by the Rules.

6.2 This instrument amends the CM Regulations to include new provision to enable capacity providers to exit their CM Agreement in order to access a Power CCUS DPA, which is included as a "CCS CFD" because they are a type of CfD. Amendments are also made which enables a capacity provider to use an existing mechanism in Regulation 69 to dispute a decision by the Delivery Body to refuse that capacity providers notification seeking to exit the CM. Alongside these amendments, the Rules are to be updated by the Capacity Market (Amendment) Rules 2025.

Why was this approach taken to change the law?

6.3 The proposals which have been consulted on can only be implemented through changes to the legislation, in particular the introduction of new CM Regulations which enable the Delivery Body to terminate a CM agreement to enable a person to exit the

CM and for that termination to take effect at a later date nearer the start of support under a power CCUS DPA.

7. Consultation

Summary of consultation outcome and methodology

7.1 It is a statutory requirement to consult on any changes to the CM. Consultations were conducted in relation to the measures in this instrument. A government response published on 6th May 2025[1] for the consultation.

7.2 The first consultation was conducted between 15th October and 10th December 2024 and sought to strengthen security of supply and enable flexible capacity to decarbonise. 42 responses were received from a variety of stakeholders, including Capacity Providers and trade associations. Respondents were broadly supportive of the proposals.

7.3 Regarding changes to the Regulations to introduce a new process by which a capacity provider can notify for exit and be terminated, the majority of respondents supported the timings for how the policy would work in practice. The process requires Capacity Providers to notify the Delivery Body no later than 19 months before their nominated exit date using a "CCS CFD Transfer Notice". This is to ensure the Delivery Body has sufficient time to factor in the exiting capacity into security of supply considerations.

7.4 Regarding changes to Regulation 60, covering credit obligation periods, this is a consequential change identified as a result of consultation with the Delivery Body.

7.5 Regarding changes to Regulation 68 and Regulation 69, the majority of respondents supported a refusal of a CCS CFD Transfer Notice being a Delivery Body Reviewable Decision. This provides Capacity Providers with a route to appeal if their CCS CFD Transfer Notice is refused for any reason.

7.6 The second consultation was conducted between 16th December 2024 and 17th February 2025 and sought to ensure the continued accessibility and modernisation of the CM. 27 responses were received from a variety of stakeholders, including Capacity Providers and trade associations. Respondents were broadly supportive of the proposals.

7.7 Regarding miscellaneous revocations to provisions in the CM Regulations, the Electricity Capacity (No.1) Regulations 2019 (S.I. 2019/862) and the Electricity Capacity (Amendment etc.) (Coronavirus) Regulations 2020 (S.I. 2020/697), most of the respondents (95%) agreed that reference to the standstill auction, coronavirus provisions, and the initial CM auction were redundant and it would be beneficial for these provisions to be removed from the Regulations.

No significant changes were made to the policy after consultation. The devolved governments were engaged during the policy process but as energy is a reserved matter for UK government the Devolved Governments were not formally consulted. The government response is due to be published in June[2].

[1] DESNZ, 'Capacity Market: Proposals to maintain security of supply and enable flexible capacity to decarbonise: government response', May 2025

[2] DESNZ, 'Capacity Market: proposals to modernise Rules and improve participation and delivery assurance of consumer-led flexibility'.

8. Applicable Guidance

8.1 Guidance on the CM is produced by the Delivery Body and the Electricity Settlements Company Ltd/Low Carbon Contracts Company and is published on their website.

8.2 Guidance on how the changes made by this instrument will impact the CM will be published by the Delivery Body, if necessary.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because the Capacity Market is exempt from the Better Regulation Framework and there is no direct cost to businesses.

9.2 The CM was subject to a full Impact Assessment when it was first produced.

Impact on businesses, charities and voluntary bodies

9.3 There is no, or no significant, impact on business, charities or voluntary bodies.

9.4 The legislation does not impact small or micro businesses.

9.5 No specific action is proposed to minimise regulatory burdens on small businesses. It is anticipated that due to the technical nature of the changes, any impact on small businesses would be small.

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

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring the legislation is that review is required of the CM Regulations and the provisions of the Energy Act 2013 which underpin the CM and under which the CM Regulations are made (these statutory review requirements are set out in section 66 of that Act and regulation 81 of the CM Regulations). These provisions require a five-yearly review. The first five-year review was published 22 July 2019. The review found that the CM performance against its objectives has been good. The review did not recommend any major changes but identified incremental improves which the government continues to review. The second five-year review of the CM was published 16 December 2024. The review found that the CM has been effective in meeting its objectives and will inform the broader strategy to ensure energy security and move towards making Britain a Clean Energy Superpower.

10.2 The instrument does not include a statutory review clause. Th CM Regulations, which this instrument amends, include a provision requiring review (detailed in paragraph 10.1 above).

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Minister for Energy has made the following statement regarding Human Rights:

"In my view the provisions of the Electricity Capacity (Amendment) (No.2) Regulations 2025 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").