EXPLANATORY MEMORANDUM TO

THE ELECTRICITY CAPACITY (AMENDMENT) REGULATIONS 2021

2021 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 This instrument amends the Electricity Capacity Regulations 2014 (S.I. 2014/2043) in order to provide participants in the Capacity Market with greater flexibility when trading their Capacity Agreements and when appealing decisions made by the Capacity Market Delivery Body. These changes will indirectly improve security of electricity supplies in Great Britain.

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 Anne-Marie Trevelyan has made the following statement regarding Human Rights:

"In my view the provisions of the Electricity Capacity (Amendment) Regulations 2021 are compatible with the Convention rights."

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 Laid with this instrument are the Capacity Market (Amendment) Rules 2021, which amend the Capacity Market Rules 2014 ("the Rules"). The Rules contain the technical administrative requirements of the Capacity Market.

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 necessary investment to maintain and refurbish existing capacity, and to finance new build capacity. The large majority of Capacity Market agreements are one-year in duration, but agreements of up to 15 years are available to certain new-build projects, in order to support investment.

7.3 *Secondary trading – enabling secondary trades to be maintained in the event of a transferor termination*: CMUs are permitted to trade all or part of their capacity agreements won in auctions between each other as part of a secondary trading market. At present, if the CMU holding the original capacity agreement (i.e. the transferor) is terminated, then any partial trade(s) they have made to any transferee(s) are cancelled. This instrument will make it so that secondary trades are not cancelled in such circumstances, allowing the traded capacity to remain in the market and so continue to contribute to security of supply.

7.4 *Reductions in the length of capacity agreements – allowing capacity providers to appeal a decision by the Delivery Body*[1]*:* Capacity providers can be penalised with a reduction in the duration of their capacity agreement if they breach certain obligations. A reduction in agreement length may significantly impact the financial viability of a CMU and hence its ability to provide capacity. This instrument (together with amendments to the Rules) provides capacity providers so affected with the ability to appeal to the Secretary of State to seek the withdrawal of the reduction decision or an extension in which to rectify the breach. Capacity providers are already able to appeal to the Secretary of State when a termination notice is issued by the Delivery Body for breach of a range of other milestones required under the Capacity Market.

[1] National Grid Electricity System Operator is responsible for administering key elements of the Capacity Market scheme in its role as the Electricity Market Reform Delivery Body.

7.5 *Prequalification – allowing the Delivery Body greater flexibility when considering prequalification appeals*: CMUs applying to bid into future capacity auctions have the right to appeal to the Delivery Body if their prequalification application is rejected. However, the Delivery Body is limited in what information it is allowed to consider as part of this process. This instrument will allow the Delivery Body to consider information submitted by applicants to correct non-material errors in their prequalification applications. This will reduce the risk of CMUs being excluded from participating in auctions due to non-material errors and will therefore maximise competition and auction liquidity.

7.6 *Housekeeping* – A minor change is required to correct a redundant cross-reference in Regulation 15.

8. European Union Withdrawal and Future Relationship

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. .

10. Consultation outcome

10.1 A public consultation was conducted in relation to the measures in this instrument. A Government Response, including a summary of consultation responses and details of the measures, was published on 21 June 2021[2].

10.2 The consultation was conducted between 5 March 2021 and 16 April 2021 and sought views on a range of proposals related to the Capacity Market. 38 responses were received from a range of stakeholders, including capacity providers and trade associations. Respondents were broadly supportive of the proposals. A few minor alterations were put forward, which have been taken into account where suitable.

11. Guidance

11.1 Guidance on the Capacity Market is produced by the Delivery Body and the 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 participation in the Capacity Market will be published by the Delivery Body.

11.3 The Government's guidance on the appeals process will be updated to reflect the changes made by this instrument.

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.

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

[2] https://www.gov.uk/government/consultations/capacity-market-2021-proposals-for-improvements

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 of this instrument are set out in analysis within the Government Response (Section 11).

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 demand side response providers, small generators, and battery developers. These operators may benefit from the implementation of this instrument. For example, by improving the arrangements relating to secondary trades of capacity agreements, or by reducing the risk that they are excluded from the capacity auctions due to non-material errors.

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[3]. 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. The second t five-year review of the Capacity Market is due to be published in 2024, and the amendments made by this instrument will be in scope of it.

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 Robert Hewitt, Deputy Director for Energy Security at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 Anne-Marie Trevelyan at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

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