EXPLANATORY MEMORANDUM TO

THE ELECTRICITY CAPACITY (AMENDMENT) REGULATIONS 2025

2025 No. XXXX

1. Introduction

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

2. Declaration

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

3. Contact

3.1 Renée Van Diemen at the Department of Energy Security and Net Zero, telephone: 07751 748125 or email: Renee.VanDiemen@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 This instrument amends the Electricity Capacity Regulations 2014 (S.I. 2014/2043) (the "CM Regulations") in order to make technical amendments and minor changes to the Capacity Market ("CM") aimed at better enabling existing provisions to be used in practice, reducing administrative burdens, and improving administrative arrangements for the CM to improve security of supply and, by accelerating investment in low carbon technologies, increase the role that they play in the CM, aligning it better with the government's net zero objectives.

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 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 on a 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 (DSR) 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 by Capacity Market Units ("CMUs") – the unit of generation, interconnection, or Demand Side Response (DSR) in respect of which a capacity agreement 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 DSR 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 legislation aims to improve security of supply and accelerate investment in low carbon technologies, by increasing the role that they play in the CM, aligning better with the government's net zero objectives. The changes represent the next phase of the evolution of the CM, to ensure it continues to deliver effectively and efficiently, which is important for ensuring security of supply. The responses to the consultation on these changes were broadly supportive, including responses from industry, commercial representation, and delivery partners.

What was the previous policy, how is this different?

5.4 Stakeholder feedback identified a need to review the wider timescales associated with the Electricity Settlements Company's (ESC) penalty calculation activities, to ensure that timelines for settlement remain appropriate. The ESC is the Settlement Body, which oversees the settlement of payments to and from suppliers and capacity providers. One area identified was the timescales for Capacity Market Volume Reallocation (CMVR), whereby capacity providers who have over or under delivered against their obligation during a System Stress Event may re-allocate this capacity volume post stress event. Under the CM Regulations prior to this instrument, ESC has been required to determine the Adjusted Eij (where E is energy delivered, i is the relevant CMU and j is the relevant Settlement Period in which that CMU delivers energy), which is the adjusted energy delivered by a CMU during a stress event, after the close of the volume re-allocation window for the relevant month, but, by no later than 20 working days after the end of that month. The time periods for penalty calculations and invoicing by the Settlement Body have previously been extended to the 35th working day after the end of the relevant month (regulation 41 of the CM Regulations). This instrument amends the timelines for ESC determinations so that they are in line with those concerning penalty charges. Regulation 7 of this instrument amends regulation 39 of the CM Regulations to effect this.

5.5 As part of the requirements under Capacity Market Rules ("the Rules") some CMUs must complete an Extended Performance Test (EPT) once every three years as one of three standard Satisfactory Performance Days (SPD) in the winter of the relevant year. This means EPTs are a subfunction of the SPD requirement. The policy intent is that failure to meet EPTs should have a similar consequence as failure to meet a standard SPD, including suspension of payments and termination. This instrument (regulation 8) ensures failure to meet EPTs are treated in the same way under the CM Regulations as failure to meet SPDs across suspension of payments, as per the policy intent, to

ensure the regime is consistent and that the two demonstrations of performance are treated in similar fashion.

5.6 Regulation 16(2) of the CM Regulations has, prior to this instrument, provided that the CM's Delivery Body, National Energy Systems Operator, must not prequalify a CMU if it is subject to a Contract for Difference (CFD) which applies for any of the delivery period. A site is classed as subject to a CFD from the point they are awarded a CFD and not from the point at which they start to receive or make CFD payments. This means a site cannot prequalify for the CM if they have been awarded a CFD, even if they would be delivering under the CFD and their Capacity Agreement in different delivery years. This instrument will further clarify to industry that a CMU can only be prequalified where no CFD has been entered into in respect of it, even if the CFD is for a later delivery period, unless the CFD in question has expired or been terminated. This instrument also further clarifies that a CFD means a CFD or an investment contract, which has always been the policy intent.

5.7 Multi-year agreements provide greater revenue certainty and are likely to incentivise further low carbon participation in the CM, which improves market liquidity and leads to a greater diversity of technologies. As this is beneficial to security of electricity supply, this instrument introduces a new 9-year Capex threshold as a midpoint to the existing 3- and 15-year thresholds, to ensure that new and refurbishing projects with costs that fall between the existing thresholds are not prevented from entering the CM. This removes barriers to participation and creates competition for low carbon capacity in the CM, supporting low carbon refurbishing projects, including the refurbishment of existing low carbon CMUs and the decarbonisation of existing carbon intensive CMUs. A new 3-year agreement with a Capex threshold of £0/kW is to be available to low-carbon New Build and Unproven Demand Side Response (DSR) capacity. This new 3-year agreement has been introduced to remove participation barriers for low carbon, low Capex technologies to facilitate CM access and support investments in the full range of technologies that can support security of supply. This instrument amends the auction parameters under the CM Regulations to refer to these. To ensure projects meet the definition of low carbon capacity, an emissions related determination has been introduced by this instrument as a further reviewable decision type.

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 rights 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 about the CM is made by the Rules.

6.2 This instrument amends the CM Regulations to update certain arrangements under those Regulations. The Rules are also to be updated by the Capacity Market (Amendment) (No.3) Rules 2024 to make changes alongside the amendments made by this instrument.

Why was this approach taken to change the law?

6.3 The proposals developed through the consultations referenced in section 7, relate to enhancing the existing CM. Where the particular aspect to be addressed is established

by a provision the CM Regulations, an amendment to those Regulations has been required. Those aspects established by the Rules require amendment to those Rules.

7. Consultation

Summary of consultation outcome and methodology

7.1 Two public consultations were conducted in relation to the measures in this instrument. A Government Responses to the first consultation, including a summary of consultation responses, was published on 12 June 2023. A Government Response to the second consultation was published on 22 July 2024, with a Policy Update published on 15 October 2024.

7.2 The first consultation[1] was conducted between 9 January 2023 and 3 March 2023 and sought to strengthen security of supply and provide greater clarity for investors around the transition to net zero. 65 responses were received from a variety of stakeholders, including capacity providers and trade associations. Respondents were broadly supportive of the proposals. Following the first consultation it was decided to take the proposals forward in two phases.

7.3 The second consultation[2] was conducted between 16 October 2023 and 8 December 2023 and sought a range of views on proposals related to the CM. The main proposals broadly related to the strengthening of security of supply and accelerating investment in low carbon technologies. 41 responses were received from a variety of stakeholders, including capacity providers and trade associations. Respondents were broadly supportive of the proposals included in this instrument.

7.4 Regarding changes to regulation 11, the majority of respondents supported the 3- and 9-year agreements, citing the importance of aligning the CM with decarbonisation goals, and enabling better access for an expanded range of technology types.

7.5 Regarding changes to regulation 16, most responses were supportive of clarification that a site cannot prequalify for the CM auction if they hold a CFD for a future year, as the previous wording was inconsistent with the policy intent.

7.6 Regarding changes to regulation 39, all respondents agreed with the proposed changes to timelines for the Settlement Body volume reallocation window and associated activities.

7.7 Regarding changes to regulation 50, the majority of respondents agreed with the amendments, further aligning the provision with the policy intent and Rules, bringing clarity to the relationship between EPTs and SPDs.

8. Applicable Guidance

8.1 Guidance on the CM is produced by the Delivery Body[3] and the Electricity Settlements Company Ltd[4] 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.

[1] https://www.gov.uk/government/consultations/capacity-market-consultation-strengthening-security-of-supply-and-alignment-with-net-zero
[2] https://www.gov.uk/government/consultations/capacity-market-2023-phase-2-proposals-and-10-year-review
[3] https://www.emrdeliverybody.com/cm/home.aspx
[4] https://www.emrsettlement.co.uk/publications/guidance/

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 this instrument relates to the maintenance of the CM and is intended to improve the operation of the existing arrangements for the delivery of the scheme. This instrument is intended to better enable existing frameworks to be used in practice and improve existing administrative arrangements for the delivery of the CM and as such the impact on businesses is small and no impact is foreseen on the voluntary or public sector.

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

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 has no significant impact on 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 and minor nature of the changes, any impacts 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 this 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 major changes but identified incremental improvements which the Government continues to review. The second five-year review of the CM will be published in 2024, and the amendments made by this instrument will be in scope of it.

10.2 This instrument does not include a statutory review clause. The CM Regulations, which this instrument amends, include a provision requiring review (detailed in 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) 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").