EXPLANATORY MEMORANDUM TO

THE ELECTRICITY CAPACITY MECHANISM (AMENDMENT) REGULATIONS 2024

2024 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Energy Security & 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 at the Department for Energy Security & 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 & Net Zero, confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Rebecca Rhodes-Spencer at the Department for Energy Security & Net Zero (email: rebecca.rhodesspencer@energysecurity.gov.uk) can be contacted with 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 statutory instrument revokes several provisions contained within, and so alters, Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity (the "Electricity Regulation") as assimilated into domestic law, in relation to the electricity Capacity Market ("CM"), the main tool to ensure security of electricity supply in Great Britain (GB). The assimilated Electricity Regulation requires capacity mechanisms (such as the CM) to be approved, and only permits an approval to last 10 years. This instrument revokes the ten-year approval requirement and references to a temporary nature, so that the framework operates in respect of mechanisms that are not subject to a timing restriction, to ensure that legislation is consistent with the continued operation of the CM. It also revokes several provisions that are inconsistent with retaining the CM, require minor correction following changes made for the United Kingdom's withdrawal from the European Union, or impose requirements which are no longer considered to be necessary.

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 England and Wales, and Scotland.

4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England, Wales and Scotland.

5. Policy Context

What is being done and why?

5.1 The CM was introduced in 2014 and is designed to ensure that sufficient electrical capacity is available to meet future predicted demand to maintain security of electricity supply. It enables certain, regular payments to be made to electricity capacity providers, in return for which those providers must be available to produce electricity (or reduce demand) when asked to do so. The CM was originally approved under EU State Aid rules for a period of ten years. Following the United Kingdom's withdrawal from the European Union, the ten-year approval requirement became assimilated into domestic law as part of the assimilated Electricity Regulation. To date the CM has been successful in ensuring that GB has adequate electricity capacity to meet predicted future demand and continues to be required in order to maintain security of supply and provide investor confidence.

This instrument revokes the approval requirement with a 10-year limit for capacity mechanisms such as the CM, as well as provisions requiring such measures to be temporary, altering them to ensure the CM continues to operate as required.

The instrument also revokes requirements for implementation plans and for an administrative phase-out of the scheme, as well as the requirement to only implement a capacity market as a last resort and subject to a hierarchy of alternative measures.

There are several controls embedded into the CM to ensure the scheme remains proportionate and limited to what is necessary. This includes the discretion of the Secretary of State not to hold auctions, and the statutory requirement to review the CM every five years which provides an opportunity to review the need for the scheme, all of which will be retained under the broader CM legislative framework.

Revoking these provisions would not prevent government from considering an alternative approach to capacity adequacy in future.

What was the previous policy, how is this different?

5.2 The previous policy was developed under the EU State Aid rules and in line with this envisaged the GB CM as a temporary measure to remedy fundamental failures in the electricity market. It was expected to be required for at least ten years and as long as additional capacity was needed to ensure security of supply. Persistent market failures mean that there continues to be a need for the procurement of and investment in additional capacity to maintain a reliable electricity supply. Future electricity demand is also expected to increase as other sectors of the economy are further decarbonised, for example transport and heating.

Since EU Exit the wider European strategic approach to capacity mechanisms has also been updated. On 16 July 2024 the EU published legislation amending the Electricity Regulation, which provides that capacity mechanisms are no longer a temporary feature of electricity markets and need not be considered as measures of last resort.[1]

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L_202401747 "Regulation (EU) 2024/1747 of the European Parliament and of the Council of 13 June 2024 amending Regulations (EU) 2019/942 and (EU) 2019/943 as regards improving the Union's electricity market design"

6. Legislative and Legal Context

How has the law changed?

6.1 Following the United Kingdom's withdrawal from the EU, the Electricity Regulation became assimilated law applying to Great Britain.

The Electricity Regulation is wide ranging, covering many aspects of the electricity market such as general principles and rules for the operation of electricity markets, networks, transmission systems and distribution systems. It contains a specific chapter on resource adequacy, which includes provisions in relation to capacity mechanisms.

The CM was established under domestic legislation: Part 2 Chapter 3 of the Energy Act 2013, the Electricity Capacity Regulations 2014 and the Capacity Market Rules 2014. The domestic provisions provide the detail of how the CM operates, whereas the assimilated Electricity Regulation provides for a wider framework in which capacity mechanisms operate. This instrument revokes and alters certain provisions of the latter.

Why was this approach taken to change the law?

6.2 This instrument revokes and alters certain provisions related to capacity mechanisms in the assimilated Electricity Regulation. This is considered to be the most appropriate and proportionate way to effect the policy intent. While capacity mechanisms were originally intended to be transitional measures, the CM was expected to be required for as long as additional capacity remuneration is needed to ensure security of supply. Removing references to such mechanisms being of a temporary nature is considered to be appropriate since market failures mean there remains an ongoing requirement for intervention to ensure security of supply, and this will be increasingly important through the transition to net zero. As set out under paragraph 5.1, the Secretary of State can decide not to hold CM auctions and regular reviews of the scheme will continue to take place in line with the requirements of The Electricity Capacity Regulations 2014, providing future opportunities to assess the need for the scheme. Furthermore, the CM remains subject to domestic subsidy control requirements introduced following EU Exit.

6.3 There is currently no policy intention to revoke or replace broader provisions from the assimilated Electricity Regulation.

7. Consultation

Summary of consultation outcome and methodology

7.1 A range of capacity mechanisms and other options for ensuring security of electricity supply were considered and raised with external stakeholders via the Review of Electricity Market Arrangements ("REMA") consultation in 2022.[2] Following this, retaining the CM as the primary capacity adequacy mechanism was announced via the second REMA consultation, published in March 2024. Consultation specifically in relation to the legislative change effected by this instrument was not undertaken. It does not introduce any new regulatory requirements but is intended to remove a potential barrier to the continuation of existing arrangements for ensuring security of electricity supply

[2] Review of Electricity Market Arrangements Consultation 2022, https://www.gov.uk/government/consultations/review-of-electricity-market-arrangements

8. Applicable Guidance

8.1 No guidance has been developed as no changes will be required as a consequence of revoking the provisions of Assimilated Law in this instrument.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 An Impact Assessment has not been prepared for this instrument because it relates to the maintenance of the CM and continuing the status quo. The 2014 Impact Assessment modelled that the scheme has an overall positive impact on businesses, as the benefits of avoiding electricity system outages and rents accrued by providers in capacity auctions outweigh the costs to businesses of supporting electricity capacity through the CM. This result will be maintained with the amendments made by this instrument, which will provide sustained revenue certainty to participating capacity market units enabling more effective forward planning and helping to de-risk future investment decisions.

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies because this instrument relates to the maintenance of the CM and the legislation will see a continuation of the administrative costs that participating businesses face. Associated resourcing will have already been established before, therefore little to no impact is expected.

9.3 The legislation does not impact small or micro businesses.

9.4 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 There are no specific monitoring arrangements required for this legislation. However, there is a requirement to review the Electricity Capacity Regulations which detail the operation of the CM at least every five years to determine whether they are meeting their objectives and remain fit for purpose. This provides an opportunity to review the need for the mechanism.

10.2 As this instrument is made under the relevant European Union Acts (as defined at 13.1), no review clause is required.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 The powers being exercised are those conferred to revoke or replace secondary assimilated law in sections 14(1) and 14(3) of the REUL Act.

11.2 This instrument does not increase the overall regulatory burden or introduce any new requirements. It is intended to remove a potential barrier to the continuation of existing arrangements for ensuring security of electricity supply by ensuring the domestic legislative framework is consistent with this.

12. European Convention on Human Rights

12.1 The Parliamentary Under-Secretary of State for the Department of Energy Security & Net Zero has made the following statement regarding Human Rights:

"In my view the provisions of The Electricity Capacity Mechanism (Amendment) Regulations 2024 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is made, under sections 14(1) and 14(3) of the Retained EU Law (Revocation and Reform) Act 2023 and therefore relates to the reform of assimilated law. As the instrument follows the affirmative procedure (see paragraphs 5(1) and (5) of Schedule 5 to the 2023 Act) it does not trigger the statements required under the 2023 Act.