EXPLANATORY MEMORANDUM TO

THE ELECTRICITY CAPACITY (AMENDMENT) (No. 2) REGULATIONS 2015

2015 No. 1974

1. This explanatory memorandum has been prepared by the Department of Energy and Climate Change 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) to:

- substitute a new definition of "relevant grant" in regulation 17; and
- extend the number of days from 5 to 15 in regulation 59(3) to permit applicants a longer period in which to submit credit cover after receiving a conditional prequalification notice.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 The Energy Act 2013 ("the Act") contains powers enabling the Secretary of State to implement measures to reform the electricity market, including measures to ensure security of supply. The reforms which have been implemented are known as Electricity Market Reform (EMR).

4.2. The Capacity Market is one of the main mechanisms for reform and is now operational with the first Capacity Market auction having taken place in December 2014. A second Capacity Market auction is planned for 2015.

4.3 This mechanism was implemented by a suite of secondary legislation, in particular the Electricity Capacity Regulations 2014 (S.I. 2014/2043) ("the Principal Regulations"), the Electricity Capacity (Supplier Payment etc.) Regulations 2014 (S.I. 2014/3354), and the Capacity Market Rules 2014. A draft instrument amending the Principal Regulations, the Electricity Capacity (Amendment) Regulations 2015, was approved by resolutions of each House of Parliament in February and March 2015, and it is intended to make that instrument shortly. The amendments that are to be made by this further amending instrument are in addition to those made by the earlier instrument, and the latter will not be affected by the amendments now proposed.

4.4 This instrument amends the Principal Regulations (regulation 17) to modify the definition of "relevant grant", receipt of which renders a Capacity Market Unit (CMU) ineligible to participate in a capacity auction. This potentially allows further CMUs to participate in future auctions. It also will allow applicants submitting credit cover to have longer that the current 5 working day period (regulation 59(3)).

4.5 This instrument is made under the powers in sections 27, 28, 30 and 40(1) of the Act.

5. Territorial Extent and Application

5.1 This instrument extends to Great Britain.

6. European Convention on Human Rights

6.1 Matthew Hancock, Minister of State at the Department of Energy and Climate Change has made the following statement regarding Human Rights:

> In my view the provisions of the Electricity Capacity (Amendment) (No. 2) Regulations 2015 are compatible with the Convention rights.

7. Policy background

7.1 The EMR programme is intended to incentivise investment in low-carbon electricity generation, while improving affordability for consumers and maintaining energy security. These regulations are concerned with one element of the wider reform package – the Capacity Market.

7.2 The Capacity Market has been established to meet the objectives of:

i. incentivising sufficient capacity to ensure security of electricity supply; and
ii. implementing changes at minimum cost to consumers.

7.3 The Capacity Market is designed to achieve these objectives by incentivising investment in new capacity and getting the best out of existing assets by offering all capacity providers (new and existing power stations, electricity storage and capacity provided by voluntary demand reductions) the opportunity to participate in capacity auctions. The only capacity excluded from participating are those in receipt of low carbon support (e.g. from the CFD), those receiving certain grants under the NER 300 or a Carbon Capture and Support grant scheme or Short-Term Operating Reserve (STOR) providers if they do not meet the eligibility criteria included in the Electricity Capacity Regulations 2014.

7.4 The Electricity Capacity Regulations 2014 set out:

i. The Secretary of State's role in the Capacity Market, such as how and when the Secretary of State will determine whether to run a capacity auction, as well as providing for the Capacity Market to be implemented and administered by a combination of the Secretary of State, the Gas and Electricity Markets Authority, a Delivery Body (National Grid Electricity Transmission plc) and a Settlement Body (to which position the Secretary of State has appointed the Electricity Settlements Company).
ii. The process for determining whether a capacity auction is to be held and the auction parameters for a capacity auction.
iii. The process of determining eligibility and holding capacity auctions, issuing capacity agreements, establishing and maintaining a register of

capacity agreements and terminating a capacity agreement (with further detailed provision about each of these matters contained in the Capacity Market Rules 2014 referred to below).

iv. Payment and settlement provisions.

v. Dispute resolution and appeals.

7.5 The primary purpose of this instrument is to amend the Electricity Capacity Regulations 2014 (S.I. 2014/2043) so as to amend the definition of "relevant grant" in regulation 17 to ensure that grants, the purpose of which is to support feasibility studies or research and development in relation to Carbon Capture and Storage (CCS), will not preclude a CMU from participation in the Capacity Market. The essential feature is that the CCS support should not have provided effective material support for a CMU bidding in the Capacity Market which would put it at an advantage compared to units which have not so benefitted. This will not be the case for such early-stage grants for CCS purposes.

7.6 This instrument also amends the number of days from 5 to 15 in regulation 59(3) to enable applicants submitting credit cover after receiving a conditional prequalification notice, to have longer to submit credit cover.

8. Consultation outcome

8.1 The amendments to regulation 17 and 59(3) set out in this instrument were subject to a three-week consultation. The consultation on Capacity Market supplementary design proposals and changes to the Rules was published on 12 February 2015 for stakeholders to provide feedback on the proposal to amend regulation 17 so as not to exclude CMUs in receipt of grants which provided no effective, material support on a unit's ability to compete in the Capacity Market from participation; and also to seek feedback on any unintended consequences from extending the deadline of posting credit cover from 5 to 15 days. (The consultation also covered a number of potential changes to the Capacity Market Rules 2014, which are not the subject of this amending instrument).

8.2 The consultation closed on 5 March 2015 and 22 responses were received. While stakeholders supported the thrust of the Government's proposal on regulation 17, there were some concerns that the specific drafting approach proposed, of seeking to exempt "capital support", might not always be self-explanatory, with scope for varied accounting treatments within and outside Government. The approach finally adopted for the amendment does not therefore rest on the distinction between "capital" and "non-capital", but rather defines certain types of grant (e.g. those made for research and development purposes) which should not render a unit ineligible to participate in a capacity auction.

8.3 Stakeholders were largely content with the amendment to the credit cover deadline. To address the one concern raised on the shortened period to re-post credit cover if necessary, further guidance will be issued to make clear the relevant timelines, and the potential implications of posting credit cover towards the end of the 15 working day period.

9. Guidance

9.1 The Government Response to the *Consultation on Capacity Market supplementary design proposals and changes to the Rules* has been published to coincide with the laying of this amending instrument in Parliament. The Government Response sets out the views of stakeholders and an explanation of the final policy decisions taken.

10. Impact

10.1 An Impact Assessment relating to the wider Capacity Market regime, to which this instrument relates, is attached to this memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website. The impact of this instrument is minor, such that it falls within the costs and benefits within that existing Impact Assessment, first published in September 2014, as there is no material impact from these minor amendments on suppliers or consumers. The impacts of the wider Capacity Market mechanism still hold true, and therefore the original published Impact Assessment remains valid.

11. Regulating small business

11.1 The legislation implementing the Capacity Market applies to small businesses and there are no restrictions on the size of business or organisation participating in the Capacity Market.

11.2 It is expected that the Capacity Market will primarily impact electricity generators which are mostly classed as large businesses, although some capacity providers, particularly those that are demand side response providers, may be small or medium sized. It should though be noted that participation in the Capacity Market is voluntary, so there will only be an impact on those small businesses that elect to apply and participate in the Capacity Market.

11.3 Those that do participate will be impacted by the additional administrative costs associated with participation, although these impacts should be mitigated as businesses that do participate, of all sizes, will have a more secure and predictable funding stream. The Capacity Market is also expected to reduce barriers to entry, increasing participation.

11.4 Electricity suppliers will also be impacted by the Capacity Market in that they will be charged the costs of the Capacity Market and will need to recover the costs from consumers. The design of the Capacity Market should minimise any adverse impacts on the financial flows of suppliers but the additional administrative requirements are likely to have a greater impact on small and medium suppliers.

12. Monitoring and review

12.1 Section 5(4) of the Energy Act 2013 requires the Secretary of State to prepare and lay before Parliament a report setting out how the Secretary of State has carried out his EMR functions. This requires the Secretary of State to report, before 31 December each year and beginning in 2014, on how he has carried out his functions in

Part 2 of the Act in order to deliver EMR's objectives. The report must be laid in Parliament and be shared with the Devolved Administrations.

12.2 The first of such reports was laid before Parliament on 6 November 2014. As well as fulfilling the reporting requirement, the EMR Annual Update 2014 provides Parliament and other stakeholders with a forward look of the path ahead and a summary of EMR progress since the Energy Bill received Royal Assent in December 2013.

12.3 In addition, section 66 of the Energy Act 2013, requires the Secretary of State to report to Parliament by the end of 2018 on a number of aspects of the operation of the EMR programme. These aspects include the extent to which the original objectives have been met, whether these objectives are still appropriate and whether they could be delivered in a way that imposes less regulation.

12.4 Evaluation will help to provide evidence for whether the EMR programme and its processes are as efficient and effective as possible and on whether the benefits of the programme are being achieved. The Government has commissioned independent contractors with appropriate expertise to provide evaluation of the first Capacity Market auction. The outcome of this evaluation will help inform future decisions in relation to the delivery of EMR and DECC's policies more broadly.

12.5 The Government currently envisages that evaluation work over the lifetime of the instrument will include (but not be confined to) the extent to which the first Capacity Market auction has met expectations of providing security of supply.

13. Contact

Helena Forrest at the Department of Energy and Climate Change. Tel: 0300 068 6716 or email: Helena.Forrest@decc.gsi.gov.uk can answer any queries regarding the instrument.