

ENERGY ACT 2013

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 2: Electricity Market Reform

Chapter 3: Capacity Market

Section 27: Power to make electricity capacity regulations

136. This section enables the Secretary of State to make regulations (“electricity capacity regulations”) about the provision of capacity to meet the demands of consumers for the supply of electricity in Great Britain. *Subsection (3)* specifies that “providing capacity” means providing electricity or reducing demand for electricity. *Subsection (4)* makes clear that provision made about “reducing demand for electricity” can include provision that reducing the consumption of electricity reduces demand.

Section 28: Capacity agreements

137. This section provides that electricity capacity regulations may make provision about capacity agreements, and specifies some particular matters relating to capacity agreements about which such provision may be made.
138. *Subsection (2)* states that a capacity agreement is an instrument that can give rise to obligations for the holder of the agreement (a “capacity provider”) and for electricity suppliers. It can require a capacity provider to provide capacity (i.e. provide electricity or reduce demand for electricity) and to make payments for the benefit of electricity suppliers (“capacity incentives”). A capacity provider may, for example, be required to pay a capacity incentive if their capacity was not delivering electricity in circumstances defined in or determined in accordance with regulations. In addition, all electricity suppliers may be required to make payments (“capacity payments”) for the benefit of capacity providers; it is intended that the revenue payable to capacity providers under capacity agreements will be funded by electricity suppliers in this way.
139. *Subsections (2)(b)* and *(c)* allow capacity agreements to provide for capacity payments and capacity incentives to be paid to an intermediary (a “settlement body”) as referred to in *subsection (4)(g)*.
140. *Subsection (3)* enables electricity capacity regulations to make provision regarding the definition of “electricity suppliers” for the purposes of a capacity agreement. For example this may allow a threshold to be put in place to exclude smaller suppliers if the Secretary of State considered that it was not proportionate to require all electricity suppliers to pay for the costs of the Capacity Market.
141. *Subsection (4)* identifies the sort of provision that may be made about capacity agreements in electricity capacity regulations, including: the terms of a capacity agreement; how capacity agreements will be issued; the persons who may be a capacity provider; the circumstances in which capacity must be available; the duration of a capacity agreement; the calculation of payments associated with capacity agreements

and the body that will administer those payments; the enforcement of the terms of a capacity agreement; resolution of disputes; and the circumstances in which a capacity agreement may be changed, terminated, assigned or traded.

142. *Subsections (5)(a) and (b)* clarify that such provision can include provision conferring functions on the national system operator to issue capacity agreements, and provision about the outcome of a capacity auction (see section 29). For example this would enable a requirement to be placed on the national system operator to issue a capacity agreement to a person whose bid is successful in a capacity auction. *Paragraphs (c) and (d)* enable electricity capacity regulations to set out the eligibility criteria for persons before they may enter a capacity auction or become a capacity provider. In particular, those persons may be required to meet certain conditions, or to satisfy the national system operator of certain matters, as provided for in electricity capacity regulations.
143. *Subsections (6)(a) and (b)* enable regulations to include provision for the calculation and determination by the settlement body, or by another person specified by the regulations, of the amounts of capacity payments and capacity incentives due from or owed to electricity suppliers or capacity providers.
144. *Subsection (7)* clarifies that regulations may include, in particular, a requirement for a person to consent to an inspection of plant or premises. For example this may be necessary to determine whether the person is capable of providing capacity under a capacity agreement.

Section 29: Capacity auctions

145. This section enables the Secretary of State to make provision in electricity capacity regulations for the determination on a competitive basis (i.e. through capacity auctions run by the national system operator) of who may be a capacity provider.
146. *Subsection (2)* allows the Secretary of State to make provision for the national system operator to run capacity auctions, the circumstances in which a capacity auction is to run, the intervals at which auctions are to take place and the process by which auctions are to be run. For example the Secretary of State may specify the process by which bids into the capacity auction are assessed and how it will be decided which bids are successful. *Subsection (2)(c)* enables regulations to make provision about the amount of capacity in relation to which a determination may be made, for example how the total amount of capacity required from a particular capacity auction is to be determined; *subsection (4)* specifies that the function of determining that amount may be conferred on the Secretary of State or the Authority but not on any other person.
147. *Subsection (3)* provides for electricity capacity regulations to require the national system operator to prepare and publish rules or guidance about capacity auctions, and for the process to be followed in doing so.
148. *Subsection (5)* clarifies that provision made within *subsection (2)(f)*, which relates to the manner in which the Secretary of State exercises any function in relation to capacity auctions, may include provision about the frequency of any decision, the persons who will be consulted and the matters to be taken into account. For example the Secretary of State may take a decision on the amount of capacity which is to be sought through a particular capacity auction, on an annual basis, taking into account information or advice relating to available capacity and consumer demand.

Section 30: Settlement body

149. In the event that a settlement body is appointed to administer capacity payments and capacity incentives, this section enables regulations to require electricity suppliers or capacity providers to make payments to the settlement body for certain ancillary purposes. Under *subsection (1)*, payments may be required to cover the settlement body's administration costs, to enable it to hold sums in reserve, and to mutualise

payments across suppliers to cover those not made by an insolvent or defaulting supplier. *Subsection (3)* also enables the regulations to require electricity suppliers or capacity providers to provide collateral. *Subsections (4)* and *(5)* enable regulations to include provision for the determination by the settlement body or by another person specified by the regulations, of the amounts of payments due from electricity suppliers or capacity providers, under this section and the form and terms of any collateral.

Section 31: Functions of the Authority or the national system operator

150. This section enables the Secretary of State to make provision in electricity capacity regulations to confer functions on the Authority or the national system operator.

Section 32: Other requirements

151. This section enables the Secretary of State to make provision to impose other requirements, in addition to those particularly associated with capacity agreements, on licence holders, persons carrying out functions under the capacity market and any other person who is, or has ceased to be, a capacity provider.
152. *Subsection (3)* sets out that such requirements may, in particular, include requirements relating to the manner in which functions are to be exercised, restrictions on the use of generation plant and participation in a capacity auction, and the inspection of plant or property (to supplement the provision in section 28(7)). For example, the Secretary of State may require a person carrying out functions under the capacity market to comply with requirements regarding a particular format, such as to report on its activities, or provide advice. In relation to restrictions on the use of generation plant and participation in a capacity auction, the Secretary of State could, for example, prevent any part of a generating plant to which a capacity agreement does not apply to be used in a way that undermined the efficient operation of the capacity market.

Section 33: Electricity capacity regulations: information and advice

153. This section enables the Secretary of State to make provision in electricity capacity regulations for the provision and publication of information including: to require the Authority and the national system operator, or any other person specified in the regulations to provide information or advice; for the Authority and the national system operator to require the provision of information for a purpose specified in the regulations; to require capacity providers and electricity suppliers to share information with one another and with any person named in the regulations; for the publication of information or advice; for the classification and protection of commercial or sensitive information; and for the enforcement of these requirements to provide, publish or protect information or advice.
154. These provisions mean, for example in relation to *subsection (2)(b)*, that the national system operator could require the provision of any information specified in the regulations regarding the operation of the Capacity Market necessary to enable it to administer it, and to report to the Secretary of State on this. In addition, the Secretary of State could for instance, by *subsection (2)(d)*, provide for a body such as the national system operator or an expert group to publish information regarding the operation of the Capacity Market in order to support transparency and accountability of the participants and the administration. Some information, for example relating to forecasts of available capacity some years ahead, may be based upon commercially sensitive or confidential information. *Subsection (2)(e)* enables regulations to include provision about the protection of any such information.

Section 34: Power to make capacity market rules

155. This section confers power on the Secretary of State to make capacity market rules, which may contain any provision that may be made by electricity capacity regulations except for the matters referred to in *subsection (2)*. The matters which may

not be included in capacity market rules include, in particular, provision about the circumstances in which, and the amount of capacity for which, a capacity auction is to be held, and provision about the calculation and settlement of payments.

156. By virtue of *subsection (3)*, electricity capacity regulations may confer power to make capacity market rules (which includes power to amend, add to or revoke such rules) on the Authority. Thus, the power in this section enables the capacity market to be implemented partly by means of an instrument which the Authority may be given power to add to or amend in future.
157. If electricity capacity regulations give the Authority power to make capacity market rules, *subsection (4)* provides that the regulations must include a condition requiring the Authority to consult before exercising the power.
158. *Subsection (5)* requires such regulations to secure that the Authority must obtain the Secretary of State's consent on each occasion that it seeks to make capacity market rules which confer functions on itself.
159. Supplementary provisions about capacity market rules are contained in sections 41 and 42.

Section 35: Provision about electricity demand reduction

160. *Subsection (1)* applies this section when electricity capacity regulations made under the power in section 27 relate to the provision of capacity which is created by reducing demand for electricity. Where this is the case, *subsections (2) and (3)* of this section apply.
161. *Subsection (2)* enables the Secretary of State to confer functions on a person or body for the purposes of, for example, administering an electricity demand reduction regime. In relation to the capacity market, section 31 allows the Secretary of State to confer functions on the national system operator (or the Authority). Where provision is made in electricity capacity regulations relating to reducing demand by reducing electricity consumption, it may not be appropriate to confer functions on the national system operator; another person or body may be identified and regarded to be better placed to, for example, administer the electricity demand reduction regime. To cater for this possibility *subsection (2)* enables the Secretary of State to confer functions on a person or body for this purpose and makes clear that the person or body appointed does not have to be the national system operator.
162. *Subsection (3)* ensures that where the power in *subsection (2)* is exercised the references to the national system operator in the provisions listed in *paragraphs (a) to (e)* are construed as references to the person or body appointed under *subsection (2)*. The effect of this provision is to ensure that the powers which might be provided to the national system operator are equally applicable to a person or body appointed under *subsection (2)* for an electricity demand reduction regime.

Section 36: Enforcement and dispute resolution

163. This section enables the Secretary of State to make provision in electricity capacity regulations and capacity market rules about enforcement and the resolution of disputes, including conferring functions on any public body or any other person.
164. *Subsection (1)* enables electricity capacity regulations to include provision about enforcement of obligations contained either in the regulations or in capacity market rules, while *subsection (2)* only permits capacity market rules to make provision about the enforcement of obligations contained within the rules.
165. *Subsection (4)* clarifies that such provision can include powers to impose financial penalties, provision for requirements imposed by the regulations or rules to be

enforceable by the Authority using the enforcement regime set out in the Electricity Act 1989, for reference to arbitration and for appeals.

Section 37: Licence modifications for the purpose of the capacity market

166. This section enables the Secretary of State to make licence modifications and to amend electricity industry codes (which are documents maintained under licences), for the purposes of a Capacity Market. Industry codes (such as the Balancing and Settlement Code, made under the standard conditions of the electricity transmission licence) generally contain provisions relating to the functioning of the electricity industry and electricity markets. They also ordinarily contain provision about the procedure for their modification, usually involving the participation of the parties to the code and the Authority.
167. *Subsection (1)* allows the Secretary of State to amend the conditions of generation, transmission, distribution, supply and interconnection licences, electricity industry codes and agreements that give effect to industry codes.
168. *Subsection (2)* allows the Secretary of State to provide for a new document to be required to be prepared and maintained in accordance with the conditions of a licence. This would enable the Secretary of State to create a new industry code rather than modifying an existing one, for example to set out the arrangements governing the settlement of payments relating to capacity agreements. This subsection also enables a licence or code modification to confer functions on the national system operator.
169. *Subsection (3)* enables provisions included in a licence or industry code by a modification made under this section to include any provision of a kind that can be made in electricity capacity regulations, to make different provision for different cases, and confirms that provision need not relate to the activities that the licence authorises. For example modifications to a code may make different provision for different types of capacity (such as electricity generation in contrast to demand side response technologies) or provide for different capacity agreements to apply for different lengths of time.
170. *Subsections (4) and (5)* require the Secretary of State to consult licence holders, the Authority and any other person he or she considers appropriate before making modifications and confirms that consultation that occurs before the passing of the Act will satisfy this requirement.
171. *Section 64* makes further provision about licence modifications.

Section 38: Amendment of enactments

172. This section enables the Secretary of State to: amend or repeal section 47ZA of the Electricity Act 1989 regarding the annual report by the Authority on security of electricity supply; amend section 172 of the Energy Act 2004 regarding the annual report on security of energy supplies; amend section 25 of, and Schedule 6A to, the Electricity Act 1989 regarding enforcement of obligations of regulated persons (i.e. to supplement section 36)); and to make consequential amendments to any other enactment as the Secretary of State considers appropriate as a consequence of provision made under this Chapter, including to repeal or revoke such enactments.

Section 39: Principal objective and general duties

173. This section provides that sections 3A to 3D of the Electricity Act 1989, which set out the principal objective and general duties of the Secretary of State and the Authority, apply to the functions of the Authority under or by virtue of this Chapter.

Section 40: Regulations under Chapter 3

174. This section sets out how the Secretary of State can use the powers to make regulations under this Chapter and the process that must be followed.
175. *Subsection (1)* enables the Secretary of State to make different provisions in regulations for different cases or circumstances. For example, this power might be used to apply different eligibility criteria to capacity provided using different technologies. It also enables the Secretary of State to make regulations including provisions of an incidental, supplementary, consequential or transitional nature.
176. *Subsections (2) and (3)* require that the Secretary of State must consult the Authority, any person who is a holder of a licence to supply electricity under section 6(1)(d) of the Electricity Act 1989 and other persons that he or she considers it appropriate to consult before making any regulations under this Chapter and confirms that this requirement can be satisfied by consultation before the passing of the Act.
177. *Subsections (4) to (7)* provide that regulations must be made by statutory instrument and that, subject to two exceptions, any regulations made under Chapter 3 must be laid in draft before, and approved by affirmative resolution of, each House of Parliament.. Exceptions are made for electricity capacity regulations which only make provision about information and advice (other than the first regulations making such provision), and regulations under section 38 which do not amend primary legislation; these are subject to negative resolution.
178. *Subsection (8)* sets out that the regulations relating to the Capacity Market should not be treated as a hybrid instrument.

Section 41: Capacity market rules: procedure

179. This section describes the procedures which must be followed in making capacity market rules. *Subsections (1) to (6)* specify that the first set of rules must be laid in draft before both Houses of Parliament for 40 days, and is subject to the negative procedure. *Subsection (9)* specifies that subsequent capacity market rules or amendments must be laid before Parliament and published as soon as is reasonably practicable after they are made.
180. *Subsection (7)* specifies that the Secretary of State must consult certain persons prior to making capacity market rules: the Authority; any licence holder under section 6(1)(d) of the Electricity Act 1989; any capacity provider; and any other person the Secretary of State considers it appropriate to consult. *Subsection (8)* allows consultation undertaken before or after the passing of the Energy Act 2013, to count towards the duty in *subsection (7)* when making capacity market rules.

Section 42: Capacity market rules: further provision

181. This section confers powers for capacity market rules to make the additional changes required to enable them to function. In particular *subsection (1)* allows for: incidental, supplementary and consequential provision; transitory or transitional provision or savings' provision for different cases, circumstances or purposes; and to make provision subject to exceptions.
182. *Subsections (2) and (3)* have the effect that, if electricity capacity regulations give the Authority power to make capacity market rules, that includes power to amend, add to or remove capacity market rules made by the Secretary of State, subject to any provision made by the regulations.

Section 43: Pilot scheme for electricity demand reduction

183. *Subsection (1)* of this section enables the Secretary of State to spend money on an electricity demand reduction pilot programme. Before proposing a particular design

*These notes refer to the Energy Act 2013 (c.32)
which received Royal Assent on 18 December 2013*

for an electricity demand reduction regime, the Secretary of State may wish to explore particular design options by running a pilot programme to test different options. This spending power enables the Secretary of State to spend money for these purposes.

184. *Subsections (2) to (4)* of this section add a statutory reporting requirement for any pilot schemes. *Subsection (2)* sets out a duty to review the operation and effectiveness of any pilot scheme, while *subsection (3)* requires the results of that review to be reported to Parliament. This can be done through a written report laid in both Houses, or, if the Secretary of State thinks it should be done orally, by making a statement. *Subsection (4)* specifies that this should be done as soon as reasonably practicable after the conclusion of any pilot.