EXPLANATORY MEMORANDUM TO

THE ELECTRICITY CAPACITY (AMENDMENT AND TRANSITIONAL PROVISION) REGULATIONS 2026

2026 No. XXXX

1. Introduction

1.1 This Explanatory Memorandum has been prepared by the Department for Energy Security and 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 (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/ Capacity Market (CM) Delivery, at the Department of Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Matt Harriman-Brady at the Department for Energy Security and Net Zero Telephone: +447858688019 or email: Capacity.Market@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 2014 Regulations"), the Electricity Capacity (Supplier Payment etc.) Regulations 2014 (S.I. 2014/3354) ("the Supplier Payment Regulations") and the Electricity Capacity (No. 1) Regulations 2019 (S.I. 2019/862) ("the 2019 Regulations") to implement technical reforms to the CM. The changes aim to maintain security of electricity supply, align the scheme with the government's decarbonisation objectives, and improve its functionality and efficiency to ensure it remains fit for purpose in a rapidly evolving energy system.

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 the 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 available 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 (e.g., wind and solar), consumer-led flexibility (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 of CM Units ("CMUs") – the unit of generation, interconnection, or consumer-led flexibility 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 reducing demand) at a time of system stress ("Capacity Obligations"). They face financial penalties in the form of termination fees 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 confidence that Capacity Providers can deliver on their Capacity Obligations, increase value-for-money and to further integrate low carbon technologies into the CM. The legislation also makes technical amendments which ensure the efficient continued operation of the scheme. These changes are essential to ensuring that the CM continues to deliver effectively and provide value-for-money security of supply.

What was the previous policy, how is this different?

5.4 Some CMUs are excluded from participation in the CM if they receive support under other specified low-carbon support schemes such as a contract for difference ("CfD"). If a CMU is subject to a CfD that has not expired or terminated, it cannot enter the CM. The policy intent is to ensure there is no overlap in benefits from these schemes. This instrument (paragraph 2 of Schedule 1) creates an appropriate exception and ensures that where a CfD is awarded to a generator following a direction from Secretary of State (SoS), the generator is allowed to enter the CM, so long as it declares that the CfD will not commence whilst it has a Capacity Obligation. Distinction is made between a CfD awarded following a direction from SoS, and a CfD awarded in an allocation round auction. A Capacity Provider awarded a Capacity Agreement at a T-4 capacity auction can withdraw from the Capacity Agreement into order to enter an allocation round CfD and that policy will remain unchanged.

5.5 As part of the requirements under the CM Rules, all applications to prequalify into the CM must be done via an IT portal that is assigned by the Delivery Body. There is a risk that if there was a severe IT issue that impacted this portal, then prequalification could not happen fairly. The CM Rules will be amended to allow the Delivery Body and SoS to extend the prequalification application window to cater for this scenario. The amendment made in this instrument (paragraph 3 of Schedule 1) sets out the requirement that updated auction guidelines must be published following such an extension to detail the updated timetable for the CM auctions.

5.6 To ensure delivery of Capacity Obligations, the CM has Termination Fees that a Capacity Provider must pay to the Settlement Body if their Capacity Agreement is terminated. These fees are graduated to reflect that some termination events are more severe than others. These fee rates were last updated in 2016 when three additional fee rates were introduced. Inflation since these fees were introduced has reduced the real-term value of this delivery assurance measure. This instrument (paragraph 4 of Schedule 1) introduces four new termination fee rates. These new fees represent a 30 per cent increase in the four termination fees that are currently used in the CM. This aligns the termination fee mechanism with the policy intent from when the fees were last reviewed in 2016.

5.7 To ensure that the CM is value-for-money, the policy intent is that payments should never be issued to a CMU once it is known that that CMU is subject to insolvency proceedings. This was already the policy intent of the 2014 Regulations. This instrument (paragraphs 7 and 8 of Schedule 1) provides further clarity as to how the Settlement Body must withhold credit once it becomes aware that a CMU is subject to insolvency and how this credit can be paid if a termination notice for insolvency is subsequently withdrawn.

5.8 Prior to this instrument, some prospective CMUs would have to provide the Settlement Body with credit cover during prequalification if it had not met the requirements in the CM Rules regarding financial commitments i.e. £10,000 per MW of Capacity Obligation. The rates for credit cover are equivalent to the banded termination fee rates. Credit cover is returned if the CMU later meets specified financial commitment and delivery milestones. If the CMU fails to meet the financial commitment milestone within 11 months, it would have to provide credit cover up to £15,000 per MW instead. This instrument (paragraph 10 of Schedule 1) increases the amount of credit cover initially posted to £13,000 per MW. This is a 30 per cent increase. If a New Build CMU misses the initial 11-month deadline, they must now post credit cover equal to £19,500 per MW for the same reason. This enhances delivery assurance because if the CMU is terminated, the credit cover will be used to pay the termination fee to the Settlement Body and ensures credit is an incentive for CMUs deliver on time and contribute to security of supply.

5.9 Prior to this instrument, a Demand Side Response (DSR) CMU (which delivers consumer-led flexibility) that had not completed a DSR test (making it "Unproven DSR") must post £5,000 per MW of credit cover, or £10,000 per MW if the Unproven DSR was seeking an agreement that would last more than one year. This instrument increases the amount of credit cover to £6,500 per MW and £13,000 per MW respectively. The policy intent is to align the credit cover to the 30 per cent increase in the related termination fees for failing to conduct a DSR test.

5.10 All changes in respect of credit cover will apply only to agreements awarded in the future, so this instrument (paragraph 11 of Schedule 1) makes transitional provision for Capacity Agreements already in force.

5.11 In the Supplier Payment Regulations, the Settlement Body is required, if it obtains further data after making calculations and determinations, to carry out monthly reconciliation runs after each month of a delivery year in respect of the determinations made for that month, and annual reconciliation runs after the end of each delivery year in respect of all the determinations made for that year. This instrument (Paragraph 2 of Schedule 2) amends this timetable by providing accelerated reconciliation runs that the Settlement Body will be required to use in the future when the Authority (Ofgem) determines it becomes appropriate for the Settlement Body to do so. The provision is drafted so the existing timetable can be used until that time This maintains the policy intent of the regulations without causing any disruption to suppliers or Capacity Providers.

5.12 The 2019 Regulations included temporary provisions that adjusted supplier charge payments to account for the State aid standstill period which applied to the CM in 2019. Those provisions were intended to operate on a temporary basis. As they are no longer required, the revocation of Chapter 1 of Part 3 removes obsolete provisions. This streamlines the regulations without altering the ongoing operation of the CM.

6. Legislative and Legal Context

How has the law changed?

6.1 The CM is a statutory scheme and Capacity Agreements are statutory bundles of rights and obligations. The 2014 Regulations made under the Energy Act 2013 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 the right to receive capacity payments, and which also impose obligations on Capacity Providers to use their CMUs to provide capacity when required to do so.

6.2 This instrument amends the 2014 Regulations, the Supplier Payment Regulations and the 2019 Regulations to modify existing provisions where necessary. Corresponding amendments to the Rules are also being made through the Capacity Market (Amendment) Rules (No.2) 2026 to ensure coherence between the Regulations and the operational framework set by the Rules

6.3 In summary, the changes made are as follows:

<u>The 2014 Regulations</u>

6.4 Under existing regulations, termination fee and credit cover arrangements operate with a fixed number of termination fee bands and low credit cover thresholds. The updated framework introduces additional termination fee bands and higher credit cover requirements in specified circumstances for new capacity agreements going forward. Regulations 2, 32, 43, 59, 60 are amended to increase Termination Fee rates and Credit Cover requirements by 30% for Capacity Agreements won in Auctions from 2027 onwards, while also allowing for Credit Cover to be held for longer, in certain circumstances. New regulation 59A includes transitional provision to protect agreements already in existence from being subject to the higher rates.

6.5 Under existing regulation 16, an installation subject to a CfD cannot prequalify for the CM. Regulation 16 is amended to provide an avenue for a generator to prequalify for the CM if they have agreed to a CfD following a direction from SoS, so long as there is no overlap between the period to which the generator benefits from the CfD, and the obligated Delivery Years to which the generator has a Capacity Agreement for. The CfD is treated as commencing when there are financial flows between the person holding the CfD and the CfD counterparty.

6.6 Regulation 21 is amended to make provision for an extension to the Prequalification Window if a severe IT outage occurs that affects all participants, to ensure that Prequalification can be completed fairly in line with the CM Rules which are amended alongside this instrument.

6.7 Regulations 51 and 52 are amended to allow the Settlement Body to withhold Capacity Payments to CMUs that have been terminated for an Insolvency Termination Event (as specified in Rules), to improve the scheme's value-for-money for consumers.

The Supplier Payment Regulations

6.8 The process of recalculating and redetermining the amounts of payments due to or from electricity suppliers are fixed to a specified monthly and annual timeline. Regulations 2 and 18 are amended to allow for an accelerated timeline for reconciliation of supplier payments. The Authority will determine when it is appropriate to move to the new timetable, and the existing reconciliation timeline is maintained to allow for a transition to the new timetable.

The 2019 Regulations

6.9 The 2019 Regulations contain provisions modifying supplier charge payments in respect of the impact of the State aid standstill period which applied to the CM temporarily in 2019. Chapter 1 (supplier charge payments during standstill period) of Part 3 (payments administered by the Settlement Body) is revoked as it contains redundant provisions relating to the impact of the State aid standstill.

Why was this approach taken to change the law?

6.10 The proposals developed through the consultations referenced in section 7, relate to enhancing the existing CM. Where the policy is established by a provision in the 2014 Regulations, the Supplier Payment Regulations or the 2019 Regulations, an amendment to those Regulations is required.

7. Consultation

Summary of consultation outcome and methodology

7.1 It is a statutory requirement to consult on any changes to the CM. Two public consultations were conducted in relation to the measures in this instrument. A Government Response to both consultations, including a summary of consultation responses, was published on 14 May 2026.

7.2 The first consultation1 was conducted between 2 October 2025 and 27 November 2025 and sought views on maintaining security of supply, aligning the scheme with the government's decarbonisation goals, and improving the functionality of the scheme. 65 responses were received from a variety of stakeholders, including Capacity Providers and trade associations. Respondents were broadly supportive of most of the proposals.

7.3 The second consultation2 was conducted between 2 December 2025 and 8 January 2026 and sought views on integrating low-carbon technologies and strengthening delivery assurance ahead of Prequalification 2026. 46 responses were received from a variety of stakeholders which were broadly positive however there was some opposition to proposals in respect of termination fees and credit cover.

[1] https://www.gov.uk/government/consultations/capacity-market-proposed-changes-for-prequalification-2026
[2] https://www.gov.uk/government/consultations/capacity-market-proposals-to-integrate-low-carbon-technologies-and-enhance-delivery-assurance-ahead-of-prequalification-2026

7.4 Regarding amendments to allow the Delivery Body and the Secretary of State to extend the Prequalification Window in the event of severe IT issue, most respondents supported the change.

7.5 Regarding amendments to enable CMUs holding a CfD awarded following a SoS direction to participate in the CM, most respondents supported the proposal provided that no overlapping benefit could be received from both schemes.

7.6 Regarding amendments to strengthen delivery assurance (including increases to Termination Fees, extended Credit Cover requirements), this has been consulted on, and the Government has taken account of the views provided in finalising its approach. The majority of respondents supported suspending Capacity Payment immediately once an insolvency-related Termination Notice has been issued.

7.7 Regarding amendments to the Supplier Payment Regulations most respondents supported the proposals. Respondents agreed that changes were necessary to ensure that CM reconciliation processes remain operable once accelerated settlement replaces the existing 14-month reconciliation cycle.

7.8 Regarding the revocation of legacy provisions in the 2019 Regulations relating to the expired state aid standstill period in 2019, most respondents agreed with the proposal.

8. Applicable Guidance

8.1 Guidance on the CM is produced by the Delivery Body[3] and the Electricity Settlements Company Ltd[4]/Low Carbon Contracts Company[5] 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.

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 the CM is exempt from the Better Regulation Framework and there is no direct cost to businesses.

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

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 does not impact 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 nature of the changes, any impact on small businesses would be small.

9.6 There is no, or no significant, impact on the public sector.

[3] https://www.neso.energy/what-we-do/energy-markets/electricity-market-reform-emr-delivery-body
[4] https://www.emrsettlement.co.uk/publications/guidance/
[5] https://www.lowcarboncontracts.uk/

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring the 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 any major changes but identified incremental improves which the government continues to review. The second five-year review of the CM was published on 16 December 2024. The review found that the CM has been effective in meeting its objectives and will inform the broader strategy to ensure energy security and move towards making Great Britain a Clean Energy Superpower.

10.2 The instrument does not include a statutory review clause. The 2014 Regulations, which this instrument amends, include a provision requiring review (detailed 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 and Transitional Provision) Regulations 2026 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").