



# CfD Allocation – securing contracts

## EMR CfD Expert Group

- Context
- Decision 1: The transition between ‘first-come-first-served’ (FCFS) and allocation rounds
  - The trigger for the switch
  - The process governing the interaction with the LCF
- Decision 2: The rules for rationing applications to the available budget
  - What options are available for Objective Criteria?
    - Price?
    - Others?

# Context: Factors affecting the design of the CfD allocation process



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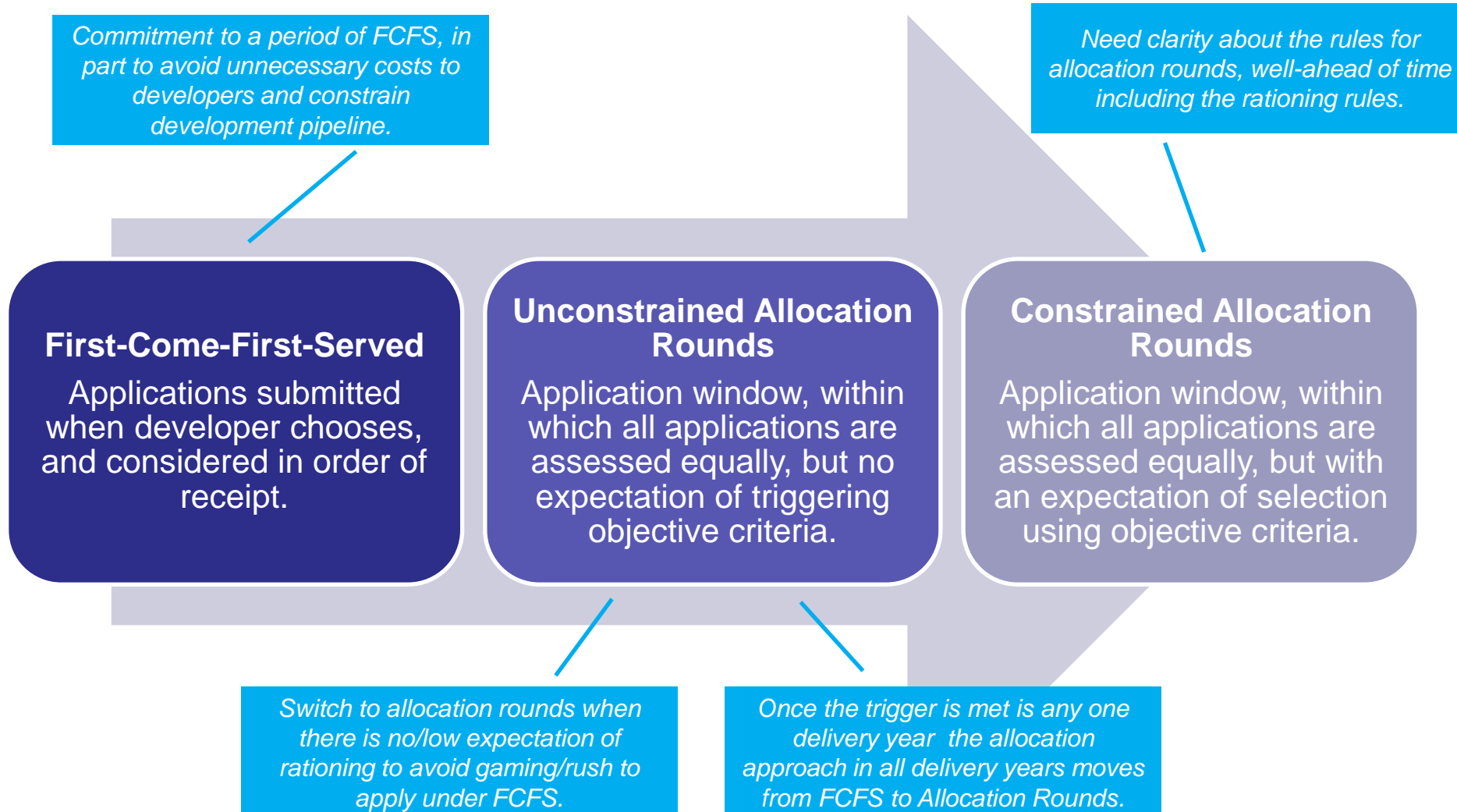
- The LCF is shared between a number of policies but the proportion available to the CfD needs to be allocated in a way that cost-effectively delivers HMG objectives.
- The Department still needs to agree:
  - The shape of the LCF, any flexibilities around its use, how inflation will be applied;
  - How the LCF should be split between the CfD and other policies;
  - How much LCF will be used by FID for Renewables and whether there will be an allocation methodology used for FID for Renewables that will inform the design of the enduring regime; and
  - The Strike Prices for the CfD technologies.
- The allocation design will need to reflect all these factors and also take account of :
  - Any objectives for allocation that serve to ensure a minimum/maximum amount of some technologies receive CfDs irrespective of strike price in order to ensure diversity or drive cost reduction for less mature technologies.

The design of the allocation process cannot be finalised while some of these design criteria are unresolved. However, this pack sets out a number of key features that will allow more detailed options to be worked up.

# Context: FCFS to Allocation Rounds



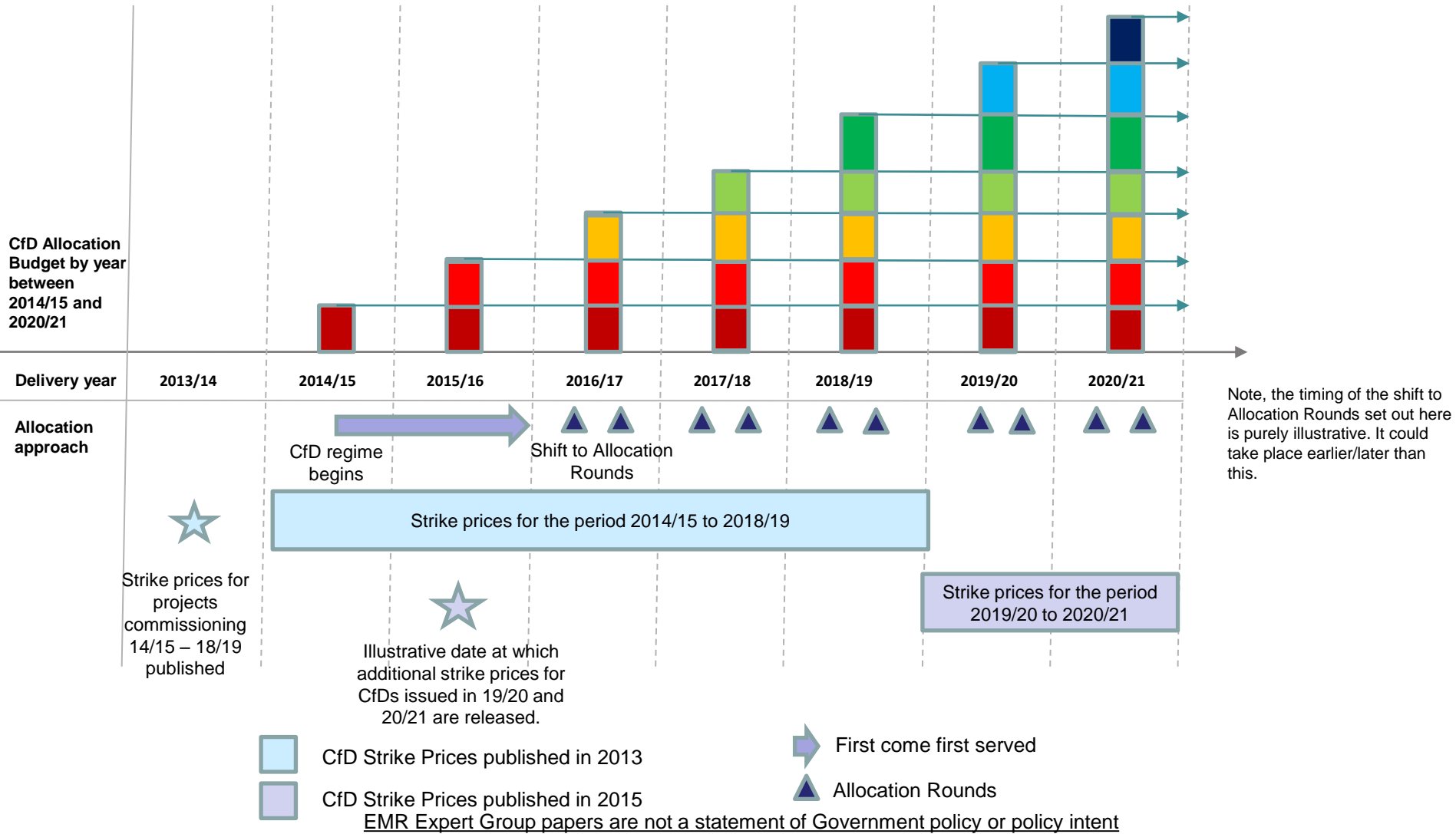
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# Context: Reminder of the Delivery year landscape in which allocation approaches must operate



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# Transition between first come first served and Allocation Rounds



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- In November, Government indicated its *intention was “not to artificially restrict the allocation of CfDs, or to impose allocation processes that are unnecessarily costly”*.
- The principles governing the allocation process are :
  1. Minimise the risk of the CfD Budget being breached
  2. Protect a reasonable portion of the budget so it is possible to take account of potential falls in technology costs over time
  3. Begin by using First Come First Served (following FID-Renewables) to allow for simple allocation to market participants.
  4. Transition from FCFS to Allocation Rounds at a point that means the Rounds can initially run without the risk of a cost control mechanism being activated. This allows market participants to familiarise themselves with the methodology:
    - Lack of precision over the CfD Budget trajectory makes it difficult to determine the precise threshold at which the transition should occur; however
    - on the simplistic basis that a 10% or 20% threshold would be rapidly breached and an 80% or 90% threshold would result in inefficient allocation we have proposed using circa 50%.
  5. Use an objective methodology to discriminate between projects at the point that the CfD budget limit for a delivery year is breached and choices between projects need to be made.

# Options for the trigger governing switching from FCFS to Allocation Rounds



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## Two particular considerations apply:

1. Should the Trigger for the transition be set at a level which is :
  - “High”, (circa 80+% of CfD Allocation Budget used through FCFS);
  - “Conservative” (circa 40% - 60% through FCFS); or
  - “Low” (circa 10% of CfD Allocation Budget used by FCFS)

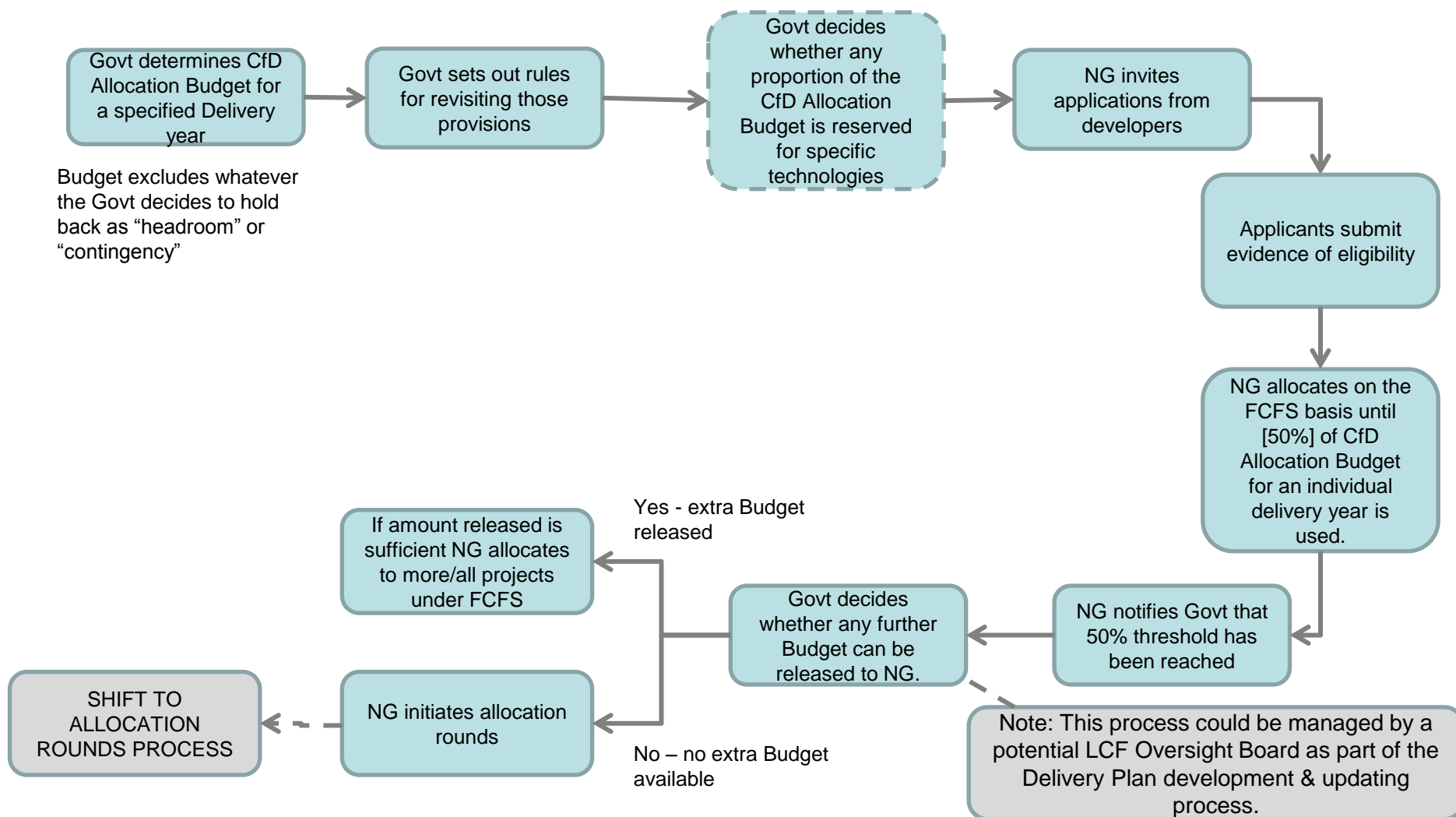
→ **We would advocate setting the trigger at a conservative level**
2. Should the trigger for transition be forward-looking?
  - a) Trigger could be based on a forecast of projects coming forward and their potential impact on the CfD Allocation Budget
  - b) Trigger could be based on Objective leading indicators
  - c) Trigger could be based on actual Applications –
    - This is the favoured approach. The trigger would be met when actual applications show a specified percentage of the CfD Allocation Budget has been allocated.
    - This approach is consistent with a Conservative or Low approach to triggering the move from FCFS.

## What are the Expert Group’s views on these questions?

# Straw man of possible FCFS process and Allocation Round Trigger



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## **Selection must take place in line with specified rules published well in advance of first allocation.**

- The process which FIDe for Renewables employs may set precedents for the approach the enduring regime adopts. E.g. if the FID process uses allocation methodology with an element of competition it may be prudent to adopt something similar when allocating under constraint in the enduring CfD regime.
- Constraints:
  - National Grid as Delivery Body have indicated they would prefer government to set objective criteria against which they can manage a selection process;
  - Ensuring the selection method is understandable and brings a low risk of challenge also suggest objective criteria are preferable; and
  - Govt must be mindful of State Aid, WTO and EC Treaty considerations.
- Initial potential models for rationing using objective criteria:
  - Model 1: Stack projects by the Price they would accept
  - Model 2: Stack projects by the % discount on strike price which they are prepared to offer

## **Questions:**

- **What are the Expert Group's views of these options?**
- **Are there any other selection methods we should consider?**



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# Model 1: Stack by price Projects would accept

## 1. Illustrative Strike Prices published alongside Delivery Plan:

**Dedicated Biomass - £120/MWh**

**Offshore Wind - £140/MWh**

**Onshore Wind - £90/MWh**

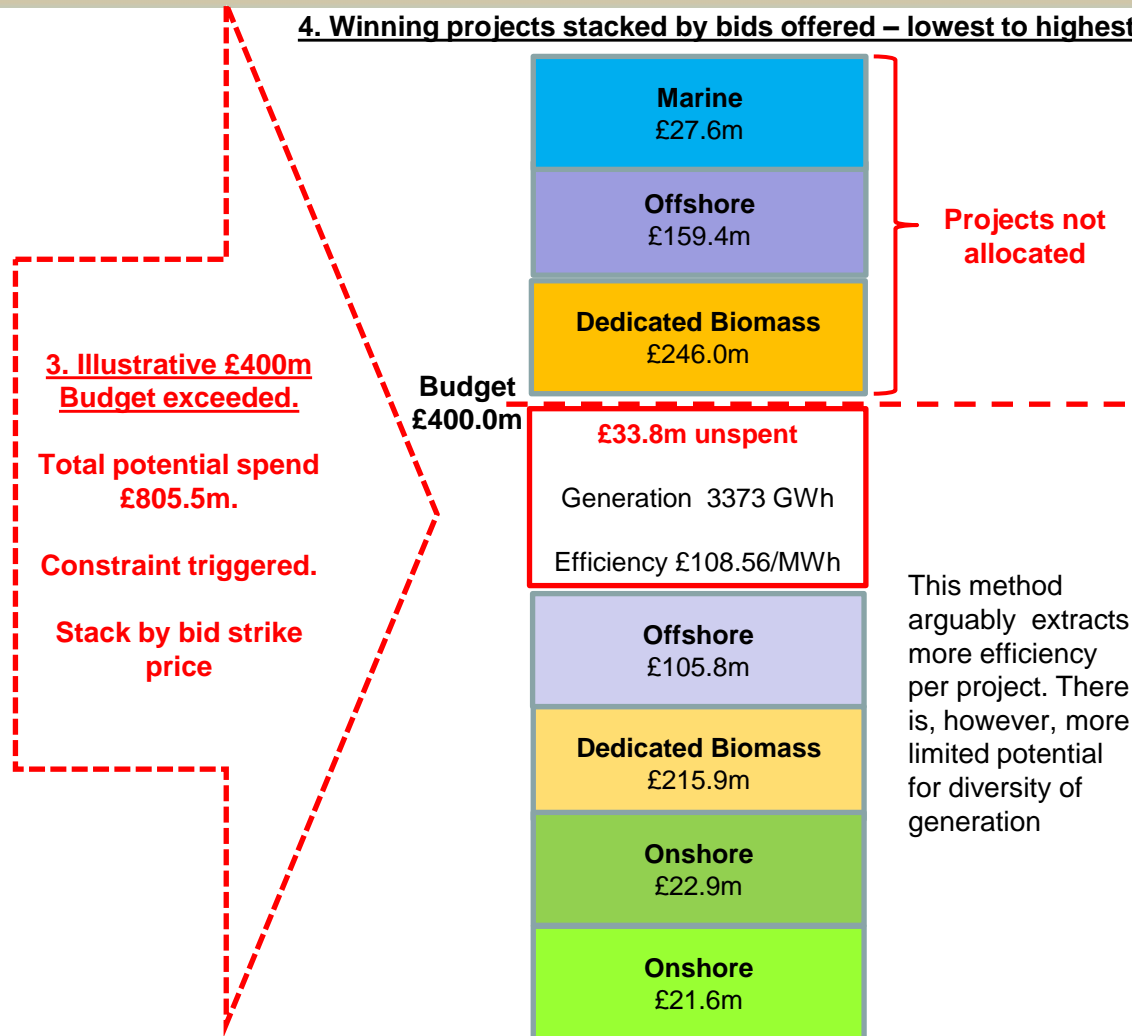
**Marine - £240/MWh**

**Bids invited from projects if strike prices they are prepared to accept**

## 2. Projects applying in application round

<b>Marine</b> 50 MW / 35% LF 153 GWh <b>Bid £180/MWh</b>	
<b>Offshore</b> 300 MW / 35% LF 920 GWh <b>Bid £115/MWh</b>	<b>Offshore</b> 400 MW / 35% LF 1226 GWh <b>Bid £130/MWh</b>
<b>Dedicated Biomass</b> 275 MW / 80% LF 1927 GWh <b>Bid £112/MWh</b>	<b>Dedicated Biomass</b> 300 MW / 80% LF 2102 GWh <b>Bid £117/MWh</b>
<b>Onshore</b> 100 MW / 30% LF 263 GWh <b>Bid £82/MWh</b>	<b>Onshore</b> 100 MW / 30% LF 263 GWh <b>Bid £87/MWh</b>

## 4. Winning projects stacked by bids offered – lowest to highest



Note, this example is a simplification of the actual process. Here the reference price is assumed to be zero, and the value of the top-up is deemed to be the entirety of the strike price. In actuality when valuing the CfD a project might receive it would also be necessary to consider the reference price and the value of the top-up from that reference price to the strike price. This example values the top-up payment at maximum cost (significantly more than would be the case in reality).



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# Model 2: Stack by % discount

## 1. Illustrative Strike Prices published alongside Delivery Plan:

**Dedicated Biomass - £120/MWh**

**Offshore Wind - £140/MWh**

**Onshore Wind - £90/MWh**

**Marine - £240/MWh**

**% Discount of Bids calculated.**

## 2. Projects applying in application round

**Marine**  
50 MW / 35% LF  
153 GWh  
**Discount 25.0%**

**Offshore**  
300 MW / 35% LF  
920 GWh  
**Discount 17.9%**

**Offshore**  
400 MW / 35% LF  
1226 GWh  
**Discount 7.1%**

**Dedicated Biomass**  
275 MW / 80% LF  
1927 GWh  
**Discount 6.7%**

**Dedicated Biomass**  
300 MW / 80% LF  
2102 GWh  
**Discount 2.5%**

**Onshore**  
100 MW / 30% LF  
263 GWh  
**Discount 8.9%**

**Onshore**  
100 MW / 30% LF  
263 GWh  
**Discount 3.3%**

**3. Illustrative  
£400m Budget  
exceeded.**

**Total potential  
spend £805.5m.**

**Constraint  
triggered.**

**Stack by  
discount.**

**Pay bid strike  
price.**

## 4. Winning projects stacked by % discount

**Dedicated Biomass**  
£246.0m

**Onshore**  
£22.9m

**Dedicated Biomass**  
£215.9m

**Projects not  
allocated**

**Budget  
£400.0m**

**£85.6m unspent**

Generation 2562 GWh

Efficiency £122.56/MWh

**Offshore**  
£159.4m

**Onshore**  
£21.6m

**Offshore**  
£105.8m

**Marine**  
£27.6m

This mechanism is not as efficient as model 1. However, there is potential for greater diversity of generation.

Note, this example is a simplification of the actual process. Here the reference price is assumed to be zero, and the value of the top-up is deemed to be the entirety of the strike price. In actuality when valuing the CfD a project might receive it would also be necessary to consider the reference price and the value of the top-up from that reference price to the strike price. This example values the top-up payment at maximum cost (significantly more than would be the case in reality).