Department of Energy & Climate Change

Contract for Difference for non-UK Renewable Electricity Projects

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Background

1. The Government has been considering the benefits of supporting renewable electricity projects located outside the United Kingdom ('UK') for a number of reasons, including:

- to use the cooperation mechanisms created under the EU Renewable Energy Directive[1] (particularly joint projects) as a contingency option to help the UK meet its renewables target;
- to improve the security of electricity supply in the UK and to support the creation of the European internal market through greater interconnectivity with neighbouring countries;
- to reduce the cost of investment in low-carbon technologies through greater competition; and
- more generally, to support the UK in achieving its longer term carbon reduction objectives in a cost-effective way.

2. In 2013 a Memorandum of Understanding was signed between the UK and the Republic of Ireland[2] to explore the benefits of renewable trading[3] for the two countries. This was a first step in understanding the issues that need to be resolved to establish a framework to govern renewable trading with non-UK projects generally. In June 2013, the UK Government published its response to the Call for Evidence on Renewables Trading[4]. It indicated that there was potential for the physical trade in renewable energy and that more work should be undertaken to understand the issues associated with this area of work.
3. Progress has been made in assessing feasibility of renewable trading and there are a number of challenges in considering renewable trading as a realistic contingency option for meeting the UK's renewable target.
4. The strong pipeline of investment in renewable electricity projects in the UK that contribute towards the 2020 target constrains the available resources under the Levy

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[1] The Renewable Energy Directive created "cooperation mechanisms" (statistical transfers, joint projects, and joint support schemes) to give Member States flexibility to jointly exploit renewable energy sources and to facilitate cross-border support of renewable energy. Joint projects are where a new renewable energy project in one country can be co-financed by another, and the 'renewable value' of the energy (i.e. renewable credits) can be shared, accompanying the physical flow of energy. http://eur-lex.europa.eu/legal-content/EN/ALL/;jsessionid=xH2JTQLC8vYMgvQsjvYn7cVmslp1vvvcqtXqYflj3KvFBxL86hqH!2097610408?uri=CELEX:32009L0028

[2] https://www.gov.uk/government/news/energy-trading-creates-opportunities-for-ireland-uk-davey-rabbitte

[3] Renewable trading refers to physical export of renewable electricity generated in one country (e.g. Ireland) to another country (e.g. the UK).

[4] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/251889/130627_Response_to_Call_for_Evidence_on_Renewable_Energy_Trading_Final.pdf

Control Framework (LCF). And the long lead times for renewable trading projects suggests they should not be considered as a contingency for 2020. Over the longer term increasing investments into low carbon technologies in a way that is cost effective while improving the UK's electricity supply and moving towards an integrated internal market are key objectives for this Government to continue exploring the benefits of renewable trading in the future.

Purpose

5. This document outlines the existing high level issues regarding the use of Contracts for Difference ('CfDs') to incentivise the development of new renewable electricity projects connected to the electricity systems of Great-Britain ('GB') but located outside the UK. It sets out indicative areas of work that would need to be addressed to open the UK CfD scheme to eligible non-UK renewable electricity projects.
6. The Electricity Market Reform ('EMR') programme will increase investment in low-carbon technologies, ensure the UK's security of supply in the short, medium and long term, at least cost to consumers. The government's long-term vision is for intervention in the electricity market to decrease over time, achieving transition to a market where low carbon electricity generation can compete on price. Therefore the design of the CfD scheme includes competition between technologies to meet the EMR objectives in the most cost-effective way. Opening the EMR CfD scheme to projects from outside the UK in due course is an aspect of EMR originally announced in 2012[5]. This type of support would be the first of a kind in Europe and, reflecting this, we need to find ways of addressing a number of complex issues set out in this document.
7. For the purposes of this document and the scope of future development of non-UK CfDs policy, the definition of non-UK renewable generator is that: the generator operates an eligible renewable electricity generation facility; is located outside the UK territory; and exports its generation to the GB electricity system[6].
8. This paper sets out initial areas of work to explore and, over time, address in order to open up the UK CfD scheme up to non-UK projects. At this stage, all timings and suggested areas of work are indicative.

Transmission asset regime

9. It should be noted that another major issue that needs to be resolved is the regulatory approach to the transmission asset connecting non-UK generation to the electricity system in Great Britain ('GB').
10. Progress on the possible regulatory approach had been set out in more detail separate to this document. Ofgem provided an update[7] on the regulation of transmission connecting non-UK generation to the GB transmission system earlier this year. In this update it confirmed that future non-GB connections regulation would be captured within the Integrated Transmission Planning and Regulation (ITPR) project and timelines.

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[5] www.gov.uk/government/uploads/system/uploads/attachment_data/file/65635/7077-electricity-market-reform-annex-a.pdf

[6] The intention would be to explore if and how exports to the Northern Irish electricity system could work once the CfD is implemented in Northern Ireland.

[7] https://www.ofgem.gov.uk/publications-and-updates/update-regulation-transmission-connecting-non-gb-generation-gb-transmission-system

11. The ITPR project will help to establish a regime for non-GB connections which best reflects the use of the assets, coordinated system planning and arrangements for revenue regulation. Further updates on ITPR are likely to follow in September this year. Additional work has also been undertaken by The Crown Estate to establish how they will grant seabed rights to developers bringing forward renewable energy import projects with cables on seabed[8], which The Crown Estate manages. This work will progress in tandem with the work programme set out in this document.

Non-UK CfDs Programme of Work

12. The purpose of the CfD is to increase revenue certainty for low-carbon generators over the duration of the contract. This reduces the commercial risks faced by the projects thereby lowering the cost of raising finance and ultimately supporting low-carbon generation at least cost to UK consumers. CfDs can be allocated to a range of low-carbon technologies, including renewables, and relies on a dedicated institutional framework for the allocation, signature and management of the contracts.
13. To date the CfD policy, processes, systems and institutional arrangements have been designed for projects located in GB (which will be extended to cover Northern Ireland from 2017). Opening the CfD scheme to projects located outside the UK, with the challenges and complexities that this carries, will require most aspects of the EMR policy design to be reviewed, notably the allocation of CfDs, the CfD contract itself, and the supporting institutional framework.

CfD Allocation

14. There are two main aspects of the process for allocating CfDs: eligibility for CfDs and the process of managing the budget for CfDs, including how CfDs are awarded when demand for contracts exceeds the available budget.

Eligibility

15. The legislative framework for CfDs defines eligible projects by reference to their renewable electricity technology, rather than their geographic location. However the current allocation system relies on the generator demonstrating that they meet certain qualification requirements, which ensure that the project is of an appropriate technology and that the project is sufficiently advanced to warrant the award of a CfD.[9] We will need to ensure and if necessary develop eligibility criteria that have a similar policy effect as they do for GB and NI projects without treating non-UK generators unfairly.

The Budget for CfDs (the Levy Control Framework)

16. CfDs are funded through the Levy Control Framework (LCF) which allows the UK Government to manage public expenditure paid for through UK consumers' energy bills. Budget control through the LCF reflects the importance the Government places on

[8] http://www.thecrownestate.co.uk/energy-infrastructure/notices/cables-and-pipelines/

[9] https://www.gov.uk/government/publications/electricity-market-reform-contracts-for-difference

monitoring and controlling spending on levy schemes that are funded in this way. The LCF sets annual limits on the overall costs of all DECC's low carbon electricity levy-funded policies. These comprise the Renewables Obligation (RO), small scale Feed-in Tariffs and CfDs (including Investment Contracts).

17. Government is committed to achieving value for money for UK consumers, and ensuring that the award of CfDs allows it to remain within the LCF constraints. The use of auctions is an important aspect of the CfD allocation process, which supports value for money and allows for orderly management of the LCF budget. The Government is minded that non-UK renewables applicants would apply for CfDs in competition with UK projects – participating in auctions when applications exceed the available budget – and be subject to the same budget management requirements as for GB/NI CfDs. Ofgem is establishing the regulatory regime for transmission connecting non-UK generation to GB. We intend competition to apply regardless of the regulatory regime for transmission assets.

CfD Contract

18. The CfD takes the form of a private law contract, providing generators with a clear set of rights and obligations. This structure supports investor confidence in the arrangements, not least through providing certainty that the CfD payments are reliable; further reducing revenue risk to investors and therefore costs to consumers. A non-UK CfD would seek to maintain similar policy principles, contract structure and risk profiles as under the UK contract while ensuring value for money for UK consumers. It would be based on the UK CfD Terms and Conditions, although several terms would need amendment.

CfD Institutional Framework

19. The Government is keen to avoid duplication of institutions, and so will look to use the existing UK CfD's institutional arrangements when developing a position for non-UK CfDs. However, the challenges of non-UK projects might require the creation of new and/or complementary arrangements and cooperation with institutions in other countries (e.g. transmission system operators and regulators).

20. To date the CfD Institutional Framework defines clear roles for the institutions that govern the scheme in GB. The Low Carbon Contracts Company (LCCC) acts as the CfD Counterparty to all CfDs and administers the supplier obligation. National Grid, acting as the Delivery Body, administers CfD allocation and provides analysis to Government to underpin the setting of (maximum) strike prices. Ofgem, as regulator of the electricity market in GB oversees National Grid's delivery and enforces the supplier obligation. A subsidiary of Elexon carries out the settlement for CfDs on behalf of the LCCC. The Government will work closely with these institutions when developing a position for the non-UK CfD institutional framework.

Indicative Timings

21. The Government understands that giving greater visibility on when non-UK renewable electricity projects can expect to have access to CfDs is a key question for interested parties. At this early stage of the CfD implementation and given the number of challenges and complexities that setting up a non-UK CfD policy will raise, the Government cannot commit to specific timelines. However to start managing the interested parties' expectations we can outline a couple of timing constraints that will determine the timelines for non-UK CfDs.

22. As set out in the CfD Implementation Plan[10] it is anticipated that the application process for CfDs will open and allocation is expected to begin in autumn 2014, with first contracts awarded in late 2014 or early 2015 for projects located in GB. The Government's priority is to implement the CfD across the UK before opening it to non-UK projects. Because the electricity market is under reform in Northern Ireland with the new market arrangements under the Integrated Single Electricity Market due to be operational from December 2016, we currently expect the CfD regime to start in Northern Ireland from April 2017. The dependency on the CfD implementation across the UK and the complexity of the issues that need to be resolved to open the CfD to non-UK generators means that under our current planning assumptions the non-UK projects would be likely to have access to CfDs from 2018 at the earliest.

23. Another constraint to the timing for opening of the CfD scheme to non-UK renewable electricity projects is the availability of budget within the LCF. More details on the CfD budget were published in July 2014.[11]

24. Further updates on indicative timing will be communicated in the future as the CfD implementation across the UK and the areas of work progress

[10] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/301464/cfd_implementation_plan.pdf

[11] https://www.gov.uk/government/publications/indicative-cfd-budget-notice-for-the-autumn-2014-cfd-allocation-round

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