



Department
of Energy &
Climate Change

Electricity Market Reform: Allocation of Contracts for Difference

Consultation on Competitive Allocation

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Consultation on Competitive Allocation

Prepared by the Department of Energy and Climate Change

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Executive Summary

1. This consultation document seeks views on the Government's approach to allocation of Contracts for Difference (CfD). Responses are invited from all interested parties by 12 February 2014.
2. Responses should be submitted to secondarylegislationemr@decc.gsi.gov.uk.
3. The Government's Electricity Market Reform (EMR) programme provides an ambitious package of measures to incentivise the investment needed to replace the UK's ageing electricity infrastructure with a more diverse and low-carbon energy mix. Up to £110 billion of capital investment is needed from now until the end of the decade.
4. The Government's objectives for EMR are to:
 - ensure a secure electricity supply;
 - ensure sufficient investment in sustainable low-carbon technologies;
 - minimise costs to, and ensure value for money for consumers.
5. The Government has, through the publication of the EMR Delivery Plan¹ and CfD contract terms² provided certainty for investors by finalising key components of the EMR package.
6. This consultation aims to finalise key elements of the approach for allocating CfD contracts, in line with the objectives of EMR.
7. We recognise that allocation risk (that is, the risk of not being allocated a CfD contract) is a key issue for developers of renewable projects – in particular for technologies which are less established, and which have long and expensive development timelines. In reaching the proposals set out in this document we have taken that point into account, as well as considering:
 - the recently published draft EU guidelines on environmental and energy aid for 2014-2020³, which indicate the need for a move to genuine competitive processes for some technologies;
 - the challenge of how best to allocate the available budget given the strong progress of the renewables pipeline, and the potential high demands that this strong pipeline of projects could place on the funding available through the Levy Control Framework (LCF). The proposals for managing the CfD budget are consistent with the upper limits on annual spending on low-carbon generation (including CfDs⁴, the Renewables Obligation and the Feed-in Tariffs (FITs) scheme) within the LCF; and

¹ <https://www.gov.uk/government/publications/electricity-market-reform-delivery-plan>

² <https://www.gov.uk/government/publications/electricity-market-reform-contracts-for-difference>

³ The EEA guidelines were published in draft form in December 2013 and are due to be finalised in July 2014 http://ec.europa.eu/competition/consultations/2013_state_aid_environment/index_en.html.

⁴ This includes FID Enabling for Renewables.

- the potential for competitive processes to be used for some technologies to maximise value for money for consumers.

Summary of proposals

8. We propose the following approach to the allocation of Contracts for Difference:
 - Contracts will be allocated on the basis of allocation rounds. The period of 'First Come First Served' (FCFS) allocation that we had previously considered will not apply.
 - The CfD budget will be divided between:
 - a group of 'established' technologies (Onshore Wind (>5 MW), Solar Photovoltaic (PV) (>5 MW), Energy from Waste with CHP, Hydro (>5 MW and <50 MW), Landfill Gas and Sewage Gas.
 - a group of 'less established' technologies (Offshore Wind, Wave, Tidal Stream, Advanced Conversion Technologies, Anaerobic Digestion, Dedicated biomass with Combined Heat and Power and Geothermal).
 - There will be constrained allocation (competition) for at least those technologies deemed 'established' from the commencement of allocation.
9. We will need to consider further how to treat biomass conversion and Scottish Islands projects, both in terms of their technology grouping and in the context of wider, on-going work on the CfD allocation process.
10. For established technologies, the proposed move to competition builds on the strong progress on cost reduction and the well-developed pipeline. For less established technologies, our aim is to ensure that they can deploy at levels which enable continued cost reduction and which ultimately support cheaper deployment in the long-term.
11. Consultation questions are set out at the end of this document. We are seeking views on the proposed list of established and less established technologies, and on the proposal to introduce competition for at least the established technologies.

Next steps

12. Following the closure of this four week consultation, we will consider responses and publish a Government response confirming our approach to competitive allocation and technology groupings towards the end of February. We will also use responses to questions on our rationale for the treatment of technologies to help shape a further consultation planned for March 2014 that will explain proposals for any technology specific minima (floors) or maxima (caps) that could be used to further manage how the CfD budget will be allocated to particular technologies within the proposed technology groupings.
13. We will set out further details of how the CfD auction process will operate in the coming weeks, in advance of the publication of a draft CfD Allocation Framework in March detailing the rules that will govern the administration of budget and contract allocation.

Introduction and Policy Context

1. The Government has clearly stated its intention to move to a competitive price discovery process for all low-carbon technologies as soon as practicable⁵. Competition will enable us to reduce the costs of decarbonisation, limit the bill impacts on consumers of achieving our low carbon objectives, and drive efficiencies across the sector. In the medium to long-term we aim to introduce technology neutral low-carbon competition.
2. Through the document 'Electricity Market Reform: consultation on proposals for implementation'⁶, published in October 2013, Government sought views on the principle of the use of maxima (caps) and minima (floors) for particular technologies or groups of technologies within the budget available to the EMR Delivery Body for "generic" Contracts for Difference (CfD) allocation. "Generic" CfD allocation is the process that will apply to most renewable technologies.
3. The proposed approach to allocation set out in that consultation included a "First Come First Served" (FCFS) phase⁷, during which applications would be submitted by developers, and considered in order of receipt. This period of FCFS would be followed by unconstrained allocation⁸ rounds and these in turn would give way to a competitive, constrained allocation process when the number of projects seeking support in an allocation round exceeded the funding available in that round.
4. The consultation also set out that decisions on the duration of any FCFS phase of allocation would be impacted by wider decisions on the use of the Levy Control Framework (LCF) cap⁹, including decisions relating to the Renewables Obligation (RO) calculation¹⁰ and wider value for money and affordability considerations. This noted that

⁵ As set out in the October EMR consultation document, and previous publications including the CfD allocation methodology published in summer 2013
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/226976/Allocation_Methodology_-_MASTER_-_6_Aug_v_FINAL.pdf.

⁶ <https://www.gov.uk/government/consultations/proposals-for-implementation-of-electricity-market-reform>.

⁷ Under FCFS proposals, applications would be awarded in order of application date until a proportion of the available budget (50%) was reached, and allocation rounds triggered.

⁸ As set out in the EMR October consultation document (p.69), under allocation rounds all applications (bids) for a round will be assessed at the same time. If there is insufficient budget to satisfy all bids, or a constraint specified within the budget for a group of technologies is exceeded, competitive allocation will take place through an auction. Under proposals set out today, the constraint for the established technologies grouping will be set at a level that will ensure competition from the first allocation. These technologies will compete with each other via an auction process.

⁹ As set out in the Delivery Plan, the Levy Control Framework (LCF) sets annual limits on the overall costs of DECC's levy funded policies.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/268221/181213_2013_EMR_Delivery_Plan_FINAL.pdf.

¹⁰ The RO requires licensed UK electricity suppliers to source a specified proportion of the electricity they provide to customers from eligible renewable sources. This proportion (known as the 'obligation') is calculated each year and has increased annually. The RO is part of the Levy Control Framework mechanism. Therefore the level of the

there were scenarios in which FCFS might only last for a short period or might not be able to operate at all, and if so, Government would consider moving immediately to allocation rounds, and would also consider introducing constraints for certain technologies or groups of technologies.

5. The consultation closed on 24 December 2013, and we received responses from around 40 stakeholders to the questions relating to the use of FCFS allocation and the role of competition in allocation. These responses indicated that a number of stakeholders recognised that budget limitations in the early years of the CfD would mean that a quick move to constrained allocation was likely. Responses also called for certainty over whether FCFS would take place, and for greater clarity on when constrained allocation would be introduced.
6. This document updates our proposed approach on these issues and invites further views from stakeholders on our emerging proposals for the treatment of particular technologies within constrained allocation, in particular in light of the European Commission's draft guidelines on State Aid, published on 18 December 2013¹¹. Government will be responding in due course to the Commission's consultation on these guidelines and therefore the proposed approach set out in this document is without prejudice to the Government's response to that consultation.
7. We will be carrying out further detailed stakeholder engagement during January and February 2014, including bi-lateral engagement. We will also work with a Panel of Technical Experts (expected to be in place February 2014), as part of their role to provide technical scrutiny of the System Operator's analysis relating to EMR.
8. We will issue a further consultation planned for March 2014 that will explain proposals for any technology specific minima (floors) or maxima (caps) that could be used to further manage how the CfD budget will be allocated to particular technologies within the groupings.

Approach to managing the CfD budget and wider Levy Control Framework

9. As set out in the Delivery Plan on 19 December 2013, the Levy Control Framework (LCF) sets annual limits on the overall costs of DECC's levy funded policies. These comprise the Renewables Obligation (RO), the Feed-in Tariffs (FITs) scheme, Investment Contracts (for the Final Investment Decision (FID) Enabling for Renewables process) and Contracts for Difference (CfD).
10. The Delivery Plan summarised the estimated committed spend under the RO and the FITs scheme and the projected funds available for new build renewable and low carbon

RO calculation will influence the amount of LCF available for other schemes within the LCF including Contracts for Difference and ssFITs <https://www.gov.uk/government/policies/increasing-the-use-of-low-carbon-technologies/supporting-pages/the-renewables-obligation-ro>.

¹¹ http://ec.europa.eu/competition/consultations/2013_state_aid_environment/index_en.html.

generation¹². The budget for CfDs for renewables will be allocated from within funds available for new build renewable and low carbon generation.

11. The affordability cap for Investment Contracts for FID Enabling for Renewables was published on 4 December 2013¹³. Any funds within this which are not allocated to FID Enabling for Renewables projects, following the final affordability assessment and award of Investment Contracts in spring 2014, will be available for the CfDs in the enduring regime.

Approach to allocation of Contracts for Difference

12. This consultation seeks views on the proposed approach to managing the CfD budget through allocation, as described in the Delivery Plan¹⁴, and in light of responses received to the October 2013 EMR consultation.

13. In developing the proposed approach to allocation, Government has had regard to a number of factors including the following:

- the responses to the October 2013 EMR consultation;
- the need for the renewables CfDs and Investment Contract to comply with European rules relating to State Aid;
- pipeline data on development and deployment of renewable technologies¹⁵; and
- the latest budgetary position for the LCF cap.

14. The Delivery Plan, published in December 2013, set out the maximum strike prices for renewable energy technologies (Annex A).

15. That document explained¹⁶ that Government was considering introducing immediate competition from the start of the CfD regime for certain technologies on the basis that these are more established technologies. Responses to the October 2013 EMR consultation indicated that a number of stakeholders were receptive to the proposal to move to earlier competition, with a majority of respondents in support of the potential use of minima and/or maxima to manage the budget. Stakeholders also called for greater transparency and further details to be set out on the design of the competitive allocation

¹² [Delivery Plan](#) P. 26.

¹³ http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263169/FID_Update_3_Contract_Award_Process.pdf

¹⁴ P.12.

¹⁵ Pipeline information comes from the Renewable Energy Planning Database (REPD). The REPD tracks the progress of projects (>0.01MW) from inception, through planning, construction and operational phases and is a store of information about renewables projects before they begin operation.

¹⁶ P 12, P. 35-6

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/268221/181213_2013_EMR_Delivery_Plan_FINAL.pdf, See also October 2013 EMR consultation document p.68.

process and treatment of particular technologies, with further opportunity for stakeholder involvement in shaping final decisions on design.

16. Current indications, based on our understanding of the pipeline for renewable energy projects, are that there will be a high level of demand for Government support schemes for renewables. This information means that we are better placed than we had previously anticipated to introduce competitive forms of allocation. We now judge that the best way to manage an orderly process for the allocation of CfDs, and to give applicants a fair chance of accessing a CfD, will be to move immediately to allocation rounds from autumn 2014. We also judge that we will not carry out the period of First-Come-First-Served allocation that we had previously been considering.

Summary of approach

17. We propose that the approach to allocation of budget for the enduring CfD regime will be as follows:

- Government intends to divide the CfD budget between a group of more established technologies and a group of less established technologies, and run allocation rounds for both groups. This is consistent with our previously published position¹⁷ that set out that at the point we move to allocation rounds, we would move the entire system to allocation rounds.
- The size of the budget in the CfD allocation rounds for more established technologies would be set to ensure competition from the start of the CfD regime. Therefore at least the more established technologies would be subject to an auction process from the beginning of CfD allocation.
- Government is currently considering the constrained allocation auction design, as explained in the October 2013 consultation document. We will set out more detail on the final design of the auction in the coming weeks.
- First-Come-First-Served will not apply for either allocation, but instead we plan to move straight to allocation rounds to allow orderly grouping of applications so that the CfD budget can be effectively monitored and managed.
- Our policy intent is to support investment and provide confidence in the continued sustained deployment of less established technologies – reflecting in particular the significant development costs and risks faced by technologies such as offshore wind.

¹⁷ As set out in the CfD Contract and Allocation overview published in summer 2013 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/233004/EMR_Contract_for_Difference_Contract_and_Allocation_Overview_Final_28_August.pdf - See Para 3.14

- As explained in the October EMR consultation, Government is considering further whether to apply minima and maxima to individual technologies. We expect to consult on any further decisions in relation to this in March 2014.

Treatment of established technologies

18. The European Commission is proposing in its draft guidelines on environmental and energy aid that genuine competition should apply to those technologies that have already achieved significant deployment across the EU.
19. We also need low carbon technologies to compete in order to meet the Government's objectives to ensure sufficient investment in sustainable low-carbon technologies and minimise costs to, and ensure value for money for consumers. Introducing this competition will achieve the same level of generation from these technologies for less, ensuring that we deliver within the budget levels previously announced.
20. Government considers the following technologies to be more "established", and therefore considers that these should be subject to immediate competition through a competitive process of CfD allocation:
 - Onshore Wind (>5 MW)
 - Solar Photovoltaic (Solar PV) (>5 MW)
 - Energy from Waste (with Combined Heat and Power)
 - Hydro (>5 MW and <50 MW)
 - Landfill Gas
 - Sewage Gas
21. The above technologies do not display the same characteristics as the group of less established technologies set out below. They have established, responsive supply chains; they have already realised the effects of early R&D and learning; and as a result they have already secured significant cost reduction. In a number of cases, they are taking forward large-scale deployment.
22. This is reflected in their lower strike prices, with the exception of solar PV. Although large-scale solar PV is currently more expensive than others in this group, there is a widely held view across Europe that the global costs of PV module and panel costs will continue to fall significantly for the remainder of the decade. This on-going cost reduction will largely be driven by large-scale deployment in global markets (notably India, China and the US) rather than UK deployment (as is the case with offshore wind, wave and tidal stream).
23. Energy from Waste is a mature technology which is well established in the UK. Although there are still barriers to the production and use of good quality heat from Energy from Waste plants, as with other forms of CHP, we propose that we introduce competition immediately. Energy from Waste CHP plants are more able to compete at costs on a par with the more mature technologies, compared with other CHP technologies.
24. We would expect the allocation process for this group to work as follows:
 - a. All projects would first be ranked by their bid, representing the strike price they would be willing to accept (with the strike price for each technology capped at the price published in the EMR Delivery Plan);

- b. Those technologies that can offer the lowest bids would be allocated CfDs first;
 - c. Allocation would then proceed to the next cheapest projects in the group;
 - d. This would continue until the entire budget allocated to the group had been used up.
25. Based on the current technology costs, we would expect the technologies that could offer the lowest bids to be landfill gas, sewage gas and Energy from Waste with Combined Heat and Power (CHP). It is anticipated that these technologies would represent a relatively small proportion of the available budget. Onshore, hydro and solar PV projects would compete directly for the remaining budget. This would drive value for money, ensuring that only the cheapest projects and those that can drive down their costs are awarded contracts.

Treatment of less established technologies

26. In addition to the technologies above, there is a group of technologies that could have a significant long-term role in the UK energy mix, and where there remains significant potential for future cost reduction. Delivery of that cost reduction relies on a sufficient level of on-going deployment.
27. Exposing these technologies to competition with more established and lower cost technologies could lead to inadequate levels of investment in technologies that have the potential to deliver significant low-cost renewable generation in future. It could also limit our ability to secure a diverse renewables mix and, ultimately, could increase costs to consumers over the longer-term. Through the proposed technology groupings we will therefore ensure that these technologies do not compete with the more established technologies before they are ready to do so¹⁸.
28. Government therefore considers that the following technologies should not have to compete in allocation rounds against lower cost, more established technologies before they are ready to do so:
- Offshore wind
 - Wave & tidal stream
 - Advanced Conversion Technologies (ACT; gasification and pyrolysis)
 - Anaerobic Digestion
 - Dedicated biomass with Combined Heat and Power (CHP)
 - Geothermal
29. In the case of offshore wind, there is scope for significant further cost reduction. Sustained deployment in the UK – the world’s largest market – will play an important role in delivering this by increasing scope for learning, encouraging investment to develop

¹⁸ The Government has clearly stated its intention to move to a competitive price discovery process for all low-carbon technologies as soon as practicable.

innovative technology, and promoting expansion of, and investment into, the supply chain. A wider, competitive supply chain will drive innovation and cost reduction.

30. Technologies such as wave and tidal stream are still at the demonstration stage and are not currently competing in the mainstream market. Introducing competition at this stage could mean that the industry is not able to develop at all. In recognition of this, Government is minded to reserve a minimum allocation of 100MW for these technologies for this Delivery Plan period. In any given allocation round, should such a minima apply, this would mean that any wave or tidal stream projects up to the reserved minimum of 100MW would be allocated CfDs first. The need for a reserved allocation post 2019 for these technologies would be reviewed in future, in line with their deployment and any associated cost reduction
31. The ACT sector includes immature technologies, with the first commercial scale projects in operation or under construction. Analysis undertaken by the UK Bioenergy Strategy¹⁹ and Technology Innovation Needs Assessment²⁰ highlight ACT's potential to deliver efficient low carbon electricity, heat and transport fuels in future. There is significant potential for future cost reduction in the sector.
32. Government is committed to achieving significant increases in Anaerobic Digestion (AD), which is as yet under-developed in the UK. The majority of AD is likely to be small scale (below 1MW), and there are relatively few cases where larger scale AD is appropriate. This means achieving cost reductions over a short timescale is likely to be challenging. However, there is an on-going programme of innovation designed to help secure potential future cost reductions.
33. Unlike much of the rest of Europe, Combined Heat and Power, and in particular biomass CHP in the UK, faces several specific barriers which mean that deployment at a large scale has not yet occurred, unlike other established technologies. Prospects for cost reduction in the short-term are low.
34. There are no deep geothermal power plants in the UK. A recent report on deep geothermal power suggested a possible potential of up to 3-4% of UK generation by 2050. The major barrier facing the sector is the upfront risk and the uncertainty of the resource. The Government has prioritised support for the development of deep geothermal heat schemes which may contribute to future cost and risk reductions.
35. If all the projects seeking support within this group could be accommodated within the allocated budget, those projects would receive support at the administrative strike price.
36. These technologies have been grouped together (rather than having individual allocations) to ensure a simpler, more flexible allocation system and avoid the complexity of managing multiple budgets. For example, if one technology does not deploy at the level expected, there will be flexibility in the system to use the available budget for other technologies to ensure delivery of Government's renewables objectives.

¹⁹ <https://www.gov.uk/government/publications/uk-bioenergy-strategy>.

²⁰ <http://www.carbontrust.com/our-clients/b/bioenergy-tina>

Other technologies

37. We will need to consider further how to treat biomass conversion and Scottish Islands projects, both in terms of their technology grouping and in the context of wider, on-going work on the CfD allocation process. We will develop our thinking further on this in the coming weeks.
38. Tidal range projects will be considered on an individual basis against the amount of funding available in the CfD budget within the LCF at the point they apply for the CfD.

Consultation Questions

Consultation Question	
1.	Do you agree with the Government’s proposed list of “established” and “less established” technologies?
Consultation Question	
2.	Do you agree that the “established” list of technologies should be subject to competition from the outset of an allocation process as part of helping to manage the LCF and delivering value for money?

Considerations

39. This document has set out how competition might operate for more established technologies in order to manage calls on the overall budget and the likely requirements of State Aid rules. We would welcome comments from respondents on whether and how they would amend their responses to the questions asked in this consultation if, in light of those factors, the Government was also required to amend the RO for more established technologies as a result.

Further consultation & next steps

1. Over the next few months we will be working to confirm and further clarify information required by developers in advance of the first allocation round and to set out further detail on budget and allocation policy in order to support investment decisions.
2. We will determine the level of the CfD budget available to National Grid for allocation under the enduring regime and publish this in advance of the first CfD allocation by summer 2014. In advance of this announcement, we will finalise the following policy issues, drawing on responses to the present consultation and further detailed engagement with stakeholders:
 - confirm the position on whether there will be separate budgets for groups of technologies and finalising the groupings of technologies, drawing on stakeholder responses to this consultation;
 - confirm an indicative CfD budget envelope;
 - determine and set out indicative sizing for of each technology group from within the indicative CfD budget envelope;
 - have established how any maxima or minima could apply within technology groupings; and if these should apply, determined indicative sizing for these minima and maxima within technology groupings.
3. Government is continuing to consider whether to apply minima and maxima to individual technologies, and plan to consult on this in March. We intend to set out details of the auction design under constrained allocation shortly. This detail will be published in advance of the draft allocation framework, which will set out the rules for allocation and budget management.
4. Responses to this consultation are invited from all interested parties by 12 February 2014 and should be submitted to: secondarylegislationemr@decc.gsi.gov.uk.

Forward CfD programme timetable:

5. We will publish further details on the design of the auction under competitive allocation in the coming weeks.

March 2014

- In March we will publish the draft CfD allocation framework, with an opportunity for stakeholders to comment on the rules for managing the CfD budget and allocation process.
- We also plan to publish for consultation further detail of:
 - The treatment of individual technologies, including detailed proposals for the application of technology specific minima or maxima, if any.
 - An update on interactions between budgets within the LCF based upon our understanding of the pipeline of renewables projects, State Aid developments and actions we may need to take to ensure that we stay within the LCF cap.

Late spring 2014

- The CfD allocation framework is expected to be published alongside the laying of secondary legislation.

Summer 2014

- We will confirm any further remaining details of the auction.
- We will publish the CfD budget to be released to National Grid for allocation.
- Subject to the will of Parliament, secondary legislation will be passed in July 2014.

October 2014

- The application process for CfD will open and allocation is expected to begin.²¹

Late 2014/early 2015

- First contracts under the enduring regime will be awarded.

²¹ Subject to the will of Parliament.

Annex A: Strike Prices

Advanced Conversion Technologies (with or without CHP)	155	155	150	140	140
Anaerobic Digestion (with or without CHP) (>5MW)	150	150	150	140	140
Biomass Conversion	105	105	105	105	105
Dedicated Biomass (with CHP)	125	125	125	125	125
*Energy from Waste (with CHP)	80	80	80	80	80
Geothermal (with or without CHP)	145	145	145	140	140
*Hydro (>5 MW and <50MW)	100	100	100	100	100
*Landfill Gas	55	55	55	55	55
*Sewage Gas	75	75	75	75	75
Offshore Wind	155	155	150	140	140
*Onshore Wind (>5 MW)	95	95	95	90	90
*Solar Photo-Voltaic (>5MW)	120	120	115	110	100
Tidal Stream*	305	305	305	305	305
Wave *	305	305	305	305	305
Scottish Islands – onshore wind (>5MW)	-	-	-	115	115

**The strike prices for Tidal Stream and Wave are intended for the first 30 MW capacity of any project. For higher capacity projects, the additional MWs are offered at a strike price capped at the level of offshore wind (for budgetary reasons).*

Glossary

ACT	Advanced Conversion Technologies
AD	Anaerobic Digestion
Allocation	The process by which CfD contracts will be awarded to applicants
AF	Allocation Framework
CfD	Contract for Difference
CHP	Combined Heat and Power
DECC	Department of Energy and Climate Change
EC	European Council
EU	European Union
EMR	Electricity Market Reform
EU	European Union
FCFS	First Come First Served
FID	Final Investment Decisions
FITs	Feed-in Tariffs
LCF	Levy Control Framework
MW	Megawatt
PV	Photovoltaic
R&D	Research & Development
RO	Renewables Obligation
SA	State Aid
ssFITs	small scale Feed In Tariffs
SO	System Operator, National Grid

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