



Department  
of Energy &  
Climate Change

# Contracts for Difference

Break out session

EMR Stakeholder Event

11 February 2013



- Introduction: rationale for CfDs?
- Contract design: what is the CfD and what are the key terms?
- Contract allocation: how do you get one?
- Implementation
  - Route-to-market
  - Final Investment Decision Enabling



# INTRODUCTION

# The Context for Electricity Market Reform



Department  
of Energy &  
Climate Change



**Fifth of plants closing by 2020**



**Long run electricity demand could double**



**Weak signals in the market for low carbon generation**

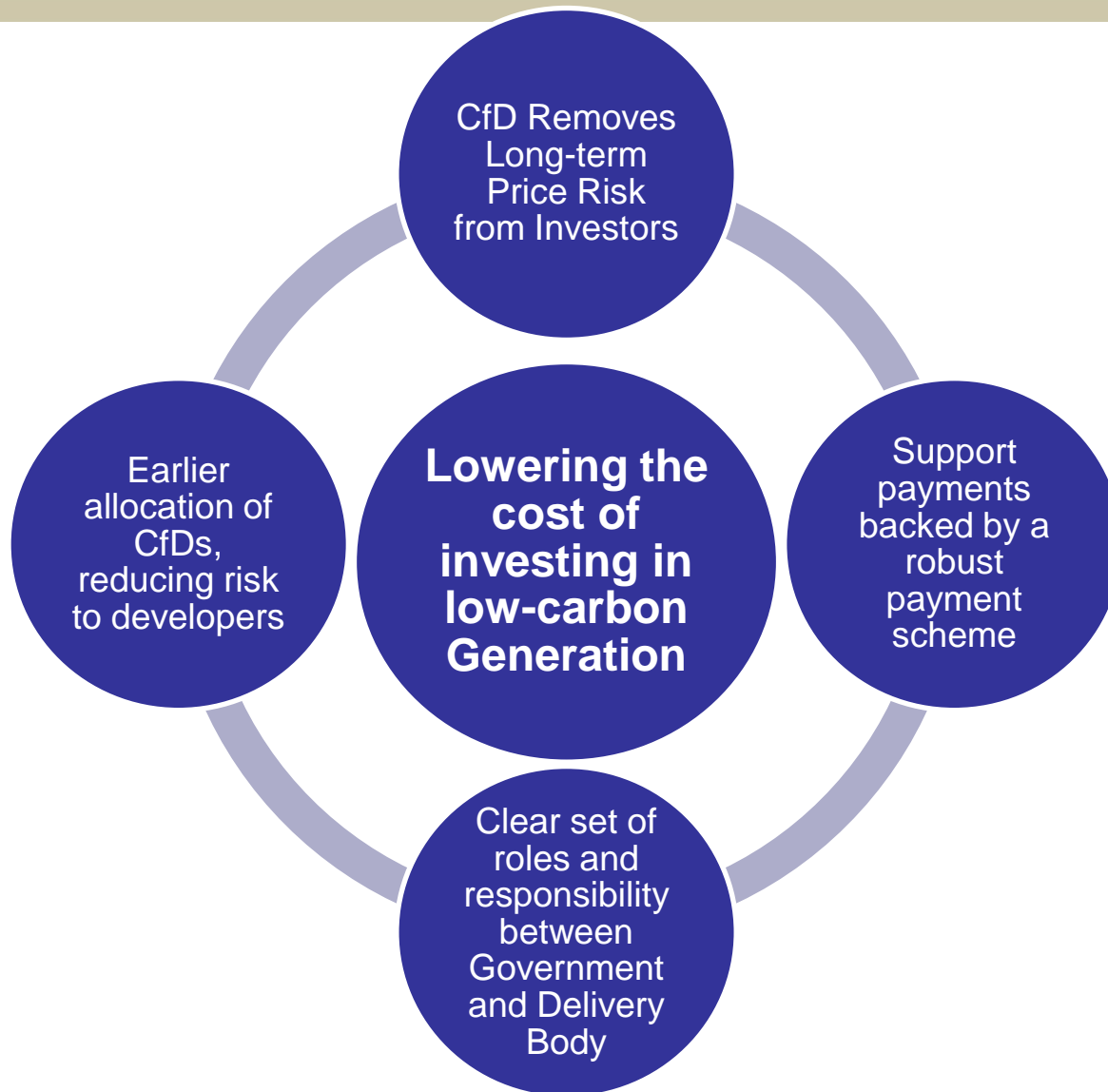


**Current market suits gas, but harder to build low carbon plant**

# Supporting Investment in Low-Carbon Generation



Department  
of Energy &  
Climate Change



# The Framework for Allocating CfDs



Department  
of Energy &  
Climate Change

## Government

Sets overall policy direction and sets out key parameters



## Delivery Body (National Grid)

Provides analysis to allow Ministers  
to set key policy parameters

Runs allocation system



## CfD Counterparty

Enters into CfDs with developers

Collects supplier levy to fund CfDs

# The CfD introduces a number of clear benefits for developers ...



Department  
of Energy &  
Climate Change

1

**Removal of wholesale electricity price exposure** by providing a fixed strike price to developers, therefore stabilising project revenue

2

**Robust and reliable private law contractual arrangement** providing developers with a clear set of rights and obligations, and recourse to arbitration processes to resolve disputes

3

**Robust single counterparty** owned by government and set up as a limited liability company

4

**Early certainty and security of support levels** in the project development process

5

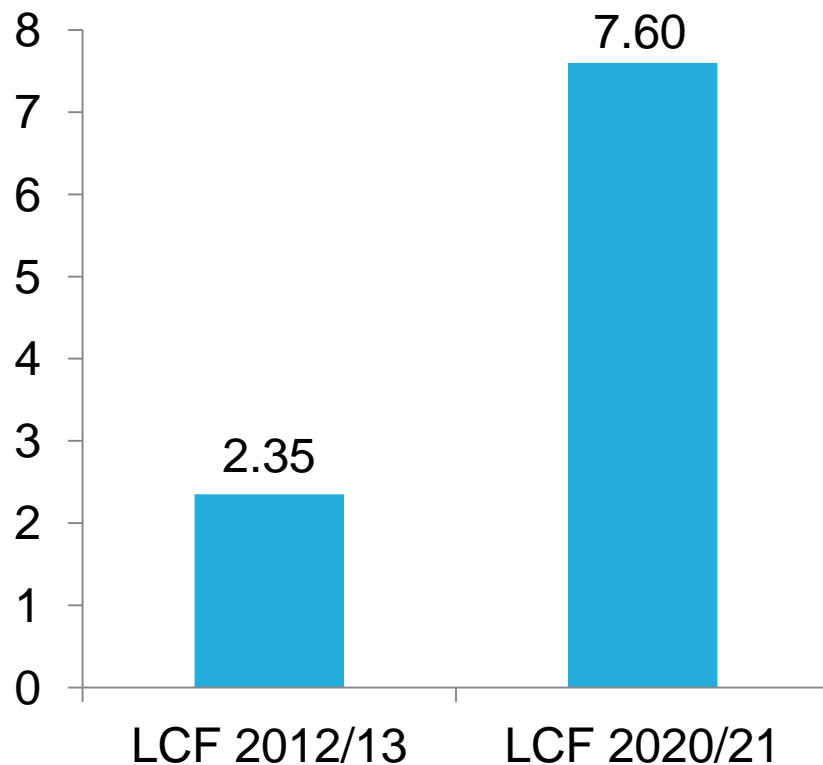
**Provisions that protect the value of the CfD** to developers (e.g. change in law protection)

## ... whilst balancing the needs of Government and delivering at least cost to consumers



Department  
of Energy &  
Climate Change

Evolution of the Levy Control Framework (£bn, real 2011/12 prices)



- The EMR package will allow the UK to meet its 2020 renewables and carbon budget targets
- Coalition government reached an agreement on the amount of support available to low carbon projects
  - £7.6bn (2011/12 prices) in 2020
  - Covers RO, CfD, small-scale FiTs and demand reduction measures
- Long-term commitment and transparency on the amount of support available will ensure affordability and sustainability of the proposed measures



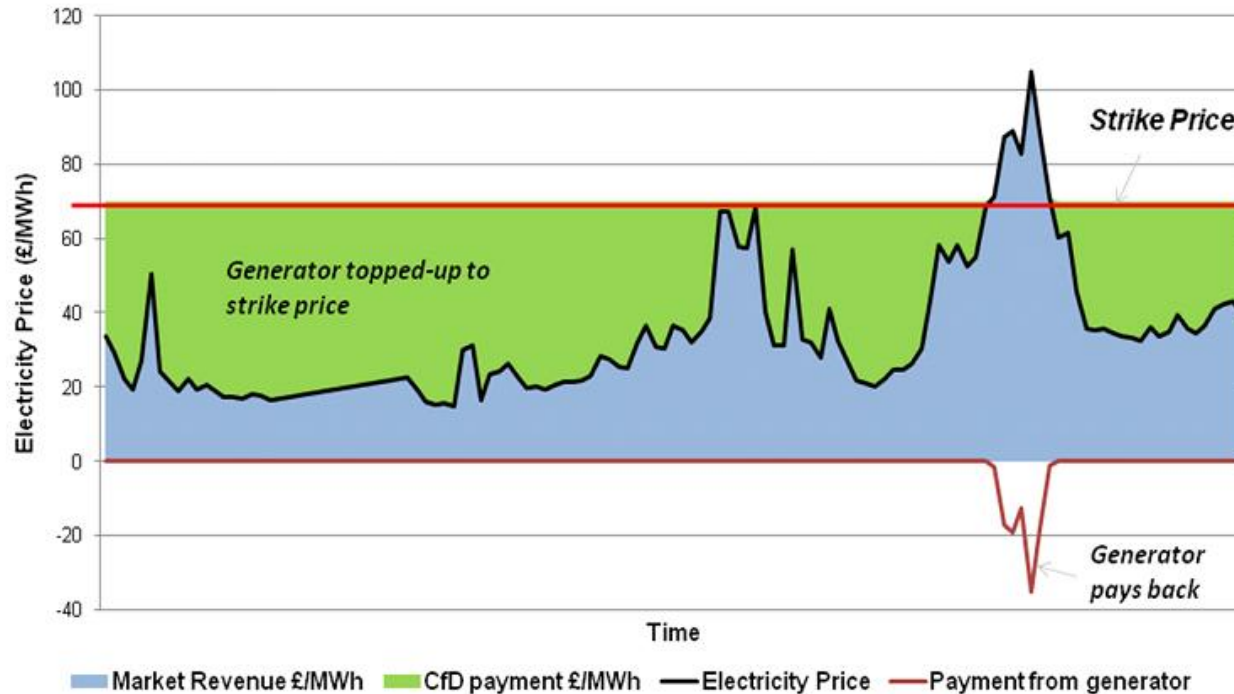


# CONTRACT DESIGN: WHAT IS THE CFD AND WHAT ARE THE KEY TERMS

# What is the CfD?



Department  
of Energy &  
Climate Change



- The CfD provides long-term electricity price stability, lowering risk to investors and costs to consumers
- Generator sells power as normal, but receives a 'top-up' payment
- Top-up pays the difference between the 'Strike Price' and the market price:
  - Generator paid when market price below strike price
  - But, generator pays back when market price is high

# What are the key contract terms?



Department  
of Energy &  
Climate Change

## Contract length

- 15 years for renewables
- To be determined for nuclear and CCS

## Reference price

- Intermittent: hourly day ahead auction price
- Baseload: forward price, source to be determined

## Inflation indexation

- Some or all of the strike price to be linked to general index such as CPI

## Change in law etc.

- Plan to provide limited, credible cover for change in law, change in circumstances and force majeure



Department  
of Energy &  
Climate Change

# CONTRACT ALLOCATION

## Early visibility of strike prices

- **Strike prices will be set in advance for a five yearly period**, providing visibility to developers on the strike price they can access in the year of commissioning of their project.
- In its role as the delivery body for EMR, National Grid (“NG”) will be preparing the analysis to support strike price setting.
- CfD Strike prices will initially be set to reflect the construction, operating and financing costs of each technology.
- Final strike prices will be set out in the EMR Delivery plan by the end of this year.

## Early certainty of a contract

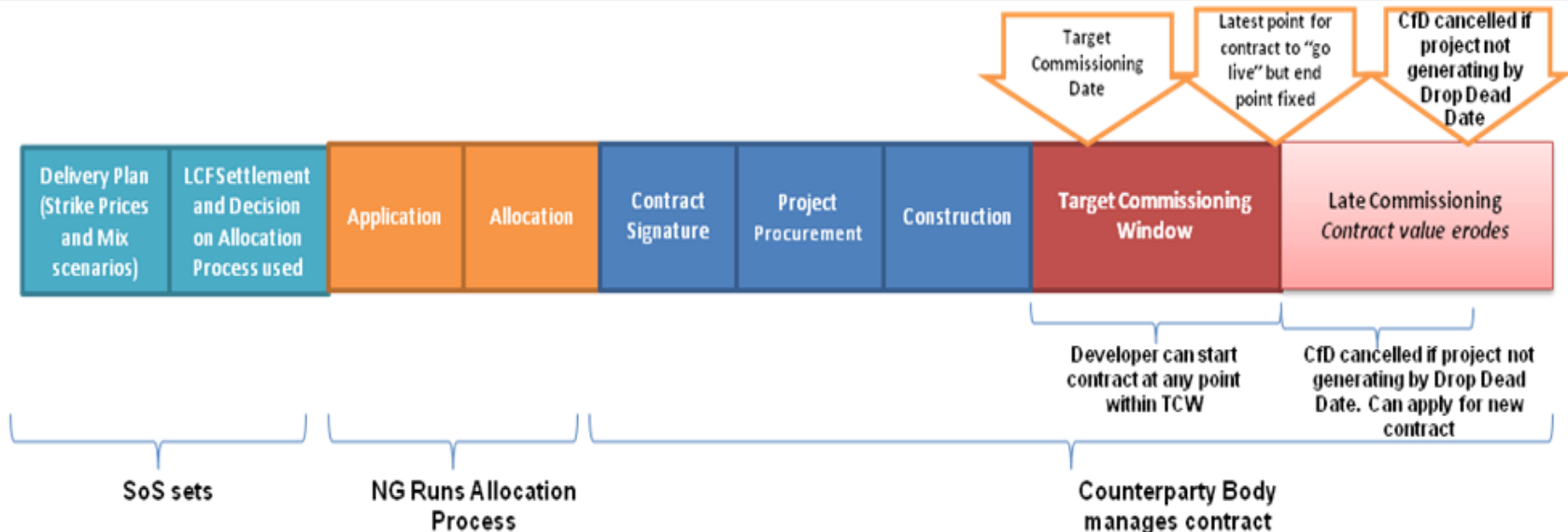
- **The Contract is allocated much earlier than under RO**, and earlier than previously proposed.
- **Strike prices are set out in contract**
- In order to obtain a CfD, developers will be required to apply to NG with the following information in their applications:
  1. Project details (e.g. type of generation, capacity, company details)
  2. Planning Permission
  3. Grid Connection Acceptance Letter
  4. Target Commissioning Date – which determines the strike price for the project.
- The above criteria may not be appropriate for all technologies and ongoing work will define alternative criteria where needed.

# Obtaining a CfD: the developer journey



Department  
of Energy &  
Climate Change

## Illustrative project timeline



- Subject to satisfying the eligibility criteria and there being budget availability, a project receives a signed CfD stipulating the following:
  - The Strike Price;
  - The Target Commissioning Date ("TCD") specified by the developer and a "window" around the TCD; and
  - The Longstop Date by which the project must commission.
- As long as the project commissions within the Target Commissioning Window it will be able to access the full value of the CfD.
- The appropriate lengths of TCW and longstop date for each technology are currently being defined.



# IMPLEMENTATION: HOW ARE WE MANAGING THE TRANSITION TO EMR

# Route-to-market: Power Purchase Agreements (PPAs)



Department  
of Energy &  
Climate Change

## What is the problem?

Responses to our call for evidence showed that the market has changed in recent years:

- Generators are receiving fewer offers
- Offers they do receive are on less favourable terms

## What are the drivers?

Less clear what drivers for change are:

- Lack of participation in the market (accounting, credit conditions and competition)
- Impacts of the RO regime
- Uncertainty around future costs of balancing/value of intermittent generation

## How will the CfD help?

The move to CfDs will have some positive impacts on PPAs:

- Removes the need for floor prices & reduces impact on balance sheets;
- But, we are mindful of the transition from the RO to CfDs.

### **Government way forward – 3 strands:**

1. Engaging with participants to ease the transition from the RO to CfD
2. Exploring options available to Govt. to improve PPA market under EMR
3. Taking powers to allow further action, if necessary, to improve liquidity



## Importance of liquidity:

- Liquid markets support competition in generation and retail markets
- Reliable pricing information and confidence about market access supports investment decision-making
- Liquidity should improve market conditions for all generators and support PPA providers, including new entrants
- Increases the robustness of the CfD reference price

## Process

- Ofgem is taking forward proposals to increase liquidity in the wholesale market and remains the primary vehicle for delivering regulatory reforms.
- Government has included backstop powers in the Energy Bill to promote market liquidity if industry and Ofgem do not deliver the necessary improvements.
- Ofgem has always stated that industry is best placed to deliver improvements. We believe that is the case but there is a diminishing window of opportunity.

## Timing

- Ofgem decision on whether to intervene and the shape of any intervention due before Summer 2013. Any changes to licence conditions would come in before the end of 2013.
- DECC will make a decision on whether to intervene after Ofgem has reached a decision on how to proceed with their reforms.

# Supporting Investment Decisions during the transition to EMR / CfDs



Department  
of Energy &  
Climate Change

- The existing Renewables Obligation continues to support investment:
  - Completion of 2012 banding review
  - Investors can still plan to enter the RO, but also have flexibility to enter CfD scheme
- Government is providing clarity on the operation of CfDs:
  - Clarity on significant contract terms this year
  - Price setting process underway, providing clarity during 2013
  - Initial CfDs allocated as early as 2014
- Support during the transition through the 'FID-Enabling' process:
  - Supporting investment decisions that require earlier certainty
  - Open to all forms of low-carbon generation

# Next steps



Department  
of Energy &  
Climate Change

| Date                 | Milestone  |
|----------------------|--|
| January 2013         | Closing date for responses to National Grid Call for Evidence supporting strike price setting        |
| July 2013            | CfD final contract published   |
| July 2013            | Draft delivery plan, including draft renewable CfD strike prices, published for consultation         |
| July 2013            | Further detail on CfD allocation and price setting processes for CCS and nuclear projects            |
| October 2013 onwards | Government consultations on secondary legislation for EMR  |
| By the end 2013      | Energy Bill receives Royal Assent (subject to Parliamentary time/decisions)                          |
| By end of 2013       | First delivery plan, including final renewable CfD strike prices published (subject to Royal Assent) |
| 2014                 | EMR delivery mechanisms up and running   |



Department  
of Energy &  
Climate Change