Department of Energy & Climate Change

Implementing Contracts for Difference:

Government response to consultation on CfD Regulations (Standard Terms and Modifications)

Implementing Contracts for Difference

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Introduction

From December 2013 until February 2014 DECC consulted[1] on proposals to control what must be in the standard CfD terms, their revision over time, and the ability for Generators to seek modifications of those terms before they sign.

The Government's Electricity Market Reform ('EMR') programme is designed to promote reliable, long term generating capacity that is both low-carbon and affordable. Contracts for Difference form a major pillar of EMR, seeking to encourage early and on-going investment in new generation by ensuring that developers have confidence over their short and medium-term return on investment.

These proposals focused upon powers introduced through late-stage amendments to the Energy Bill prior to its enactment and did not therefore form part of the earlier consultation undertaken by the Department.[2]

In particular, the consultation sought responses regarding provisions that must be included in any CfD terms issued by the Secretary of State, and on the procedural requirements regulating generator requests to modify those terms prior to contract signature.

The consultation also sought views on a number of smaller and related issues, including the assignation of particular generating technologies as either baseload or intermittent, and on the way in which the Department intends to consult when there is a need to revise the terms offered for new CfDs, for whatever reason.

In total, we received submissions from 14 respondents, of which the majority, 11, were electricity generators or suppliers, while others included delivery partners and trade associations.

In most cases, the responses received were content with the proposals. Where responses were positive but did not provide substantive feedback, these are not reflected in this document.

Next Steps

The positions set out in this Government Response will be reflected, where necessary, in the implementing secondary legislation due to be laid before Parliament in June 2014.

Subject to the will of Parliament, it is intended that the implementing legislation will come into force in Summer 2014. This allows for the first allocation of contracts for difference to take place this year. A more detailed timetable is set out in the Contracts for Difference Implementation Plan, published in the first week of April 2014.

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[1] https://www.gov.uk/government/consultations/consultation-on-regulations-for-contracts-for-difference-standard-terms-and-modifications

[2] https://www.gov.uk/government/consultations/proposals-for-implementation-of-electricity-market-reform

Executive Summary

In regulating within this area, our aims have been to achieve the following:

- To ensure that the CfD has the capacity change over time in order to adapt to new and evolving situations, while ensuring that it retains its essential nature, bolstering investor confidence in the CfD terms going forward.
- To enable a wider range of potential developers to access the benefits of the CfD regime by allowing them to request minor changes to the available CfD terms where this is necessary in order for them to be able to take part.
- To guarantee transparency through the publication of information concerning those who hold CfDs, who has received modifications and why they were successful, while dealing appropriately with commercially sensitive information.
- To establish more clearly the timelines and deadlines associated with the various CfD processes, so that all involved may enjoy greater confidence in their ability to participate at an appropriate pace.

On the basis of the submitted responses, the Government will take the following actions:

- Ensure that the concepts of Billing and Payment remain clearly represented throughout the ‘provision’ required within any CfD.
- Ensure that the release of new and revised Standard Terms and their entry into force is timed appropriately to allow potential applicants time to assess them and prepare pre-signature modification requests if required.
- Require in Regulation that any time periods which might affect applicants seeking pre-signature modifications are made clear in advance, as well as the time the Counterparty expects such applications to take.
- Ensure that the concepts of ‘minor’ and ‘necessary’ as defined within Regulation with regard to pre-signature modifications are as objective as practicable, limiting the potential for the use of Counterparty discretion and ensuring clarity for potential applicants.
- Require in Regulation that before publishing information regarding a Generator-party to a CfD there should be an attempt to identify and exclude commercially sensitive information following discussions with that Generator.
- Specify in Regulation that the Counterparty must issue an offer to enter into a CfD within a set time.

Analysis of Responses

1. CfD Terms

1. The Government proposed to limit the ability of the Secretary of State to issue and revise terms such that any set of terms so published would be required to contain certain minimum provision, proposing that the following feature in any future CfD:
    a. Term
    b. Calculation of Metered Output, Market Reference Price and Strike
    c. Change in Law Protection
    d. Installed Capacity Adjustment
    e. Conditions Precedent
    f. Liabilities, Remedies and Waivers
    g. Dispute Resolution
    h. Termination
    i. Change Control Procedures
2. We went on to set our intended policy for the revision of terms over time and the way in which we would manage that process, including a distinction made between technical, minor changes and more substantial material ones.
3. Finally, we established the relative timings to be associated with such revisions.
4. We asked a number of questions that related to the nature of and revisions to the terms that may be issued by the Secretary of State for use within CfDs, in particular:

Q1 **The use of required provisions seeks to promote certainty regarding the content of the Standard Terms over time and throughout multiple revisions while retaining necessary flexibility for the Secretary of State. What are your views on this rationale?**

Q2 **The definitions and processes for technical and material revisions to the Standard Terms by the Secretary of State seek to provide a process that is both fair to stakeholders and appropriately responsive – do you think the balance is right? If not, why, and how could the proposals be improved?**

Q3 **Are the periods of notice in advance of new terms entering into use appropriate, in your view?**

Q4 **Do you have any other concerns regarding the areas of proposed regulation and policy described?**

Q1 – Required Provision

5. Twelve respondents answered the first question, with all submissions satisfied with the approach described and most also noting that it offers the balance sought while agreeing that there was a need for the flexibility described. The Department can confirm that the

approach outlined remains unchanged in its policy, with key areas of the contract set out in regulation for continued inclusion in future contracts.

6. Three respondents made special note that they would wish 'billing and payment' to be included among the required provision. Drafting of the regulations on required provision will now make the requirement for this provision within any CfD clear throughout.
7. One respondent said that changes to the regulations in the future should not be applied to contracts that have already been signed. It remains the policy intention that contracts, once signed, may only be amended through the operation of the terms contained within them and should not be impacted by any subsequent amendments to regulation.
8. It is as a result of this that the CfD as drafted contains extensive provision for such amendments, and will continue to contain this provision as a result of its inclusion in paragraph 1 and subsequent reflection in regulation.

Q2 – Process for Revision

9. Thirteen respondents addressed the second question, with all respondents in favour of an approach that would ensure that there is an adequate period of consultation prior to any revision of terms, both in order to facilitate proper scrutiny and to ensure that there is ample time to seek modifications under the newly revised terms.
10. Five respondents either raised concerns on the split between timings for material and technical revisions or the lack of specific, defined periods. The Energy Act does not provide power to restrict or control the Secretary of State's obligation to consult. However, it is a matter of stated policy that a material revision should always be the subject of a more detailed and longer term consultation exercise.
11. Two respondents queried the definition of 'material' revisions, seeking clarity on our intent. As described within the consultation, this distinction applies where a revision either impacts upon the economic nature of the CfD or introduces substantial structural changes that make comparison to the prior terms difficult.
12. The economic point is a necessarily subjective standard, though within our policy undertakings we have sought to mirror the language found within the draft CfD itself in this regard, which refers to concepts such as a the 'risk-reward balance' within the terms.

Q3 – Periods of Notice

13. Twelve respondents addressed this question, and in almost every case drew attention to the importance of observing sufficient periods prior to the introduction of newly revised terms as to allow for processes to take place. Two issues in particular were raised by several respondents.
14. First, that there be sufficient time to allow for the terms to be assessed and for necessary pre-signature modifications to be identified, applied for and potentially agreed. This is a period that will necessarily alter according to the number and complexity of applications, but it is a risk that DECC will seek to ensure is accounted for when it plans the issuance of terms and the announcement of allocation rounds, the latter of which will be included in regulation as the key date at which modification requests may begin, including an announcement of the terms that are available to be modified.
15. Secondly, that the time taken for internal approval mechanisms, up to and including assent by a company's board of directors, be accounted for in the periods allowed. These times are inherently different from circumstance to circumstance and from organisation to organisation, but DECC will undertake to ensure that this, in a broad sense, forms a consideration in the same sense as the preceding issue.

16. Various suggestions were put forward for appropriate minimum periods to be observed, differing by as much as several months. Despite this lack of commonality, it was clear that it was an important issue to many respondents, and the Department will work to make certain that the issue of terms is timed appropriately by ensuring that announcements of allocation rounds are clear in their relevance to those seeking modifications.

Q4 – Other Concerns

17. Three respondents took the opportunity to raise other issues with the concepts described in the first chapter of the consultation.

18. One respondent noted that the mere existence of the ability to revise CfD terms might negatively impact the market due to the uncertainty this naturally implies. This risk is managed by the control of the circumstances in which revisions will occur, including a requirement that the Department consult, and the fact that existing, signed CfDs are unaffected by any revisions made to the CfD terms available for new signatories.

19. Another queried whether there would be a means by which industry might suggest revisions to the standard CfD terms. There is no formal mechanism proposed for this to occur, though nothing prevents engagement with the Department in order to enable the terms offered to continue to reflect both the design and policy intent expressed at the outset of the scheme and prevailing market conditions.

20. Finally, one respondent made note of the fact that particularly common pre-signature modifications might eventually lead to revisions to the CfD terms, and sought confirmation that this would be the case. The standard terms will remain under review and although the Department cannot provide an undertaking to incorporate common pre-signature modifications, these would form one of a number of available sources for revision.

2. Pre-Signature Modifications

21. We set out a clear process for the request and consideration of pre-signature modifications, including establishing the tests that the CfD Counterparty would undertake in assessing whether a given modification is ‘minor’ and ‘necessary’.

22. We posed five questions in relation to the ability for generators to apply for and receive pre-signature modifications to the CfD terms otherwise offered:

Q1	**The proposed process for requesting modifications seeks to balance flexibility whilst maintaining the balance of risk in the Standard Terms. On this basis, how do you view the proposed process?**
Q2	**The definitions of 'minor' and 'necessary' aim to ensure that only minor reasonable requests can be accommodated. In light of this, how do you view the definitions?**
Q3	**These proposals aim to ensure open and public access to as much of the modification process as is commercially practicable. What are your views on the publication of modification requests and decisions, and the redaction of commercially sensitive information?**
Q4	**How might these processes be altered to enhance access for smaller or independent generators?**
Q5	**Are there any ways in which the proposals under this section be improved while still achieving the goals outlined?**

Q1 – Modification Process

23. All respondents provided views on the pre-signature modification process as described. Most were in favour of the detail given, though a small number raised specific issues.

24. Three respondents noted that there is no provision for an appeals process in those cases where the Counterparty refuses a pre-signature modification. In two cases, the use of Ofgem as an appeals body to review the Counterparty's decision-making was proposed. Although the Department recognises the importance that certain generators will attach to the receipt of a modification agreement, the amount of time available to engage in the modification process in advance of allocation closing is already highly limited.

25. Although sought by these respondents, the addition of a dedicated appeals process in addition to the requirement that the Counterparty would burden delivery substantially without any clear means of mitigation.

26. The Counterparty will be under a duty to disclose its reasoning to any modification applicant it presents a decision to, ensuring that there is transparency and an ability to re-assess and re-submit even where there is no formal means of appeal, with no limitation on the number or frequency of applications for modification.

27. This addresses concerns raised by two further respondents, who commented that the Counterparty might fail to provide such explanation. It is also important to note that the exercise of the Counterparty's actions will be guided by a guiding principle and framework document that will be published later this year.

28. One respondent sought clarity on the time it is likely to take the Counterparty to consider and respond to an application for a pre-signature modification. The uncertainty that surrounds both the number and the nature of potential modification requests makes it impractical to give a defined period within which assessments will occur, and it is therefore inappropriate to include a required response time within regulation. Instead, the Secretary of State will establish which terms are available for applicants to seek to modify at the same time that he announces a forthcoming allocation round.

Q2 – 'Minor' and 'Necessary'

29. Twelve respondents made comments on the proposed approach to defining what the Counterparty will consider to be of 'minor effect' and 'necessary'.

30. A repeated concern arose around the level of subjectivity which might exist within the narrative test described. As far as is practicable, the binding Regulation to be employed by the Counterparty in assessing modification requests will be objective and clear, and will not hinge upon excessive exercise of Counterparty discretion.

31. In line with this, respondents were supportive of the concepts put forward even where they raised these concerns. 'Risk' and 'Reward' are not objective concepts, but they do make clear that the Department intends to bar any attempt to gain advantage through the use of a modification. The Department will seek to ensure that the Regulations are clear on this point.

32. One respondent suggested that 'necessity' be defined with reference to the aims of the Energy Act 2013, implicitly referring to the matters that the Secretary of State is obligated to have regard to by section 5(2) of that Act. These include carbon budgets, security of supply, cost to the consumer and EU Law as it relates to renewable generation. While these are important, and have formed part of the policy process, they are not appropriately specific or relevant standards by which to judge alterations to individual contracts.

33. Another respondent drew our attention to the potential to pursue modifications that seek to achieve the same ‘balance’ of risk and reward by increasing risk while decreasing reward, or vice versa, potentially in a way that the applicant in question is more capable of hedging. It is our intent to bar any change in the absolute levels of risk and reward, and the drafting of the regulation will reflect this.

34. Finally, it was noted by a single respondent that it might be possible to modify the terms of a CfD before signing while keeping to the policy intent of the regime and without the need to refer to ‘necessity’ at all. The Department is keen to ensure that CfDs are as standardised as possible in their form and that modifications are as rare as is practical. Even were this not the case, the Energy Act requires that ‘necessity’ form one of the tests applied by the Counterparty.

Q3 - Transparency

35. Eleven respondents commented on the proposals to publish aspects of pre-signature modification agreements received by Generators and of CfDs entered into with or without such a modification.

36. There was clear support for both proposals, with nine respondents in favour of publication, most often on the basis that it would aid in transparency, though others highlighted the utility in having access to an expanding catalogue of successful modifications in order to aid in preparing future applications.

37. In spite of this broad positivity, there was a recurrent concern about the ability for applicants to guarantee that the information they submit will be protected from publication where it is commercially sensitive. Although the consultation contained an undertaking that an ability to agree the redaction of sensitive information with the Counterparty will form part of the pre-signature modification application process, it is clearly an important aspect for many stakeholders.

38. Regulations will reflect this concern, requiring that the Counterparty work with affected parties where there is the potential for the publication of information regarding them in the public register of modifications, and will not hinge solely upon a unilateral determination of commercial sensitivity by the Counterparty.

39. A single respondent put forward a concern that pre-signature modifications might themselves provide a commercial advantage, and should not therefore be the subject of publication as any advantage gained would therefore be lost. As noted in paragraph 31, modifications are intended to be barred where they seek to establish a commercial advantage, and this is not an issue expected to arise within the regime.

Q4 – Smaller Generators

40. Five respondents addressed this question, addressing the issue of smaller generators. Three stressed the importance of clear guidance on the way in which the modification process will operate, and on the way in which the Counterparty is likely to exercise its residual discretion. This was seen as particularly important for smaller generators who will lack the resources larger applicants might have in order to pursue a modification, and who will depend far more upon the information made available by the Department and by the Counterparty.

41. One respondent queried the way in which modifications would be funded. As with most functions carried out by the Counterparty pursuant to the Energy Act, it will recover the costs associated with managing the process via the Supplier Obligation, the form and function of which is not the subject of this consultation. No costs relating to the modification application itself will be directly recovered from applicants for modifications.

42. Finally, a single respondent commented that the Counterparty could aid smaller generators by appointing a case officer or similar for each such applicant, to aid them in

preparing a successful application in the first instance. It is not currently envisaged that such support will be available to any generator.

Q5 – Potential Improvements

43. Five respondents offered proposals for improving the process while keeping to the policy objectives.

44. One respondent suggested that successful modifications should automatically be available to other applicants in order to improve the efficiency of the process. The Department considers that this approach would undermine the need for a modification to be 'necessary'. However, our intent to publish details of successful modifications will aid applicants in preparing their applications accordingly.

45. Two respondents voiced concern that modifications put those who legitimately require them at a disadvantage due in part to the potential for the modification process to delay or postpone their entry into an allocation round. This latter concern was supported in particular by one respondent, noting that simply requiring that the Counterparty provide a determination within a 'reasonable time' would not be sufficient to provide the comfort that applicants would depend upon.

46. As a recognised risk, consideration has been given to requiring that the Counterparty conclude modification agreements or refusals within a set period, however this has been rejected as impractical given the elastic nature of the demand that will be placed upon the Counterparty as the CfD programme develops.

47. Instead, regulation will ensure that deadlines and estimated times for response are made clear appropriately well in advance, ensuring that individual applicants are able to plan accordingly. Notably, not all modifications will require the same amount of time to assess as one another, with simpler requests likely to see a faster response.

48. Finally, one respondent put forward the point that the 'generic' CfD terms, however well drafted, may be fundamentally unsuitable for certain technologies, and that modifications might aid in providing technology-specific changes in advance of the release of a tailored 'category' of CfD terms for that technology. Such a modification may be acceptable where that modification providing it fulfils the required 'minor' and 'necessary' criteria, ensuring that it does not provide an inappropriate commercial advantage to any generator.

3. Notification and Contract Offer

49. The Government put forward a process for the completion and offer of a CfD that sought to avoid unreasonable uncertainty for applicants.

50. We raised a single question concerning the processes that will govern the interaction between the Notification released by National Grid and the offer of a contract by the CfD Counterparty:

Q1 In your view, will the proposed mechanisms for notification and offer to contract function effectively? How might they be improved?

Q1 – Contract Offer

51. Nine respondents offered views on the mechanics of contract offer and acceptance.

52. Five respondents queried the lack of a time limit within which the Counterparty must offer a contract following the receipt of a notification, instead only providing for this to occur within ‘a reasonable time’. Responding to this concern, regulations will now set out that the Counterparty must offer a contract within ten business days of receiving a notification, accompanied by a requirement that an acceptance also be returned within ten business days.

53. As far as is practical the Counterparty will be placed in a position where the exercise of its discretion with regard to the offer of a contract will be minimal. It retains the potential for the exercise of discretion in certain areas beyond this, particularly when agreeing pre-signature modifications. This desire for a purely mechanical, formulaic approach to contract offer and signature was supported by two respondents, who in each case noted the benefit associated with such clarity.

54. Two respondents expressed concern regarding the period after which an offer will be withdrawn. In both cases it was suggested that the Counterparty might have discretion to extend the validity of any offer on a case-by-case basis. The Department disagrees with this approach, as it violates the stated principles of predictable and uniform treatment of applicants, while increasing the burden upon the Counterparty and calling for what might potentially be a highly subjective assessment of a Generator’s worthiness for an extension.

55. Two respondents noted that a period of weeks or months, rather than days, would be necessary to gain the approval required from their boards or other internal structures. There is not sufficient time available within the timelines envisaged before and after allocation occurs to permit this, and the Department would expect that such approval would be gained on the basis of the Standard Terms applied for (modified or otherwise) at or prior to application, rather than at the point of contract offer, an expectation supported by other respondents.

4. Baseload and Intermittent Technologies

56. The Department asked two questions with regard to the assignation of technologies to either ‘baseload’ or ‘intermittent’ status:

Q1 What are your views on the proposals for the technologies to receive the baseload and intermittent reference prices?

Q2 What are your views on the potential need to make alternate arrangements for smaller generators (supported, where possible, by evidence)?

Q1 – Designation of Baseload and Intermittent Generating Technologies

57. Ten respondents offered their views on the division of technologies between different reference prices, with eight supporting the lists of technologies put forward as matching the generally-accepted view of what constitutes intermittent and baseload generation.

58. One respondent noted their belief that certain aspects of solar photovoltaic generation meant that it might more appropriately be classified as baseload; predictability, low cost of balancing and a pattern of generation that inherently coincides with periods of high demand. Although many intermittent technologies feature individual elements that might militate in favour of their being considered otherwise, in general the consistency and the degree of control a generator may exert over that source of generation are distinct from that found in a baseload technology. Although Solar PV is consistent, it is inherently uncontrollable, dropping to little or no output for large parts of the day.

59. Similarly, the same respondent questioned whether certain forms of hydroelectric generation, in particular run-of-river, might not better be described as intermittent. While aspects of run-of-river generation do align with intermittent generation, it remains more consistent and reliable than the intermittent generating technologies listed within the consultation, and it is our policy to treat all forms of hydroelectric generation alike.

60. One respondent raised a concern that the assigned reference price represents an arbitrary division of technologies that does not necessarily reflect the ability for those technologies to hedge the price they are assigned. The Department seeks to ensure that a given technology is able to achieve a reasonable approximation of the reference price it is assigned. While the ability to hedge the reference price might vary somewhat from technology to technology, the intention is to ensure that the technology receives the reference price that best suit its individual characteristics.

Q2 – Smaller Generators

61. Seven respondents made comments concerning the ability for smaller generators to participate in the enduring CfD regime.

62. Of these, three opposed any measures designed to aid such generators, either feeling that the regime is not designed to support smaller Generators and should not be compromised in order to allow for their participation, or that it was suitable at present.

63. Four other respondents felt that some degree of intervention was justified, though of these three restricted their views to suggesting an appropriate cut-off capacity at which to judge a Generator ‘small’.

64. The Department has also engaged directly with stakeholders on this issue and is currently considering the evidence on the ability of smaller generators to achieve the baseload market reference price. An update will be provided in due course.

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