



Department
of Energy &
Climate Change

Consultation on directions to offer Contracts for Difference: government response

June 2014

URN 14D/185

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Introduction

1. The Electricity Market Reform (EMR) programme is promoting investment in secure and low-carbon electricity generation, while improving affordability for consumers. As part of the EMR programme, Contracts for Difference (CFDs) will provide long-term price stabilisation for low-carbon plant, allowing investments to come forward at a lower cost of capital and therefore at a lower cost to consumers.
2. In March 2014 the Government consulted¹ on regulations that will govern the process by which the Secretary of State can direct the Low Carbon Contracts Company (LCCC)² to enter into CFDs with eligible generators. This route to a CFD is separate to the generic CFD allocation process which is the route that will be used by almost all generators seeking a CFD³. A draft of the proposed regulations was included in the consultation. The consultation also included a proposal to develop and extend the definition of 'eligible generator' that the Government previously consulted on⁴.
3. 22 responses were received to the consultation. This document includes a summary of the responses and sets out the decisions the Government has now taken. A list of all respondents is included in Annex A.
4. The decisions taken following this consultation are reflected in the secondary legislation, in part 10 of The Contracts for Difference (Allocation) Regulations 2014 and regulation 3 of The Contracts for Difference (Definition of Eligible Generator) Regulations 2014. This secondary legislation will be laid in Parliament in June 2014, and is expected to come into force at the start of August 2014.
5. The Government's aims have been to achieve the following:
 - to ensure that regulations are in place that will govern the process by which the Secretary of State can direct the LCCC to offer a CFD to an eligible generator; and
 - to ensure that the definition of eligible generator in regulations is sufficiently broad to allow the Secretary of State to issue a direction for a CFD to be offered to any project that uses a relevant low-carbon generation technology across a broad range of appropriate project structures.

¹ <https://www.gov.uk/government/consultations/electricity-market-reform-emr-contracts-for-difference-regulations>

² The Low Carbon Contract Company (LCCC) is a Government-owned limited liability company. LCCC will be designated as a CFD counterparty and is intended to be the only CFD counterparty for the foreseeable future.

³ For more information on the generic CfD allocation process please see the recently published *Implementing Electricity Market Reform* and the Government response to *Electricity Market Reform: Consultation on proposals for implementation*

⁴ <https://www.gov.uk/government/consultations/proposals-for-implementation-of-electricity-market-reform>

Actions following the Consultation

6. On the basis of the submitted responses, the Government has decided that:
 - the process for the Secretary of State to direct the LCCC to offer a CFD to an eligible generator will be in line with the regulations included in the consultation document;
 - the definition of 'eligible generator' will follow the principles set out in the consultation document. In particular, the definition will build on the language in the October consultation⁵ and extend the scope to include 'associated' corporate bodies as set out in section 67 of the Energy Act 2008⁶; and
 - regulations will include a requirement that all CFDs entered into following a direction to offer are published.

⁵ <https://www.gov.uk/government/consultations/proposals-for-implementation-of-electricity-market-reform>

⁶ http://www.legislation.gov.uk/ukpga/2008/32/pdfs/ukpga_20080032_en.pdf

Analysis of Responses

Overview

7. The consultation document included draft regulations that would govern the process by which the Secretary of State can direct a CFD Counterparty to offer a CFD to an eligible generator. The Government asked two questions about the draft regulations.

Q1 - Do you agree that the regulations contained in Annex A set out an appropriate process for the Secretary of State to direct the CFD Counterparty to offer a CFD to an eligible generator?

Q2 - Do you have any other comments on the wording of the regulations contained in Annex A?

Issues raised in response to these questions are summarised and analysed in Section 1 of this chapter.

8. In addition, the Government proposed a change to the definition of eligible generator and asked one question about that proposal.

Q3 - Do you agree that the definition of an eligible generator should follow the principles set out in paragraph 14 and 15 of this consultation?

Issues raised in response to this question are summarised and analysed in Section 2 of this chapter.

Section 1: Comments on the proposed regulations

Q1 - Do you agree that the regulations contained in Annex A set out an appropriate process for the Secretary of State to direct the CFD Counterparty to offer a CFD to an eligible generator?

Q2 - Do you have any other comments on the wording of the regulations contained in Annex A?

9. Of the 22 responses to these two questions, the majority (13 respondents) agreed that the regulations set out an appropriate process with the remaining responses being mixed, neutral or negative towards the proposals. The issues raised by stakeholders are summarised below.

Issue 1.1: Contracts should be published

10. Five respondents commented that the details of any CFDs offered following a direction from the Secretary of State should be published or that the direction should be published. One such respondent requested that confidential information within the contract should not be published.
11. In response to these comments, the Government has included a provision in the regulations will require the LCCC to publish CFDs that they enter into in accordance with a direction from the Secretary of State. This provision is based on the Investment Contract publication requirements in the Energy Act 2013. Certain commercially sensitive information will not be published (reflecting the provisions of Schedule 2 to the Energy Act 2013), but the key commercial terms, the strike price and the reference price will be published. Although some respondents asked for the direction to offer to be published, the drafting in the regulations follows the previously accepted approach approved by Parliament for Investment Contracts and we do not consider that there is value in publishing directions as the contracts will be made available.

Issue 1.2: Clarity needed on the types of projects that might be offered CFDs

12. Eight respondents commented that the powers given to the Secretary of State are too broad and that the regulations should specify criteria that must be met or a process that must be followed before a direction to offer can be given. For example regulations could restrict the power to situations where there is a 'clear business case', to 'large and unusual' projects or to those with challenges of size and timescale. Another suggestion was that this power should be restricted to projects that are not eligible for the generic CFD allocation process except in certain specified circumstances. Others asked for the regulations to include provisions to ensure the Secretary of State takes into account budget impacts and the impact on other projects before making a direction to offer a CFD.
13. The Government may consider adding further restrictions to these powers in future amendments to the regulations. However, the immediate objective is to maintain the Secretary of State's flexibility and discretion to determine how best to allocate contracts, this flexibility is particularly valuable in the early stages of the implementation of the CFD framework. Any decisions to offer a CFD will be subject to the usual financial management and budgetary constraints (as described in paragraphs 18-20) and subject to public law requirements such as rationality of decision making.

14. Administrative strike prices for a number of current and emerging technologies including nuclear and CCS, large hydro and tidal range (including tidal lagoon and tidal barrage) were not set in the Delivery Plan. This means that it is not currently possible to use the generic CFD allocation process to offer CFDs to projects using these technologies.
15. Reflecting this, it is the Government's intention that the power to direct the LCCC to offer CFDs outside of the generic CFD allocation process may be used for nuclear, CCS, tidal and large hydro in line with the Government's stated policy objectives in relation to the deployment of these technologies.
16. In addition, this power may be used as a transitional measure to allow offshore wind generators with a signed Investment Contract to exercise their right in the Investment Contract to change the ownership of one or more phases of the project. Such a change in ownership would technically require a new contract. This new contract would have to be a CFD between the new owner and LCCC because the Secretary of State will no longer be able to enter into new 'Investment Contracts' as defined in the Energy Act 2013 once the CFD regulations come into force. LCCC will require a direction from the Secretary of State in order to offer such a contract. In such a circumstance the commercial terms of the CFD would be the same as the replaced Investment Contract so there would be no net impact on the Levy Control Framework (LCF).

Issue 1.3: Clarity needed on how budget will be used

17. Nine respondents called for clarity on how budget used for bespoke CFDs will impact on the overall LCF, how competing budget interests will be settled and whether CFDs offered outside the current LCF period will reduce the budget available to other projects in the current LCF period. A particular concern of the stakeholders was that participants in the generic process should have visibility of the budget impact of any directions to offer CFDs well in advance of an allocation round.
18. Ahead of the implementation of Electricity Market Reform, the Government has updated and improved the governance arrangements for the LCF to incorporate the new CFD scheme. These arrangements will oversee all levy schemes within the low carbon electricity portion of the LCF, including the release of budget to the delivery body for the generic CFD allocation process and for contracts outside of the generic allocation process where identified for support.
19. CFD payments to new nuclear generation are not due to be made in this LCF settlement period (i.e. before 2020/21). Funds to support CFDs for new nuclear generation would, therefore, be allocated from any future LCF settlement period, after 2020/21. CFDs for CCS projects are intended to be funded from the existing LCF and the budget for these will be allocated separately from the CFD budget for renewables.
20. The portion of the LCF that is made available to the generic CFD regime will be set in light of all calls on the funds available within the LCF such as spend on the RO, ssFiT and CFDs. If a CFD is offered following a Secretary of State direction to a project that is expected to commission within the current LCF period it would have an impact on the budget available for all schemes covered by the LCF including the generic CFD allocation regime. The Government will provide developers with appropriate information on budgets to inform their investment plans through the Annual Update, Budget Notices

(published before each allocation round) and other communications. The ‘EMR Contracts for Difference Implementation Plan’⁷, which was published on 7 April, sets out detailed implementation activities and milestones.

Issue 1.4: Clarity needed on the process that will be followed

21. Five respondents called for clarity on the application process and the process for negotiating CFDs with some requesting that this should be as transparent as possible including publishing details of compliance with State Aid guidelines. Two respondents called for a requirement to consult on the CFD to be offered before a direction to offer is made. One respondent called for there to be competition for all CFDs offered using this route. One respondent asked for parliamentary scrutiny of all CFDs offered using this route.
22. As described in paragraph 13, the immediate objective of the Government is to maintain the Secretary of State’s flexibility and discretion as the policy develops beyond the generic CFD allocation arrangements. If the Government creates any new processes for applying for a CFD it would be the Government’s intention to clearly describe how the process would operate and to engage with stakeholders during the design. Bilateral negotiation will remain as an option where competitive processes are not likely to be practical or effective.
23. While the Government aims to be as transparent as possible, details of any negotiations with developers over contract terms must be kept confidential in order to allow the Government to secure the best possible deal for consumers. During any negotiations developers would share commercially sensitive information that is necessary in order to agree a price that represents good value for money. However, as mentioned above, any CFDs entered into following a Secretary of State direction to offer will be published once they are entered into, including the key commercial information, the strike price and the reference price.
24. The Government is working with the European Commission to ensure that its policies are compliant with State aid rules. State aid issues are a bilateral matter between the Government and the European Commission. In order to maintain effective working relationships with the Commission it is not possible to provide an on-going account of this process. However, the European Commission will publish its decisions on State aid matters.
25. The Government has a long standing commitment to move to technology neutral competitive allocation approaches across all low carbon generation technologies as soon this is practical and effective. This commitment is also in line with the recently revised State aid guidelines. The guidelines require a move to an increasingly competitive electricity market but allow Member States some flexibility in the way in which they achieve this. The Government’s approach to CFD Allocation is designed to bring about a transition towards technology neutral competition between low carbon generation technologies in a way which enables the UK to reach the European Union’s 2020 Renewable Energy Directive targets, while minimising the cost to the consumer.

⁷https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/301464/cfd_implementation_plan.pdf

26. The Government considers that there may be circumstances where competition is not possible or does not represent the most cost effective option for some low carbon technologies. In such circumstances the Government will consider whether competition is appropriate on a case by case basis. Any decision to direct the LCCC to offer a CFD would still be subject to strict value for money considerations and the funds available within the LCF. The Government will continue to engage with stakeholders in developing any new arrangements for applying for a CFD outside the generic allocation process.
27. It is currently intended that the Annual Updates to the Delivery Plan would set out how many CFDs have been signed, and details on their delivery year and capacity. Any decision to offer CFDs through the direction route would also be included in the Annual Update (while the CFDs themselves would be published). The Government regularly reports on progress on large infrastructure projects through updates to its National Infrastructure Plan – this includes projects such as Hinkley Point C, the CCS commercialisation programme and HS2. The Government takes the view that a requirement to lay the contracts before Parliament should not be included in the regulations when the Energy Act 2013 does not impose it.

Issue 1.5: Impact assessment

28. Three respondents proposed that an impact assessment should be prepared for each CFD offered through this route.
29. Before making a direction to offer a CFD, the Secretary of State will have to take into account many of the factors that stakeholders suggested could be included in an impact assessment, such as why the generic process is not appropriate, the strategic importance of the capacity and its impact on the LCF and State aid considerations as described above. The Government would set out more details of its considerations in relation to new process for applying for CFDs in the event that such new processes are created. However, the Government does not consider that it is appropriate to fix a process in regulations at this stage because of the need to retain flexibility.

Issue 1.6: Timings proposed are not workable

30. Three respondents made comments about the suggested timings in the regulations. One suggested that it was not workable to provide the generator with the direction before the LCCC makes the CFD offer. Others were concerned that the regulations would allow the Secretary of State to set unreasonably long or short timelines.
31. The generator will have taken part in negotiations or an allocation process before a direction to offer is made by the Secretary of State and would therefore be aware that a contract is likely to be offered before it is offered. The Government does not consider that any difficulty would be caused by the generator seeing the direction to offer before they are offered a contract. At this stage it is difficult to fix all of the time periods (such as the period for which an offer will be open for acceptance) because the details of the contracts that will be offered are not known (such as the number of parties, complexity, corporate arrangements, etc.). However, the Government is aware of the concerns of some stakeholders in relation to an open ended offer, which is why the regulations require the Secretary of State to specify an expiry date in the direction to offer. The Secretary of

State will have to act reasonably in setting the period for which the offer is open for acceptance, as a matter of general public law.

Issue 1.7: Treatment of applicants to the generic CFD allocation process

32. Several respondents gave further suggestions for specific situations that should or should not exclude a project from being offered a CFD through this route. The Government received comments for and against preventing a developer who was unsuccessful in the generic CFD allocation process from being offered a CFD through this route.
33. In general, the Government does not expect that this route will be used by any project that is able to apply for a CFD through the generic CFD allocation process. However, there is a need to retain flexibility to deal with unexpected situations, so it is not appropriate to include this restriction in the regulations.

Issue 1.8: Regulations should not constrain the terms that can be offered

34. One respondent requested that the regulations should expressly state that the Secretary of State is not bound by the generic CFD terms when making a direction to offer a CFD. This is not necessary as neither the Energy Act 2013 nor the proposed regulations restrict the terms that can be offered following a direction to offer. In practice the contracts offered using this route will be Contracts for Difference as defined in the Energy Act 2013 and we expect that they will be based on the generic CFD terms.

Section 2: Comments on the proposed definition of 'eligible generator'

Q3 - Do you agree that the definition of an eligible generator should follow the principles set out in paragraph 14 and 15 of this consultation?

35. Of the 15 response to this question 11 agreed with the proposed approach with the remaining responses being split between the proposal being too broad and not broad enough.

Issue 2.1: Proposed definition is too broad

36. Two respondents were concerned that the definition would allow a CFD to be offered to a party that was legally remote from the project and that consideration should be made of the remaining ownership of the project.
37. The Government wishes to retain flexibility related to the ownership structure of a project in order to ensure that viable projects are not unintentionally excluded from the CFD regime. However, the Government is also mindful of the risks highlighted and these would be taken into account during any negotiation process and when deciding whether to make a direction to offer a CFD to a particular person.

Issue 2.2: Proposed definition is not broad enough

38. One respondent was concerned that the proposed definition may preclude certain commercial arrangements which could be applied to CCS projects, particularly given that the transport and storage elements of such projects may be operated by a person other than the electricity generator. The Government considers that there is not sufficient evidence to consider expanding the definition at this stage. However, this could be amended at a later stage if it can be demonstrated that the definition prevents otherwise viable projects from being offered CFDs.

Issue 2.3: Clarification on the meaning of 'participate'

39. One respondent sought clarification on the meaning of 'participate' in the eligible generator definition. This is a term that is used in the Energy Act 2013 and is not further defined, therefore it has its ordinary English meaning.

Issue 2.4: Timing of when the regulations will come into force

40. Two respondents noted that it is important that the CFD Allocation Regulations, and specifically the definition of 'eligible generator', do not come into force before a CFD Counterparty is designated. The Government is aware of this concern and for this reason intends to designate the LCCC as a CFD Counterparty by the time the regulations come into force. It is not therefore necessary to add such a provision to the regulations.

Issue 2.5: Publishing final regulations for consultation

41. One respondent expressed dissatisfaction that the consultation did not include a draft of the eligible generator definition regulations. The Government considers that stakeholders were given sufficient information to be able to comment on the proposal as draft regulations relating to the eligible generator definition were published for consultation in October 2013.

Annex A – List of consultation respondents

Carbon Capture & Storage Association (CCSA)
Ecotricity
EDP Renewables (EDPR)
E.ON
National Grid
Renewable Energy Association (REA)
Shell
SSE
Statoil
Coalpro
EDF Energy
Horizon
New Earth Solutions Group
RenewableUK and Scottish Renewables (RUK & SR)
SmartestEnergy
Statkraft
The Banks Group
Scottish Power
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