



Department
of Energy &
Climate Change

Contract for Difference: allocation process high level summary

Update to 9 April document

23 June 2014

© Crown copyright 2014

URN **14D/224**

You may re-use this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence.

To view this licence, visit www.nationalarchives.gov.uk/doc/open-government-licence/
or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU,
or email: psi@nationalarchives.gsi.gov.uk.

Any enquiries regarding this publication should be sent to us at [insert contact for department].

Contents

1.	Introduction	4
2.	Announcement of allocation round and budget.....	4
3.	Eligibility	5
4.	Applications	5
5.	Valuation	6
6.	Notice of auction and submission of sealed bids	6
7.	Auction(s).....	7
8.	Audit.....	8
9.	Notification	8
10.	Allocation Delays.....	9
11.	Withdrawal and Contract Signature and Performance Incentive Scheme	9
12.	Changes since April	9
12.1.	Contract Signature and Performance Incentive Scheme	9
12.2.	CFD Eligibility Criteria Update.....	10
12.3.	Auction	12
12.4.	CFD's outside the generic allocation process	12
12.5.	Eligible Generator	12
	Annex 1: Background to Auction Design.....	13
	Schedule Timeline: Allocation Process	15

1. Introduction

- 1.1. The Secretary of State intends to instruct the Low Carbon Contracts Company Limited (LCCC) to offer contracts for difference (“**CFDs**”) to eligible generators through a competitive allocation process.¹ This document provides a high level summary of the allocation process. An indicative timeline of the allocation process is set out in the Schedule at the end of this document.
- 1.2. The details of the allocation process are contained in the following documents² which will operate in conjunction with each other:
 - the Contracts for Difference (Allocation) Regulations 2014 (the “Allocation Regulations”);
 - the Contracts for Difference (Definition of Eligible Generator) Regulations 2014 (the “Eligible Generator Regulations”); and
 - an Allocation Framework applicable to an allocation round. An Allocation Framework applicable to the first allocation round will be published at least 10 working days in advance of the allocation round opening for application.
- 1.3. Each of the key stages in the allocation round are summarised below.

2. Announcement of allocation round and budget

- 2.1. In accordance with Part 2 of the Allocation Regulations, the Secretary of State will establish an allocation round by a notice. The Secretary of State will also (i) identify in a framework notice the Allocation Framework which applies a particular allocation round, and (ii) set out in a budget notice the budget which applies to an allocation round and how the budget is to be divided. The budget notice is to be issued no later than 10 working days before an allocation round opens for applications.

¹ Some contracts for difference will be offered to eligible generators outside of the competitive allocation process described in this document.

² These documents are to be made under powers contained in Part 2 of the Energy Act 2013.

- 2.2. The budget may be divided into one or more parts, referred to as 'pots' in respect of particular groups of technologies (for example, established technologies and less established technologies). The budget may also be subject to minima and/ or maxima, set by reference to budget or capacity levels, for particular technology types. The budget will be divided (not necessarily equally) for each delivery year of the allocation round.

3. Eligibility

- 3.1. Only an eligible generator may be awarded a CFD. The Eligible Generator Regulations define who is an eligible generator. DECC consulted on the components of this definition in October 2013 and in March 2014³. A response to this consultation will be published alongside this document.
- 3.2. In accordance with Part 4 of the Allocation Regulations, the Delivery Body will determine whether an application made by an eligible generator qualifies to take part in the allocation process applicable to the type of application. The Allocation Regulations and the Allocation Framework set out the information to be supplied in support of an application. Applications must be made in accordance with the Allocation Regulations and the Allocation Framework.
- 3.3. Where the Delivery Body determines that an application is not a qualifying application, the affected applicant may request the Delivery Body to review a non-qualification determination. The evidence to be submitted by an applicant on a review must relate directly to the information supplied at application. If unsuccessful, an applicant may appeal to Ofgem and then the High Court or Court of Session.

4. Applications

- 4.1. The general and additional requirements for applications are set out in Chapters 2 to 4 of Part 4 of the Allocation Regulations. In summary, an applicant must have in respect of an application the relevant planning consents and a grid connection agreement. Where supplemental requirements are necessary these will be set out in the Allocation Framework.

³ EMR: Contracts for Difference Regulations, Consultation on Directions to Offer Contracts for Difference, March 2014, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/295033/consultation_directions_offer_contracts_for_difference.pdf

- 4.2. Information to be submitted in support of a CFD application is to cover all the CFD Unit specific information required for a CFD contract to be offered by the LCCC. This includes the expected capacity in megawatts of the CFD Unit (referred to as Initial Installed Capacity Estimate in the CFD) and the expected target commissioning dates (referred to as Target Commissioning Date and Target Commissioning Window in the CFD) for electricity generation once the generating station has been established or altered.
- 4.3. An allocation round will remain open for applications for a period no shorter than 10 working days.

5. Valuation

- 5.1. The Delivery Body will value all qualifying applications for each delivery year – the years in respect of which strike prices have been set and published - using the valuation formula set out in Schedule 1 of the Allocation Framework. Any additional variables that may be required to be used in the valuation formula e.g. indexation, will be provided by the Secretary of State prior to the start of the allocation round.
- 5.2. The Delivery Body will then determine whether or not the valuation of all applications exceeds the relevant part of the budget and/or any minima or maxima capacity thresholds. If the total sum of the valued applications exceeds a part of the budget or a minimum or maximum, the Delivery Body will proceed to hold an auction for the relevant part, minimum and/or maximum. If no auction is necessary, the relevant Applications will be offered a CFD at the prevailing administrative strike price. The current administrative strike prices were published in in the EMR Delivery Plan by DECC on 19 December 2013 and these are replicated in the Allocation Framework⁴.

6. Notice of auction and submission of sealed bids

- 6.1. If an auction is necessary, the Delivery Body will, in accordance with the Allocation Framework, issue a notice of auction inviting all qualifying applicants to submit a sealed bid. Sealed bids must contain the proposed strike price, denominated in sterling that the applicant is willing to accept for

⁴ <https://www.gov.uk/government/publications/electricity-market-reform-delivery-plan>

each megawatt hour of electricity it generates. The bid can be no higher than the administrative set strike price for the technology and the delivery year in respect of which the application is made.

7. Auction(s)

7.1. If the budget has been exceeded, then the Delivery Body will run an auction (or auctions) to ration the available budget between qualifying applicants. Detailed rules on the auction process are set out in the Allocation Framework.

(i) Minimum

7.2. The budget notice may include requirements for a maximum or minimum budget to be provided to specific technologies. If a minimum budget is in place, then the Delivery Body will first consider the relevant minimum. If the total capacity of projects subjects to a technology minimum does not exceed the minimum, each qualifying application will be offered a CFD at the Administrative Strike Price for its technology. If the total capacity of projects subjects to a technology minimum does exceed the minimum, the Delivery Body will rank the bids subject to a minimum from lowest to highest strike price bid. Those with the lowest strike prices are offered a CFD, up to but not including the project which exceeds the minimum (and any projects with higher strike prices).

7.3. Projects accepted under a minimum will be offered a CFD at the strike price of the most expensive accepted bid (the clearing price) under the minimum for their year of delivery or the clearing price under the auction in relation to the budget for their year of delivery, whichever is the highest. This is capped by the administrative strike price for each technology for the year of delivery.

(ii) Overall budget

7.4. All applications which are not successful under the minimum auction and all applications not subject to a minimum will be included in the general auction for the relevant part of the budget, as appropriate). The Delivery Body will rank the applications on the basis of their strike price bids subject to a minimum from lowest to highest. Those with the lowest strike prices are offered a CfD, up to but not including the project which exceeds the

budget in each delivery year (and any projects in the same delivery year with higher strike prices).

- 7.5. Projects which have been successful in the auction are offered a CfD at the clearing price for a project delivering in that year, capped at the administrative strike price for that technology for the year of delivery. Once a project would have breached the budget for all available delivery years, or there are no further bids, the auction ends.

(iii) *Maxima*

- 7.6. If a maximum is in place, the Delivery Body will consider projects up to the value of the maximum. Once a maximum has been reached no more projects of that technology type will be considered. Projects subject to a maximum are considered as part of the auction in relation to the relevant part of budget if there is one. If there is no auction in relation to applications because the budget is unconstrained, but the maximum is constrained, an auction in relation to a maximum is carried out in the same way as an auction in relation to a minimum, except that any applications which are not successful under the maximum are rejected.

8. Audit

- 8.1. The valuation calculations carried out by the Delivery Body will be subject to an independent audit. The result of the audit together with the auditor's recommendation will be supplied to the Secretary of State. The Secretary of State has a discretion to request that an allocation round is re-run. The Secretary of State also has the power to terminate an allocation round before CFD notifications are given.

9. Notification

- 9.1. The Delivery Body will give notice to each qualifying applicant which will set out whether or not that applicant is a successful applicant. The Delivery Body will also give a CFD notification in respect of a successful application to the LCCC. The LCCC will offer contracts in respect of successful applications.

10. Allocation Delays

- 10.1. A qualifying applicant may be able to alter the target commissioning date and target commissioning window specified in its application where there is a delay in the auction start date or where there is a delay which applies to all qualifying applicants after the auction has been run.
- 10.2. The period by which the target commissioning date and target commissioning window will be extendable is to be based on a day for day calculation for each day of delay. The allocation framework sets out a series of trigger dates from which such delay will be calculated.

11. Withdrawal and Contract Signature and Performance Incentive Scheme

- 11.1. An applicant may provide notice to withdraw its application during the application window or prior to being considered in an auction process where an allocation round is constrained. Where an applicant has been offered a CFD but then fails to sign the CFD offered or where an applicant unilaterally terminates its CFD between contract signature and Milestone Delivery Date (which occurs 1 year after contract signature) certain consequences may apply.
- 11.2. It is likely that provision will be made to prevent an application in respect of the particular generating unit which was the subject of the original CfD application, from being considered in future allocation rounds up until the actual or theoretical Milestone Delivery Date. An exemption may apply where an applicant is unable to sign through no fault of its own.

12. Changes since April

12.1. Contract Signature and Performance Incentive Scheme

- 12.1.1. In order to minimise the gaming risk, an applicant's eligibility to participate in a future CFD allocation round or rounds is likely to be affected:

- Where an applicant has been offered a CFD but then fails to sign a CFD when offered one by the LCCC, or
- Where an applicant has its CFD terminated between contract signature and Milestone Delivery Date (which occurs 1 year after contract signature).

12.1.2. In particular, Government is likely to make regulations that will make such applicants ineligible to apply for a CFD for thirteen months after a CFD Notification has been issued to successful applicants in the Allocation Round⁵. This mechanic seeks to discourage spurious or highly speculative applications from participating in the auction process, potentially distorting auction outcomes and blocking budget that would otherwise have been available to genuine projects with a greater likelihood of delivery.

12.2.CFD Eligibility Criteria Update

12.2.1. DECC first published requirements for the Eligibility criteria in August 2013. They were tested extensively with the CFD expert group and other stakeholders and were put to public consultation in December 2013. The criteria are meant to act as a robust, consistently applied threshold assessed by the Delivery Body that acts to deter speculative bidders while not deterring credible developers. These are set out in the Allocation Regulations and the Allocation Framework.

Planning Permissions

12.2.2. Eligibility criteria require that an applicant must demonstrate that its CFD unit has the relevant planning consents to generate and supply electricity to the grid or a private wire network. Each Applicant is therefore required to certify:

- a) Which applicable planning consents have been obtained for the relevant works⁶ undertaken (being a development

⁵ The Government is currently considering any exceptions that may apply to this provision.

⁶ Relevant works” includes any of the following works—

- (a) the alteration, construction or removal of any plant, building or other structure;
- (b) the alteration, installation or removal of any cable, line, pipeline or other service media;

order; a Transport & Works Act 1992 order; a section 36 consent; a planning permission; and/or a marine licence);

- b) No other applicable planning consents are required for the relevant works undertaken; and
- c) Copies of the applicable planning consents obtained are included with the Application.

12.2.3. The applicable planning consents include consent for the CFD unit itself and consent for any other 'relevant works' which enable the CFD unit to be established/alterd or for electricity to be supplied to the grid. However, consent for relevant works undertaken by grid network operators and covered by grid connection agreements will not need to be shown by the applicant.

Grid Connection Requirements and Private Network

12.2.4. Since December, clarification on the grid connection requirements relating to CFD eligibility has been made, particularly to allow for the different structure of private networks. The policy on grid connection has therefore been updated to reflect these different forms of connection. This policy will be reflected in the Regulations and further clarified in the Allocation Framework and will outline the following requirements:

- a) for applicants connecting directly to the grid - a copy of the applicable grid connection agreement(s) between the applicant and the relevant network operator which is for at least 75 per cent of the capacity of the CFD unit;
- b) for applicants connecting indirectly (i.e. through a private network operator) – evidence of an agreement between the applicant and the private network operator; and
- c) for applicants not connected (i.e. islanded generation) – confirmation that no connection is currently applicable.

12.2.5. An applicant will be required to state in its initial application form the type of grid connection it has obtained in respect of the CFD Unit or whether the applicant intends to be a private network generator.

12.3.Auction

12.3.1. Since the April 9 draft AF, we have introduced a rule surrounding flexible bids. Rule 10 of the draft Allocation Framework, version 2 of which has been published today states that the lowest strike price bid for any given application in any given delivery year must be to the nearest pence. However, any flexible bids⁷ in respect of the same application in the same year may bid to the nearest 0.1 pence. This allows projects to nominate alternative capacities at a minimally altered price and increases the chance of flexible bids being considered under the auction.”

12.4.CFD's outside the generic allocation process

12.4.1. Part 10 of the Allocation Regulations allow the Secretary of State to direct the LCCC to enter into a CFD with any eligible generator outside of the generic CFD allocation process described above. This route may be used to offer CFDs in circumstance where the generic CFD allocation process is not appropriate. In particular it 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. We do not expect that this route to a CFD will be used by any project that is able to apply for a CFD through the generic CFD allocation process.

12.5.Eligible Generator

12.5.1. We have extended the scope of the definition of 'eligible generator' in the Eligibility Regulations to include 'associated' corporate bodies as set out in section 67 of the Energy Act 2008. This is to ensure that the definition is sufficiently broad to allow a CFD to be offered to any projects that use relevant low-carbon generation technologies across a broad range of appropriate project structures.

⁷ Flexible bids are additional sealed bids for a given application with varying Capacity and TCD.

Annex 1: Background to Auction Design

1. We have undertaken extensive stakeholder engagement to develop the design of the CfD auction under competitive allocation, including through collaborative development in autumn 2013, and more recent CfD expert group sessions. We have also used responses to publications in August 2013, and the October 2013 EMR consultation, as well as the January 2014 consultation on competitive allocation to further shape the design. We set out a further update to stakeholders through an open letter published on 12 February, and the CfD Allocation Framework setting out our design was published on 8 April 2014⁸.
2. After significant engagement on the issue of descending clock vs sealed bid, we announced in February 2014⁹ that we are adopting a sealed bid system. We considered the arguments for both approaches, including common value uncertainty, efficiency gains, provision of bidder flexibility, and complexity of auction systems and confidentiality of bid data. We also confirmed Government's intention to develop regulations to protect the confidentiality of bid information.
3. As set out in the draft Allocation Framework published in April¹⁰, we are adopting a pay-as-clear approach, whereby each project is paid the clearing price for its delivery year within the auction, capped at its Administrative Strike Price. We believe that this approach will reduce bid manipulation, drive innovation, reduce costs long term and reduce barriers for new entry. A pay-as-clear auction can assist smaller generators since they can bid their expected costs rather than requiring market information about the expected clearing price to inform their bidding strategy.
4. Clearing prices will be separated across delivery years, meaning that each delivery year may have a different clearing price within a single auction. This allows allocation to continue in other years, even when the budget has been exceeded in another.

⁸https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/301968/Contract_for_Difference_Draft_Allocation_Framework.pdf

⁹https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/279414/Policy_Letter_CfD_allocation_Auction_format.pdf

¹⁰https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/301968/Contract_for_Difference_Draft_Allocation_Framework.pdf

5. Projects will be assessed starting with the lowest strike price bid project, regardless of delivery year, technology type or capacity. Projects will be assessed to see if they are affordable within the budget. If they are (and do not exceed any Maxima), they will be accepted and the next lowest strike price bid project considered. The clearing price for each delivery year will be set by the highest strike price bid accepted in that delivery year. Each project accepted within that year will be paid that clearing price, capped by its Administrative Strike Price Bid.
6. Minima technologies will be paid either the Minima clearing price, or the general auction clearing price, whichever is higher. This is to ensure that no projects are disadvantaged by being subject to a Minimum.
7. Tie breaker rules are in place in the event that two projects are exactly tied on the same strike price bid. The first rule will first make best use of the available budget, meaning that whichever project or combination of projects comes closest to fulfilling (but not breaching) the budget will be accepted. This is also the case for projects subject to a Minimum or a Maximum – we would accept the project or combination of projects which best fulfils the Minima or Maxima. In the unlikely event that a project or combination of projects were exactly tied on both strike price bid and capacity or cost (and hence fulfilment of constraint), we would resort to random allocation.
8. Within these rules we have set out a design which includes the provision for flexibility on price, capacity and delivery year, for each applicant. We will allow bidders to submit multiple sealed bids, with varying combinations of strike price, capacity and delivery year. All bids are included in auction and ranked by strike price. Bids with the lowest strike price will be assessed first, and therefore the lowest strike price flexible bid must be the first choice bid. When a bid from an application is accepted, all further bids from that same application are removed from the auction.
9. Note that each flexible bid must be marginally different and second choice bids will only be considered if the first choice project has been rejected. Full details of the auction design including treatment of any minima and maxima, tie-breaker rules and flexibility can be found in the Allocation Framework, and accompanying slide pack¹¹.

¹¹https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/302725/af_event__9_april_slides.pdf

Schedule Timeline: Allocation Process

Note – all timescales are indicative and not binding on the Delivery Body or DECC. They are set out here purely for illustrative purposes.

Milestone	Expected Date¹²	Expected date with appeals¹³	Explanation
Budget notice published	30 Sep 2014	30 Sep 2014	Confirmation of the allocation round budget
Commencement date of the first allocation round	14 Oct 2014	14 Oct 2014	The first date that an application can be submitted to National Grid
Application closing date	28 Oct 2014	28 Oct 2014	Last date that an application can be submitted
Notices of determination	11 Nov 2014	11 Nov 2014	Grid informs applicant whether or not they are a qualifying applicant
Applicant requests review of a non-qualification determination	18 Nov 2014	18 Nov 2014	Last day that an applicant can request a review of a non-qualification determination
Non-qualification review notification	18 Nov 2014	02 Dec 2014	Grid informs applicant of the result of the review
Applicant makes appeal in respect of a non-qualification determination	18 Nov 2014	09 Dec 2014	Last day that an applicant can make an appeal in respect of a non-qualification determination
Ofgem completes appeals	18 Nov 2014	23 Jan 2015	Ofgem aims to complete appeals within 30 working days
Auction notice	27 Nov 2014	03 Feb 2015	Eligible applicants invited to submit sealed bids
Sealed bids submission closing date	04 Dec 2014	10 Feb 2015	Last date that an applicant can submit a sealed bid
CfD notifications sent to Counterparty and applicants	30 Dec 2014	04 Mar 2015	Eligible applicants informed whether they are successful or not. Grid provides the Counterparty with all information required to prepare contracts
Counterparty sends contracts to successful applicants	07 Jan 2015	11 Mar 2015	

¹² Expected date of milestone in the event that no applicants appeal or request a review of a non-qualification determination. These dates are indicative and are not binding on National Grid or Ofgem.

¹³ Expected date of milestone in the event that any applicant appeals a non-qualification determination. These dates are indicative and are not binding on National Grid or Ofgem.

© Crown copyright 2014

Department of Energy & Climate Change

3 Whitehall Place

London SW1A 2AW

www.gov.uk/decc

URN 14D/224