Department for Energy Security & Net Zero

Contracts for Difference and Capacity Market Scheme update 2024

HC 360

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Department for Energy Security & Net Zero

Contracts for Difference and Capacity Market Scheme Update 2024

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Executive summary

1. This is the eleventh annual update outlining the progress made on policy mechanisms implemented under the Electricity Market Reform programme, which closed in 2015. The key mechanisms are the Contracts for Difference (CfD) scheme and the Capacity Market. Together they are designed to incentivise the investment required in the UK's energy infrastructure and to deliver low carbon and reliable energy supplies, while minimising costs to consumers.

2. This document sets out the headline achievements over the past 12 months in the following areas:

    - **The Contracts for Difference** scheme, enabling investment in low-carbon electricity generation;
    - **The Capacity Market**, ensuring sufficient electricity capacity to meet peak demand;
    - **The Electricity Demand Reduction pilot**, designed to provide financial support to organisations to deliver electricity capacity savings at peak time;
    - **The Emissions Performance Standard**, ensuring new fossil fuel-fired electricity generation contributes to electricity security in a manner consistent with decarbonisation objectives.

Key progress since the 2023 update

Contracts for Difference

3. Following the General Election in July, the Secretary of State made a landmark decision to increase the budget for the sixth allocation round (AR6) by over 50% to over £1.5 billion – a record high.

4. The auction that followed led to the Government awarding contracts to a record number of projects, achieving the greatest capacity yet for solar and securing the world's largest commercial-scale floating offshore wind project.

5. A record-breaking total of 128 successful AR6 projects signed contracts with the Low Carbon Contracts Company (LCCC), ensuring the delivery of approximately 9.6GW of new low-carbon capacity. This is enough to power the equivalent of 11 million homes, all procured through a highly competitive auction process.

6. Work continues to prepare for AR7. In October, the Government published the response to the consultation on policy considerations for future rounds of the Contracts for Difference scheme, covering proposed changes on repowering and phasing for floating offshore wind projects.

7. The Government is now working with industry to accelerate ways the CfD scheme can be expanded even further so that we can deliver our mission for clean power by 2030.

8. The Clean Industry Bonus (CIB) has been included in the Contract for Difference scheme for AR7, for fixed and floating offshore wind. This will give fixed bottom and floating offshore wind CfD applicants an opportunity to obtain extra CfD revenue support in return for investment in the sustainability of their supply chains.

9. For AR7, as ahead of every CfD round, all auction parameters will be reviewed – this includes pot structure and Administrative Strike Prices.

Capacity Market

10. Following auctions held in February, the Capacity Market secured 42.8GW of electricity capacity for the 2027/28 Delivery year and an additional 7.64GW of electricity capacity for the 2024/25 Delivery year.

11. Rule changes to support auction liquidity were prioritised following the CM Phase 2 consultation in early 2024. These changes were implemented in time for Prequalification in August 2024, for auctions taking place in March 2025.

12. The CM Phase 2 Policy Update outlined the intention to implement the remaining policies as soon as possible and should be in place for Prequalification in July 2025, for auctions taking place in early 2026.

13. In October, the Government also published a consultation and Call for Evidence, seeking views on changes to the CM that aim to retain flexible capacity required to maintain security of electricity supply in the short-term and support the conversion of unabated gas plants to low carbon technology.

Electricity Demand Reduction

14. There have been no notable developments in 2024 regarding the Electricity Demand Reduction pilot.

15. Electricity system flexibility, including consumer-led flexibility (CLF) has an important role to play in achieving zero carbon electricity by 2030, and accelerating our journey to net zero. The Government is working in partnership with Ofgem, NESO and industry to remove barriers and enable increasing participation in CLF from consumers of all sizes. This includes supporting the deployment of “energy smart” technologies, reforming markets to ensure flexibility is appropriately valued, and introducing proportionate regulatory measures.

Emissions Performance Standard

16. There have been no notable developments in 2024 with regards to the Emissions Performance Standard (EPS), so the position remains as stated in the 2022 report.[1]

17. The government conducted a five-year review of the regulation in 2019 as required by the Energy Act 2013 which was carried out by Department for Business, Energy and Industrial Strategy officials. A call for evidence exercise was used to ask questions on the performance of the EPS in achieving its objectives, whether its objectives were still appropriate and whether any issues had arisen in its operation. A total of twenty-seven responses were received. Additionally, government reviewed plants built since implementation and obtained feedback from the Environment Agency.

1 Contracts for Difference and Capacity Market scheme update 2022 - GOV.UK (www.gov.uk)

18. The overwhelming majority of stakeholders indicated support for the EPS. The review found that the EPS has, to date, been successful as a regulatory backstop, reinforcing existing planning policy. No unintended consequences were identified through the review.

Contracts for Difference Scheme

Deliverable	Achieved	When
Allocation Round 6 (AR6)		
AR6 application window closes	✔	April 2024
Government increases AR6 budget to over £1.5 billion	✔	July 2024
The results of AR6 are announced, delivering nearly 9.6GW of new capacity – the most successful round yet	✔	September 2024
Allocation Round 7 (AR7)		
Government publishes response to consultation on introducing a CfD Sustainable Industry Reward (now known as Clean Industry Bonus)	✔	March 2024
Government publishes - Draft CfD Clean Industry Bonus Allocation Framework - Draft guidance for fixed-bottom and floating offshore wind projects on monitoring the implementation of the Clean Industry Bonus and minimum standards	✔	First published in March and updated May 2024
The Contracts for Difference (Sustainable Industry Rewards) Regulations 2024, implementing the legal basis for the operation of the Clean Industry Bonus scheme, came into effect.	✔	June 2024
Government publishes response to consultation on proposed amendments to Contracts for Difference for AR7 and future rounds	✔	October 2024
Government lays Statutory Instrument to implement policy amendments for AR7	✔	October 2024

Introduction

19. The CfD scheme is the Government's main mechanism for supporting new low carbon electricity generation projects in Great Britain (GB). Contracts are awarded in a series of competitive, pay-as-clear auctions, with the lowest price bids being successful, which drives efficiency and cost reduction. CfDs give greater certainty and stability of revenues to electricity generators by reducing their exposure to volatile wholesale prices, while protecting consumers from paying for higher costs when electricity prices are high. CfD contracts are managed by the Low Carbon Contracts Company (LCCC), a government-owned company. Information on the CfD projects managed by the LCCC is published on their CfD Register[2].

Results of the Sixth CfD Allocation Round (AR6)

20. On 3 September 2024, following the Secretary of State's decision to increase the budget to record levels, the Government published the results of the sixth Contracts for Difference auction (AR6). A record number of 128 renewable electricity projects[3] across Great Britain signed CfD contracts, delivering a total capacity of 9.6GW – enough to power the equivalent of 11 million homes.

21. AR6 secured record solar capacity (3.2 GW), representing a 20% increase to the UK's installed capacity. This round also secured the largest floating offshore wind project in the world. At 400MW, the project is double Europe's total installed capacity of this technology.

22. Along with lifting the onshore wind ban, these results will support the government's mission to deliver clean power by 2030 and accelerate to net zero, transforming our country into a clean energy superpower in the process.

23. Despite recent global cost pressures, the strike price of new offshore wind projects successful in AR6 remains approximately 50% lower than in the first CfD auction in 2015.

24. The CfD mechanism has delivered competitive prices across the board, with prices significantly below the ceiling prices (ASPs) – ensuring billpayers pay a fair price for capacity.

Allocation Round 7 Preparations

25. DESNZ published a consultation on proposed amendments to Contracts for Difference for Allocation Round 7 and future rounds in January 2024. This consultation looked at possible changes to the Contracts for Difference scheme for Allocation Round 7, and invited early views on longer-term considerations that would apply to contracts beyond AR7.

[2] https://www.lowcarboncontracts.uk/our-schemes/contracts-for-difference/register/

[3] Of the 131 successful AR6 projects, 128 have accepted contract offers and signed contracts with the LCCC. The details of the contracted projects are available on LCCC's public CFD Register - https://register.lowcarboncontracts.uk/

26. On 18 October, the Government published the response to that consultation. The government response confirms our decision on implementing the following amendments to the scheme ahead of Allocation Round 7:
    - **repowering:** to ensure repowered onshore wind projects that meet the eligibility criteria can bid into the CfD from AR7;
    - **phased CfDs for floating offshore wind (FLOW):** to extend the phasing CfD policy currently available for fixed-based offshore wind (OFW) projects to FLOW projects. This will allow larger FLOW projects of up to 1,500MW in size to construct in up to three phases. Phasing will reduce construction risk and help improve the sector's commercial viability and development.

27. The Government will consult in due course on these proposed changes to the CfD contract terms and Allocation Framework (which sets out the eligibility requirements for entering a CfD allocation round) to implement these policy decisions.

28. The Government response also confirmed the outcomes of a range of policy considerations for future rounds beyond Allocation Round 7, including:
    - **appeals:** to not pursue the introduction of a pre-qualification process ahead of the next allocation round, nor to amend the grounds for appeal, but to take forward work to implement a fixed timeline for future rounds;
    - **hybrid metering:** to not implement hybrid metering in the CfD before it is clear how such assets would be treated in the wider system. Therefore, hybrid metering will not be implemented for the next allocation round, and the need for future amendments will be considered in light of any wider market changes that are brought forward in this area;
    - **floating offshore wind (FLOW) definition:** to continue to work with stakeholders with a view to developing a long-term solution to the eligible definition of floating offshore wind projects;
    - **facilitating coordinated infrastructure:** to continue to consider how the CfD could better support projects that connect into multi-purpose interconnectors/or bootstrap infrastructure;
    - **indexation:** full CfD indexation to CPI continues to offer comparatively advantageous terms in an increasingly competitive global market. The government therefore does not currently intend to make any changes to this approach but will reflect further on alternative approaches and priorities ahead of future allocation rounds.

CfD Clean Industry Bonus

29. The CfD Clean Industry Bonus aims to help accelerate the deployment of low carbon electricity generation, specifically offshore/floating offshore wind, by addressing some of the recent supply chain challenges identified by the industry. Legislation introducing the scheme came into effect in June 2024. It will apply to Allocation Round 7 of the CfD.

30. The Bonus is a competitive scheme that provides extra revenue support to offshore wind applicants if they choose to invest in a more sustainable supply chain.

31. Applications for the Bonus will open in February 2025 ahead of Allocation Round 7 of the CfD later that year.

Capacity Market

Table 1. Deliverables achieved in the Capacity Market during 2024

Deliverable	Achieved	When
Capacity Market 2023: Phase 2 proposals - Consultation	✔	October-December 2023
T-1 and T-4 auctions successfully secured capacity out to 2027/28	✔	February 2024
Capacity Market: rule amendments to support auction liquidity – Consultation	✔	April – May 2024
Capacity Market Phase 2 Consultation and Rule amendments to support auction liquidity – Government Response	✔	July 2024
Secretary of State confirms Capacity Market parameters in letter to NG:ESO (now NESO)	✔	July 2024
Implementation of limited Rule changes from the Phase 2 and rule amendments to support auction liquidity consultations.	✔	July 2024
Capacity Market Phase 2 Policy Update – outlining intent to implement remaining Phase 2 changes	✔	October 2024
Capacity Market: proposals to maintain security of supply and enable flexible capacity to decarbonise – Consultation and Call for Evidence published	✔	October 2024
Prequalification Results Day for the T-1 and T-4 auctions to be held in March 2025	✔	November 2024

Introduction

32. The purpose of the Capacity Market is to ensure security of Great Britain's electricity supply at least cost to consumers. It does this by providing capacity providers with the right incentives to be on the system and to deliver electricity when it is needed. The Capacity Market ensures there is sufficient reliable capacity available during periods of electricity

system stress, for example during cold, still periods with high electricity demand and low wind generation.

33. Eligible capacity providers bid into a competitive Capacity Market auction to receive Capacity Market Agreements. Successful capacity providers receive payments to ensure their capacity is available to meet demand at times of system stress. These capacity payments incentivise the necessary investment to maintain and refurbish existing capacity, and to finance new capacity where necessary. Capacity providers face penalties if they fail to deliver capacity when requested during a system stress event.

34. The Capacity Market is technology neutral – it does not seek to procure allocated volumes of capacity from specific types of technology. With the exception of capacity providers in receipt of support from other specific policy measures, all types of technology are able to participate in the Capacity Market provided they can demonstrate sufficient technical performance to contribute to security of supply, and provided they comply with the Capacity Market's emissions limits.[4]

Capacity Auctions

35. Capacity auctions are held one (T-1) and four (T- 4) years ahead of the delivery year when capacity must be provided, giving investors certainty over part of the future revenues they will receive. Existing generating capacity competes against new build generating capacity, CLF delivered through Demand Side Response (DSR), and interconnectors, with the auction procuring the mix of capacity which provides best value for consumers.

36. Under the previous government in February 2024, there was a T-1 auction for delivery in 2024/25, and a T-4 auction for delivery in 2027/28.

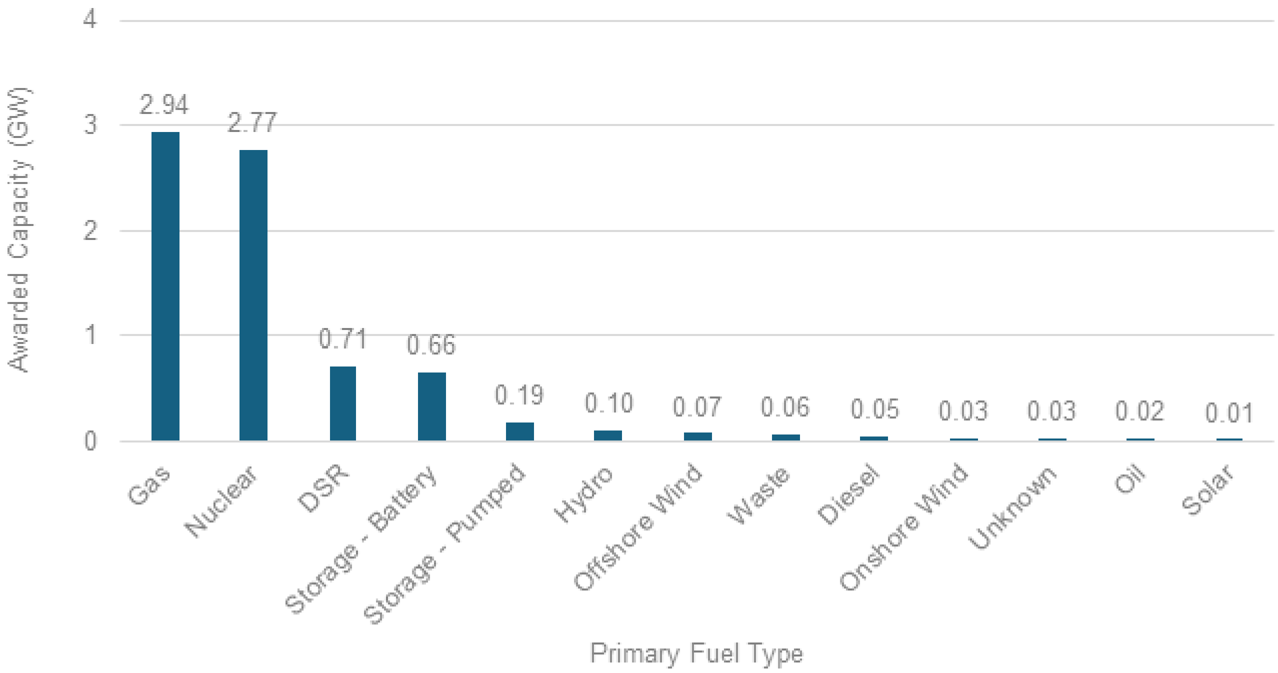
T-1 Auction results for 2024/25

37. Under the previous government, the T-1 auction for the Delivery Year 2024/25 concluded on 20 February 2024 and secured 7.64GW of de-rated capacity at a clearing price of £35.79/kW per year. A total of 9.5GW of de-rated capacity entered the auction, of which 80.8% received Capacity Market agreements (Figure 1).

38. 6.2GW of awarded capacity is from existing generation capacity, and 0.7GW is from new build generation capacity. The remaining capacity was awarded to unproven DSR (0.6GW) and proven DSR (0.2GW). DSR technologies are those consumers can use to reduce or increase the amount of electricity they take off the grid at a particular time and is a form of CLF. Unproven DSR refers to DSR that has not yet demonstrated it has the necessary metering in place or demonstrated it can deliver a specified level of capacity.

4 https://www.gov.uk/government/publications/carbon-emissions-limits-in-the-capacity-market

Figure 1. T-1 Auction results breakdown of Capacity Agreements awarded by fuel type for the 2024/25 Delivery Year (MW)



Source: National Energy System Operator Auction Report (2024[5])

T-4 Auction results for 2027/28

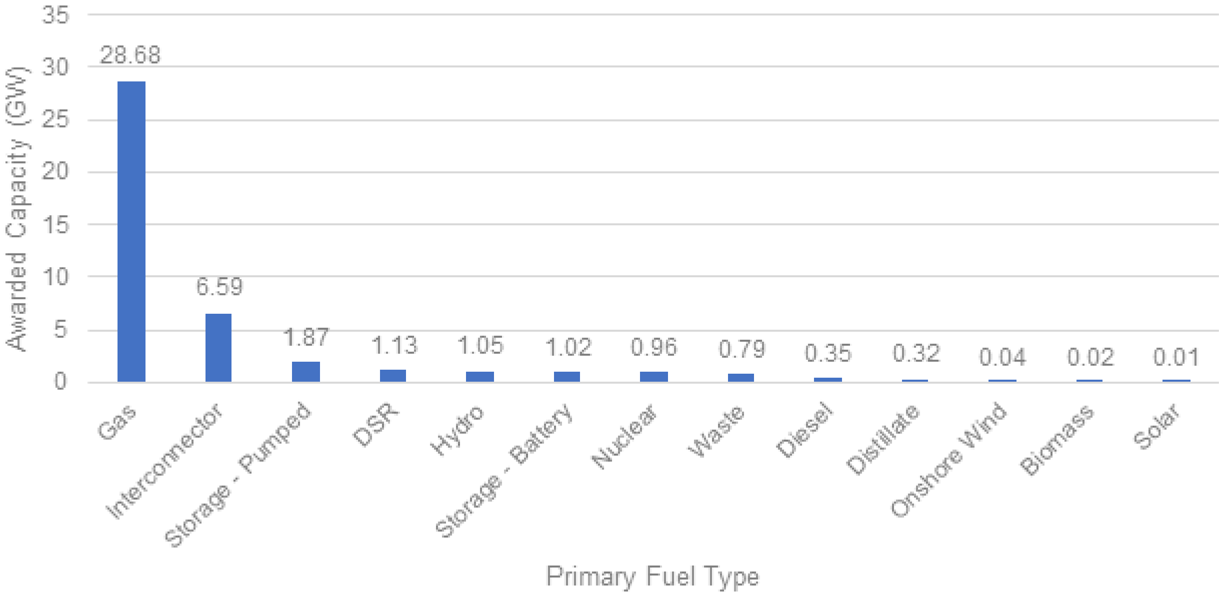
39. Under the previous government, the T-4 auction for delivery in 2027/28 concluded on 27 February 2024 and secured 42.8 GW of de-rated capacity at a clearing price of £65/kW per year. A total of 43.4GW of de-rated capacity entered the auction, of which 98.8% received capacity agreements for delivery (Figure 2).

40. 33.2GW of awarded capacity is from existing generation capacity, 1.7GW from new build generation capacity, 5.5GW from existing interconnectors, and 1.7GW from new build interconnectors. 0.2GW was awarded to refurbishing generating CMU. The remaining capacity agreements were awarded to unproven DSR technologies (0.9GW) and proven DSR technologies (0.2GW).

41. The new build capacity includes 1.0GW of new build battery storage, 0.4GW of new build gas generation and 0.2GW of energy from waste.

[5] https://nationalenergyso-emr.my.site.com/EMRIntegratedGuidance/s/article/Auction-Results

Figure 2. T-4 Auction results breakdown of Capacity Agreements awarded by fuel type for the 2027/28 Delivery Year (de-rated capacity)



Source: National Energy System Operator Auction Report (2024)

Changes to the Capacity Market Rules and Regulations

42. Changes over the last year in the CM have intended to align with the Government's clean power and net zero goals and improve security of supply. The improvements we have made to the CM in the last year are set out below.

43. As outlined in the Government Response to the Phase 2 consultation and the 2024 Rule amendments to support auction liquidity[6], published in July 2024, the following changes were put into effect via changes to the CM Rules in July 2024:
    - Rolling over a temporary amendment to enable mothballed plant to apply to prequalify for CM auctions, by allowing Existing Generating Capacity Market Units (CMU) who have not been operational for the 24 months before prequalification to use operational data older than 24 months.
    - Introduction of a new definition to Rule 4.4.4, clarifying that battery augmentation is permitted so that storage CMUs can manage the natural decline in capacity due to degradation.
    - Enabling the level of the EPT obligation to be reduced through secondary trading, in line with the approach for other CM testing frameworks.
    - Enabling CM applicants to have their emissions verified after the deadline for submitting applications to prequalify for the CM.
    - Allow some CMUs to use a Combined Heat and Power Quality Assurance Programme (CHPQA) certificate which evidences their emissions for a given calendar year to better align with the definition of an ‘Emissions Year’ in the Rules.

[6] https://assets.publishing.service.gov.uk/media/669a1e7e0808eaf43b50d28e/capacity-market-government-response__1_.pdf

- Requiring applicants relying on previous verified Fossil Fuel Emissions Declarations (FFEDs) to resubmit the relevant documents.
- Removing outdated section of the Exhibit ZA and improving functionality.
- Enabling older versions of the FFED to be accepted at prequalification.

44. The CM Phase 2 Policy Update[7] outlined the intention to implement the remaining Phase 2 policies that were not immediately progressed after the General Election. The following changes are to be put into effect as soon as possible, via changes to the CM Rules and Regulations, and will be in place for the July 2025 Capacity Market pre-qualification window, ahead of the 2026 auction:
    - Amendments to timelines for post-stress event activities to improve administrative arrangements.
    - Amending Rules on what can be captured as part of refurbishment programmes.
    - Reducing administrative barriers to Demand Side Response and other low carbon technologies competing in the CM.
    - Enabling low carbon technologies with lower capital expenditure requirements to access longer term contracts.
    - Supporting low-carbon projects with longer build times to access support from the CM, vital for supporting the refurbishment of some large pumped hydro capacity.
    - Publishing emissions data on a publicly available register.
    - Implementing a low carbon definition for declared units.

45. The previous government invited stakeholder feedback in relation to Demand Side Response (DSR) technologies' position in the CM in its Phase 2 consultation (October - December 2023). Government has considered feedback received from that consultation and intends to further explore with stakeholders DSR technologies' participation and integration in the CM.

Capacity Market: Proposals to maintain security of supply and enable flexible capacity to decarbonise

46. While low-carbon technologies are scaling up, we will continue to need existing flexible capacity, including unabated gas, to ensure security of supply. The running hours of gas generators have already significantly reduced, and we expect that the amount of unabated gas we need will continue to decline as we deploy more low-carbon technologies. Our aim is to move unabated gas into a back-up role, primarily to ensure security of supply. We intend to ensure that gas plants can decarbonise once low-carbon flexible technologies are available.

47. On 15 October 2024, in parallel with the CM Phase 2 Policy Update set out above, we published a consultation and Call for Evidence, seeking views on changes to the CM that aim to retain the flexible capacity required to maintain security of electricity supply in the short-term and support the conversion of unabated gas plants to low-carbon technology. In summary, these changes would:
    - Support the economic case for works to extend the life of ageing plants by lowering the scale of planned works needed to access three-year CM agreements. This is important to mitigate short-term risks to electricity security.

[7] https://assets.publishing.service.gov.uk/media/670d368030536cb927483102/capacity-market-phase-2-response-update-october-2024.pdf

- Provide assurance that all substantially refurbishing or new combustion power plants participating in the 2026 CM auction have a credible plan to decarbonise before they become operational, either through converting to hydrogen firing or carbon capture.
- Introduce an exit pathway for unabated gas generators with multi-year CM agreements to transfer from the CM to bespoke support, enabling the plants to retrofit carbon capture equipment to convert to low carbon.

48. Depending on the responses to the consultation and call for evidence, we would look to make any legislative changes to the CM in time for prequalification in 2025 for the 2026 CM auctions.

Low Carbon Contracts Company (LCCC) and Electricity Settlements Company (ESC)

49. LCCC and ESC are responsible for helping government to deliver key elements of the Capacity Market and CfD schemes, respectively.

50. LCCC is the counterparty to CfDs and is responsible for managing Contracts for Difference with low-carbon electricity generators under the CfD scheme, forecasting and collecting the Supplier Obligation Levy that funds CfD payments, and settling and clearing the CfDs.

51. The ESC is responsible for all financial transactions relating to the Capacity Market, including managing capacity payments, credit cover, penalties, and volume reallocation.

52. Both the LCCC and ESC are companies limited by shares and wholly owned by the Secretary of State for the Department of Energy Security and Net Zero. The companies became operational on 1 August 2014 and operate within two main frameworks: the Energy Act 2013 (and the relevant regulations made under the Act) and the corporate and company law frameworks.

53. In the past year, there have been a number of highlights across the CfD and Capacity Market schemes. These include:
    - The successful awarding of 133 new AR6 contracts for difference.
    - An increased emphasis on Solar PV contracts in AR6 which account for over 34% of AR6 capacity, representing 1.7 times more solar capacity than AR5.
    - The procurement of over 4.9GW of Offshore Wind in AR6.
    - Implementing Annual CfD auctions.
    - Helping to shape the introduction of repowered onshore wind sites into AR7.
    - Implementing the automation of key processes making participation easier across the CfD and Capacity Market.
    - Being a key partner to DESNZ on contract design for new schemes and shaping key aspects of a fundamental electricity markets review.
    - Supporting stakeholders on the requirements of new scheme contracts.
    - Improving outcomes for CM participants through a focus on data quality and the automation of highly manual processes.
    - Continued testing programme improvement, which increased confidence in a stress event outcome.

54. Over the course of the financial year, The Electricity Settlements Company handled Capacity Payments totaling £1 billion. Capacity payments were made to 52.7GW of capacity for Delivery Year 2022/23 (£333.8m) and 52.6GW for delivery year 2023/24.

National Energy System Operator

55. National Energy System Operator (NESO)[16] continues to play a fundamental role in aiding the CM and CfD schemes through its role as the Electricity Market Reform Delivery Body (DB). For the CM, the DB is responsible for running pre-qualification assessment, disputes management, auctions and ongoing agreement management for the CfD scheme, the DB has the same scope of responsibilities as in the CM, excluding ongoing contract management.

56. The DB has successfully completed their processes for the CfD Allocation Round 6 (AR6) which was launched in March 2024, including:
    - Allocated funding to a record total of 131 clean energy projects, representing ~9.6GW;
    - Worked collaboratively with DESNZ to assess the implications and deliverability of proposed scheme amendments;
    - Supported the rules drafting process for the Allocation Framework and implemented these rules into the auction system and business processes in advance of the round opening;
    - Continued co-creation of producing customer guidance, auction scenario video tutorials and webinars on the CfD application, allocation and auction processes;
    - Maintained a customer relationship management tool, with approximately 93% of 290 queries received from customers since January 2024 being resolved within a defined service level agreement period of 5 working days; and
    - Received a satisfaction score of 8.4/10 through the Customer Satisfaction Survey we carried out post-AR6.

57. For the CM, the DB successfully delivered key activities in relation to the auctions and agreement management, including:
    - Ran the 2023/24 Auctions that procured a total capacity of 50.5GW across 817 CM Agreements:
        - 7.64GW across 277 CM Agreements for Delivery Year 2024/25
        - 42.8GW across 540 CM Agreements for Delivery Year 2027/28.
    - Went live in June 2024 with the new IT Portal to administer the CM pre-qualification, auction readiness and agreement management processes. Customers were engaged via a dedicated user group on the design and testing of the new Portal, including through a dedicated familiarisation window in March/April, prior to the go live date;
    - In conjunction with the new Portal, delivered a new CM Guidance platform that is easier to navigate and has simplified material, developed in conjunction with participants;
    - Maintained a customer relationship management tool, with 90% of 1,538 queries received from customers since January 2024 being resolved within 5 working days;
    - Managed 3,324 active CM Agreements with 99.8% of 2,719 submissions reviewed and actioned within SLA.
    - Worked closely with DESNZ to draft and consult on amendments to the Capacity Market Rules for 2024 delivery and implemented them in the new IT Portal and associated processes to ensure a smooth transition for customers;
    - Actively participated in Ofgem's CM Advisory Group, which was established to improve effective functioning of the CM by reviewing and testing Rule change proposals and providing advice to Ofgem to support their decision making; and

- Continued to enhance modelling in line with recommendations in the Panel of Technical Experts' 2023 report, with delivery in the Electricity Capacity Report 2024.

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