

Final stage impact assessment

Title: Consultation on further reforms to the Contracts for Difference scheme for Allocation Round 7

Type of measure: Impact Assessment for a Consultation Government Response

Department or agency: Department for Energy Security and Net Zero

IA number: DESNZ006(CR)-25-EMA

RPC reference number: N/A Out of Scope

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1. Summary of proposal

Delivering clean power by 2030 is at the heart of the Government's mission to transform the UK into a clean energy superpower, alongside the UK's 2050 Net Zero emissions target. The Contracts for Difference (CfD) scheme is the Government's principal mechanism for incentivising new low carbon electricity generating projects in Great Britain. The CfD and its predecessor investment contracts have already delivered c.9 GW of renewable generation, with a further 26 GW contracted to become operational by 2030. In Allocation Round 6 (AR6), the final overall budget allocated was £1.555 billion (2011/12) with c.9.6GW of renewable energy secured.

The Clean Power 2030 Action Plan has set out capacity ambitions for onshore wind (ONW), offshore wind (OFW) and Solar required to meet the Government's mission¹. As such, consideration has been given to how the CfD scheme can best support the pace of renewable electricity deployment needed over the coming allocation rounds, whilst delivering value for money for electricity consumers. The Government recently consulted on further changes to the CfD design². This Impact Assessment (IA) only considers the policy proposals relating to amending the budget publication process and Secretary of State access to bidding

¹ <https://www.gov.uk/government/publications/clean-power-2030-action-plan>

² <https://assets.publishing.service.gov.uk/media/67b84bee4ad141d908353395/cfd-allocation-round-7-reforms-consultation.pdf>

information. It does not consider Allocation Round auction parameters, which will be published ahead of the round opening.

The CIB proposal has already been assessed in the dedicated Impact Assessment for this policy (note the policy was then called ‘Sustainable Industry Rewards’). All other proposals from the consultation will be assessed in a future IA if they are pursued.

2. Strategic case for proposed regulation

The next few allocation rounds will play a vital role in achieving the capacity ambitions set out in the Clean Power 2030 Action Plan, alongside meeting the Government’s longer-term decarbonisation ambitions and act as the foundation step in building a cost effective and secure future electricity system. The Government is proposing to reform the budget allocation process to support these goals, while taking account of the statutory considerations of the scheme and adhering to the Subsidy Control Principles. Further detail on the rationale for this proposal can be found in the consultation document³ and the Government response.

Monetary budgets are set based on a wide range of factors, including an assessment of the pipeline of projects that could participate in the auction⁴. Currently, this assessment is based on estimated information before the auction takes place.

An underspend risk can occur when an auction is comprised of a small number of large projects. If one of these large projects bids into the contract allocation process with a bid price that is competitive, but is ultimately in excess of the overall budget – even by a very small amount - then this capacity will not be secured. This leaves budget unspent and has the potential to meaningfully delay deployment. As such, maintaining the current approach to budget setting could lead to competitively-priced capacity not receiving a CfD in AR7, delaying deployment and risking decarbonisation ambitions.

Currently, budgets can be increased later in the allocation round process. However, given this decision must also be taken with no visibility of bid information, historically, this has not addressed the underspend risk. This risk is particularly acute for offshore wind (‘Pot 3’)⁵ which tends to have bigger projects bidding in. In AR6, the budget was revised leading to an overall increase in the budget by £530 million (2011/12 prices)⁶ - this increase was mostly comprised of the Pot 3 budget, which increased by £300 million. However, there remained a c.20% budget underspend for Pot 3 after the auction, which hypothetically could have secured additional capacity available in the pipeline. Therefore, the proposal seeks to address this underspend risk to derisk the delivery of Clean Power 2030 and Net Zero by 2050.

In cases where there is unlikely to be a significant underspend risk, there may be a weaker case for change. Typically, the Pot 1 budget is mostly spent, as was the case in AR6 – as the projects are much smaller and more numerous. In AR6 there was an underspend for Pot 2, however, this was smaller than in Pot 3⁷. Whilst emerging technologies, including floating

³ <https://assets.publishing.service.gov.uk/media/67b84bee4ad141d908353395/cfd-allocation-round-7-reforms-consultation.pdf>

⁴ <https://assets.publishing.service.gov.uk/media/65e85ea45b6524001af21a72/cfd-ar6-budget-notice-accompanying-note.pdf>

⁵ Pot 1 – Established Technologies (e.g. Onshore wind and Solar PV); Pot 2 – Emerging Technologies (e.g. Floating Offshore Wind); Pot 3 – Fixed Bottom Offshore Wind (OFW)

⁶ <https://www.gov.uk/government/publications/contracts-for-difference-cfd-allocation-round-6-statutory-notice>

⁷ The underspend for Pot 2 was c.15%.

offshore wind, are important for securing the UK's energy supply and delivering on the Government's statutory decarbonisation obligations, they are unlikely to contribute significantly to Clean Power 2030⁸. However, visibility of bid information on these techs would still provide greater control over capacity. Government proposed applying this reform to OFW only in the consultation but intends to consider the case for including these technologies in the context of their high deployment ambitions for 2030.

In AR4, a soft capacity cap mechanism was introduced, with some responses to the recent consultation suggesting this be used to address the underspend risk. However, this power does not adequately address the current underspend risk. The soft capacity cap only applies to capacity budgets, not monetary budgets. Therefore, in cases where an unsuccessful bid breaches a monetary budget, regardless of whether it breaches the capacity cap, the project will remain unsuccessful in securing a CfD. Without Secretary of State having the strike price and budget information, this option could still see underspend in an offshore wind pot.

Legislation currently requires a budget to be published a minimum of 10 working days before the application window opens. Limited and non-price information on auction bids can only be requested by the Secretary of State once CfDs have been awarded. The proposed reform would remove these restrictions, allowing Secretary of State to request anonymous, price-related information from the Delivery Body (NESO), such as bid price and capacity, and would allow the Contract Budget Notice to be published after the contract allocation process has run. This could then be used to set budgets with greater certainty of the capacity and price secured through the auction.

The Government is proposing that the regulatory changes would be broad enough to apply to all technologies. We would set out in the Contract Allocation Framework ahead of the contract allocation process which anonymised bid information we intend to review, including which technology groups it would apply to.

3. Policy objectives

The Government's proposals, and its rationale for intervention, are intended to align with the statutory considerations of the scheme as set out in the Energy Act 2013. The proposal seeks to appropriately balance the UK's decarbonisation aims with maintaining security of supply and having regard to costs for the consumer. We are also satisfied that the proposals appropriately align with subsidy control principles. More specifically, the proposals aim to do the following:

Decarbonisation

- **Derisk achieving Clean Power 2030 and beyond:** The CfD scheme is central to achieving the Government's commitment to 2030 Clean Power and Net Zero by 2050. Therefore, the implementation of this legislative change aims to increase Government control over how much capacity is secured in the forthcoming Allocation Rounds, de-risking Clean Power 2030 and its Net Zero by 2050 ambitions.

Security of supply

⁸ <https://www.gov.uk/government/publications/clean-power-2030-action-plan>

- **Maintain and develop UK energy security:** Supporting the renewable energy sectors in the UK to develop and generate an increased amount of decarbonised electricity through this proposal helps ensure that Great Britain has a strong core of electricity production capacity, and ensures that the system as a whole is less exposed to fluctuations in global gas prices.

Consumer costs

- **Protect value for money for the consumer:** Through removing some restrictions on price-sensitive bid information the proposal will allow for the budget to be set at a price which Government judges best balances value for the consumer and achieving deployment ambitions. To ensure bidder behaviour is minimally impacted, the Government is considering controls on the powers which could mitigate possible negative impacts.

4. Description of proposed intervention options:

The following options are considered in this IA:

Option 0: BAU (Business as usual) - Under this option there is no change to the CfD scheme. This option represents the counterfactual against which the costs and benefits of the policy proposals are assessed.

- **Maintain the current approach to budget publishing and access to bid information:** CfD budgets would continue to be set based on information including an estimated view of the potential bid pipeline, likely leading to conservative budget-setting decisions. Previously, this has led to CfD budgets being increased later in the contract allocation process once more information on likely bidders was available, as has happened in the last three Allocation Rounds. Notably, in AR6, the budget was increased by £530 million⁹. However, the underspend risk would remain. If a large project bids into the allocation round with a bid price that is competitive but is ultimately in excess of the overall budget – even by a very small amount - then this capacity will not be secured. Instead, this marginal unsuccessful project would have to bid into a later allocation round, delaying a substantial amount of potentially good value for money capacity from being deployed.

Option 1: Changes to the CfD Scheme - This option reflects the proposal set out in the consultation, Government response and the SI:

- **Allow budgets to be published at the end of the allocation round and the Secretary of State to request price-related information from the Delivery Body (NESO), such as bid price and capacity.** The regulatory amendments create a broad power to see any anonymised bid information at any time in the contract allocation process, and provide that the Contract Allocation Framework will set the timing for the contract budget to be sent to NESO. The Contract Allocation Framework published ahead of AR7 will set out how we intend to implement the change i.e. what anonymised bid information will be reviewed and for which technologies. This Impact Assessment

⁹ <https://www.gov.uk/government/publications/contracts-for-difference-cfd-allocation-round-6-statutory-notice>

considers different approaches to implementation and the scenarios by which impacts may differ.

5. Description of shortlisted policy options carried forward

The impacts of the proposal are highly dependent on the outcome of a number of future decisions:

- **how the powers will be implemented** – such as, how much bid visibility is exercised, and the controls placed on that (to be set out in the forthcoming Allocation Framework);
- **how much funding (budget) is made available in the auction**, as well as wider competitive outcomes driven by the ambition for the auction and the nature and number of bids received;
- **implementation of concurrent reforms under consultation** – extending eligibility criteria for fixed-bottom offshore wind and changes to the CfD contract length could significantly interact with this proposal. These reforms are still under consideration and will be assessed in a forthcoming Impact Assessment.

Therefore, a qualitative assessment was deemed more appropriate than a monetised analysis, as to provide a nuanced consideration of potential impacts.

Description of illustrative implementation of proposed powers

To assess the possible impacts driven by future decisions on implementation and the AR7 Allocation Framework, the proposal is assessed under two illustrative policy scenarios:

- **Full Bid Stack Visibility:** Secretary of State receives full, anonymised bid information once the auction opens, e.g. bid prices and capacities, and may use this information to inform budget setting.
- **Partial Bid Stack Visibility:** An example of the restrictions placed on bid information received by the Secretary of State could include only receiving anonymised bid information for bids above the marginally successful project in the bid stack, as designated by a mechanism such as: a pre-determined number of bids, capacity level, or an initial monetary budget. The Secretary of State may then use this information to decide where to set the final budget.

The following assessment considers the implications of these illustrative policy scenarios under two example bid stacks, one with fewer, larger projects and another with a larger number of smaller projects.

Assessing Bid Stack X – An example of fewer and larger projects in the bid stack

Bid Stack X consists of fewer and larger (gigawatt-scale) projects, like the OFW pipeline. Under the counterfactual, if a large project's bid is competitive, but exceeds the overall budget, the capacity won't be secured. This project would need to bid into a later round to secure a CfD, delaying deployment.

Under Bid Stack X, the proposal could lead to the following benefits and costs:

- **Derisked renewables deployment, and so, the delivery of CP2030 and carbon budgets** – Under both scenarios, the underspend risk and associated risk to deployment is addressed through access to bid information for setting the budget. In the Full Bid Stack approach, bid information would be used to set the budget once the sealed bid window has closed, and in the Partial Bid Stack approach, it would be used to assess whether and by how much the budget should increase from the budget needed by the initially, marginally successful project. As such this could derisk deployment and the delivery of CP2030 and wider decarbonisation aims, with consumers gaining from benefits associated with increased renewable energy generation.
- **Risk of bid inflation as developers aim to obscure true costs** – Under the counterfactual, no auction information is shared with the Secretary of State or DESNZ, obscuring bidders' costs. Under the proposal, bidders may obscure costs to avoid influencing parameter setting in further auctions. Under Full Bid Stack Visibility, all (anonymised) bid information is shared, while in Partial Bid Stack Visibility, only bids above the marginally successful bid are shared. Therefore, only Partial Visibility offers a mitigation to this risk, as bidders can bid competitively to fall within the pre round budget and keep their costs obscured.
- **Increased risk of gaming and bid inflation due to lack of competitive tension** - Under Bid Stack X, there may already be a perceived lack of competitive tension in as each project has significant market power. This could be exacerbated under the proposal in either scenario, if there is the perception that Secretary of State has an unlimited budget for AR7.

The Government's 2030 mission will facilitate investment to be directed at the technologies, places and people that provide the most affordable, secure and prosperous future for the British public. As part of the Government's commitment to ensure the 2030 mission is delivered in a way that protects billpayers through competitive prices, the Government is currently assessing a range of mechanisms to protect VfM under the proposal, including an internal decision process to advise budget setting and informational constraints.

Assessing Bid Stack Y – Larger number of bidders, relatively small projects

This bid stack has a larger number of bidders and, relatively, smaller project sizes (i.e. it is unlikely that the capacity available in the bid stack will be concentrated within a small set of bidders), similar to Pot 1 technologies.

Under Bid Stack Y, the proposal could lead to the following benefits and costs:

- **Increased control over the amount of successful capacity and cost within an allocation round, derisking CP2030 and wider decarbonisation ambitions**, compared to the counterfactual. However, Bid Stack Y is less likely to be subject to an underspend risk and so presents a weaker case for change.
- **Likely to face a lower risk of bid inflation, compared with the proposal under Bid Stack X** – Bid Stack Y has many bidders and therefore greater competition potential. However, this remains dependent on the interaction between supply and demand. If there is a perception that Secretary of State has unlimited funds for AR7 coupled with high ambition, this could impact competitive tension. Partial Bid Stack Visibility offers

a mitigation to this, for example, a mechanism could initially determine which projects are successful (e.g. an initial capacity or monetary budget). This may reduce perceptions of an unlimited budget as bidders bid at their minimum viable price to be successful within this constraint.

6. Regulatory scorecard for preferred option

Part A: Overall and stakeholder impacts

(1) Overall impacts on total welfare		Directional rating
		Note: Below are examples only
Description of overall expected impact	<p>The proposal will amend legislation to remove restrictions on the Secretary of State having access to price-sensitive bid information.</p> <p>The impact of the proposal is dependent on future decisions on implementation and future auction dynamics alongside further reforms being considered for AR7. An initial illustrative analysis is provided in Section 5.</p> <p>The forthcoming Contract Allocation Framework will specify how the powers will be applied and to which technologies.</p> <p>For Technology Pots which have fewer and larger bidders, the current budget setting process can create an underspend risk which could negatively impact CP2030 and wider decarbonisation ambitions. This is explored further in Section 5, under Bid Stack X. This risk is more prevalent in Pot 3, as seen in AR6 where a significant amount of budget remained unspent. There may be a weaker case for change in pots which do not have a concentrated pipeline. This is explored further in Section 5, under Bid Stack Y.</p> <p>The Government is aware that the proposal may increase the perception of a lack of competitive tension and so, an increase in the clearing price. Therefore, the Government is considering measures which mitigate the risk to VfM, as set out in Section 5. However, a potential increase in the clearing price is not the same as a net increase of the cost of renewables deployment on electricity bills. Deploying renewables at scale is expected to place downward pressures on wholesale prices and lead to increased network costs associated with supporting new capacity. The actual impact on bills will depend on future auction results and wholesale prices, both uncertain and likely affected by upcoming AR7 reforms to be addressed in a future Impact Assessment.</p>	Uncertain
Any significant or adverse	<p>The distributional impact of the proposal is contingent on future decisions as set out previously.</p> <p>The proposal may lead to increased deployment of renewables by removing the underspend risk and by</p>	Uncertain

distributional impacts?	<p>increasing Government's control over which capacity is successful in gaining a CfD. Through increasing renewable generation against the counterfactual, this will likely have a positive impact on emissions. In the counterfactual, whereby emissions may be higher, disadvantaged households may be disproportionately impacted by the future effects of climate change.</p> <p>The proposal may place upward pressure on the subsidy (levy) cost of the CfD scheme, the Government is considering a range of measures to ensure a competitive outcome is achieved. However, whilst the possibility of an upward pressure on the subsidy cost is not the same as the net impact of increased renewables deployment on electricity bills, the Government recognises that any material impact on subsidy costs borne by electricity consumers has the potential to disproportionately impact disadvantaged households (for example, disabled individuals and older individuals).</p>	
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(2) Expected impacts on businesses

Description of overall business impact	<p>Developers are likely to be positively impacted by the proposal as it seeks to derisk the deployment of higher levels of capacity.</p> <p>In the counterfactual, if a developer bids in at a price which offers good VfM, but is in excess of the budget, they are likely to be unsuccessful in securing a CfD. In this case, the deployment of the project and so the developer's ability to generate revenue would be delayed until at least the next Allocation Round, where they could then re-bid in their project. As such, this proposal could derisk revenue for developers who are placing competitive bids.</p> <p>Under the proposal, it is possible that developer confidence is negatively impacted by Secretary of State's access to price-sensitive bid information. However, all bid information will remain anonymised (e.g. site name, location), somewhat mitigating this risk.</p>	Positive
Any significant or adverse distributional impacts?	Distributional impacts are considered at a societal level in Table A above.	Positive

(3) Expected impacts on households

Description of overall	It is possible that the proposal may increase the subsidy (levy) cost of the CfD scheme as it may facilitate buying increase capacity, compared to the counterfactual. Additionally, it is possible that the proposal may increase the subsidy (levy)	Neutral
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household impact	<p>cost of the CfD scheme if it leads to developers increasing their bid prices, however the Government is exploring mitigations to limit this impact.</p> <p>However, an increase in the subsidy cost is not the same as the net impact of increased renewables deployment on electricity bills. Households are likely to benefit by the transition to a more sustainable and diverse energy mix which is supported by the proposal, such as reducing exposure to fluctuating long term gas prices. As such, a potential upward pressure on cost to the consumer is likely to be offset by significant non-monetised and non-power sector impacts.</p>	
Any significant or adverse distributional impacts?	Distributional impacts are considered at a societal level in Table A above.	Uncertain

Part B: Impacts on wider government priorities

Category	Description of impact	Directional rating
Business environment: Does the measure impact on the ease of doing business in the UK?	In the aggregate, the Government anticipates that the proposal will ease doing business in the UK. Foremost, the proposal seeks to address one of the current barriers faced by developers securing a CfD. The purpose of the CfD scheme is to support investment into new build renewable projects by protecting against the risk of high upfront capital costs and the sustained price risk across the asset's operating life. By increasing the likelihood of a developer being able to access a CfD, the policy supports investment into the UK's renewables sector.	Supports
International Considerations: Does the measure support international trade and investment?	The proposal is likely to have a positive impact investment into the UK, given that an increase in deployment of renewables under the CfD scheme could stimulate international investment.	Supports
Natural capital and Decarbonisation: Does the measure support commitments to improve the environment and decarbonise?	The proposal is designed to support the Government in achieving Clean Power 2030 and Net Zero by 2050. This induces benefits associated with the deployment of low carbon power by securing the supply of renewable energy and aiding in decarbonisation goals. Supporting the delivery of Clean Power 2030 also paves the way to decarbonising the wider economy by 2050 as the Government seeks to pursue the electrification of heat in buildings, transport, and industry.	Supports

8. Monitoring and evaluation of preferred option

M&E Objective 1: To provide timely learnings about the implementation of the proposed policy changes at the next Allocation Round to inform for AR8.

A process evaluation conducted following the launch of the next Allocation Round will provide timely insights into the policy proposal. This evaluation would aim to provide direct insights and recommendations to feed into the development of AR8.

The process evaluation would consist of:

- Interviews / workshops with DESNZ colleagues involved in the design and launch of the next Allocation Round to provide learnings about how internal processes could be improved.
- Interviews with applicants (successful and unsuccessful) to understand experiences of participating in the auction. This would provide learnings about how scheme design could be improved.

M&E Objective 2: To monitor short and long-term benefits from the proposed policy changes, enabling course-correction as needed.

A robust monitoring and benefits realisation plan will be designed and implemented alongside launch of the next Allocation Round to monitor progress and outcome metrics. Specific metrics to be monitored will need to be developed, with the intention that these will provide valuable insights to allow deeper investigation or course-correction as needed (e.g. linked to a non-delivery disincentive process).

Since the previous process and impact evaluation conducted in 2018 – 2021 by Technopolis of AR1, AR2 and AR3, the Department for Energy Security and Net Zero will be taking a proportional approach to evaluate scheme changes to the CfD scheme that were introduced after the previous evaluation was completed, for AR4, AR5, AR6 and AR7. The evaluation of AR 4, 5, 6 and 7 will be commissioned to an external contractor. Currently, the evaluation is in the procurement stage, with an estimated contract award date of 02 June 25. The evaluation is scheduled to have a 9-month duration, commencing in June 2025, and ending in February 2026.

M&E Objective 3: To evaluate the impact of the proposed policy changes, and the extent to which the proposed policy objectives have been realised.

Five years following the implementation of the proposals there will be a post-implementation review. This review will look to answer the following questions:

1. To what extent is the existing regulation working?
2. Is the existing form of Government regulation still the most appropriate approach?
3. Is Government intervention still required?
4. If this regulation is still required what refinements could be made? (What scope is there for simplification, improvements?)
5. If this regulation is not required, but Government intervention in some form is, what other regulation or alternatives to regulation would be appropriate?

Evidence from the process evaluation, monitoring and wider evaluation activities and analysis in this space will be used to inform this review.

9. Minimising administrative and compliance costs for preferred option

It is not anticipated that the proposal will incur additional costs to developers which would not already be borne by those applying to the CfD. To minimise potential administrative burden caused from the introduction of a new policy within the CfD, the Government will mitigate this by clearly outlining how the policy will be applied in the Allocation Framework, which will be published before AR7 begins. Clear guidance will also be given to NESO to inform the sharing of auction information with DESNZ to mitigate any additional administrative burdens from the policy change.

Declaration

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Department for Energy Security & Net Zero

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Minister responsible:

Michael Shanks

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed:



Date

01/05/2025

