EXPLANATORY MEMORANDUM TO

THE CONTRACTS FOR DIFFERENCE (ELECTRICITY SUPPLIER OBLIGATIONS) (AMENDMENT) (CORONAVIRUS) REGULATIONS 2020

2020 No. 709

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business, Energy & Industrial Strategy (BEIS) and is laid before Parliament by Command of Her Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 These Regulations amend the Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 ("the ESO Regulations") by:

- reducing each electricity supplier's obligations in respect of payments to CFD generators in a quarterly obligation period by the amount of any financial assistance provided by the government to the Low Carbon Contracts Company (LCCC) for that purpose in that quarter, multiplied by each supplier's market share in that quarter;
- increasing each electricity supplier's obligation four quarters later by the amount of financial assistance previously provided multiplied by each supplier's market share in that (later) quarter, to enable repayment of the financial assistance previously provided;
- enabling the LCCC to take into account anticipated receipt or repayment of financial assistance provided by the Government when setting or making in-period adjustments to the Interim Levy Rate (ILR) and / or Total Reserve Amount (TRA)[1] for a quarter; and
- enabling the LCCC to repay any financial assistance provided by the Government using monies collected from suppliers after the reconciliation process following the relevant period (the ESO Regulations currently only allow LCCC to use money collected from suppliers through the ILR or TRA to pay CFD generators or suppliers).

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 The instrument will enter into force the day after the day on which it is made. It will not impose burdens significantly more onerous than before or require people to adopt different patterns of behaviour without sufficient time to organise their affairs. The purpose of the SI is to alleviate a burden that would otherwise arise. Indeed, the urgency is that the instrument needs to come into force before the LCCC carries out

[1] More information on the ILR and TRA is available on the LCCC website: https://www.lowcarboncontracts.uk/cfd-levy

the quarterly reconciliation process that determines suppliers' obligations for quarter 2 2020, which is currently expected to take place on 9th July 2020. If the instrument comes into force after the reconciliation exercise has been carried out, it will not be possible for suppliers' obligations to be adjusted in respect of quarter 2 of 2020, so suppliers will be liable for the additional costs arising from the response to COVID-19 in this quarter and the instrument will not achieve its main policy objective.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The powers under which this instrument is made cover the United Kingdom but the territorial application of this instrument is limited to Great Britain.

4. Extent and Territorial Application

4.1 The territorial extent of the instrument is the United Kingdom, but the application of this instrument is limited to England, Wales, and Scotland. The CFD scheme does not currently operate in Northern Ireland and Northern Ireland electricity suppliers are not subject to obligations to make payments to the LCCC.

5. European Convention on Human Rights

5.1 The Rt Hon Kwasi Kwarteng MP, Minister of State for Business, Energy, and Clean Growth, has made the following statement regarding Human Rights:

"In my view the provisions of the Contracts for Difference (Electricity Supplier Obligations) (Amendment) (Coronavirus) Regulations 2020 are compatible with the Convention rights."

6. Legislative Context

6.1 This instrument amends the Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 under the Energy Act 2013. The Secretary of State for BEIS has had regard to the matters in section 5(2) of this Act before making these Regulations.

7. Policy background

What is being done and why?

7.1 The CFD scheme is the government's main mechanism for supporting new renewable electricity generation projects in Great Britain. The government designated the LCCC, a government owned company, to act as a CFD Counterparty under section 7 of the Energy Act 2013. In this role, the LCCC manages CFD contracts with generators and collects payments from licensed electricity suppliers under the ESO Regulations. We expect that suppliers pass on the costs of these payments to their customers.

7.2 The LCCC advised BEIS that as a result of measures introduced to reduce the spread of COVID-19, it was anticipating a shortfall in funds required to pay CFD generators in quarter 2 (April to June) 2020. There has been a sharp and unexpected fall in electricity demand, which, as the levy is set on a £ per MWh of electricity supplied basis, means the amount collected by LCCC from suppliers has been lower than forecast. There has also been a lower wholesale price of electricity, which has led to

higher payments to CFD generators, as generators are paid 'top up' payments between the wholesale price and the strike price[2].

7.3 As a result, electricity suppliers would have faced an unexpected increase at short notice in their obligations for the second quarter of 2020. The government was concerned that this could have had an adverse impact on electricity suppliers' businesses at a time when they were facing significant other pressures.

7.4 Therefore, in line with the government's efforts to support the economy in the light of the COVID-19 national emergency, the government agreed to provide a one-off loan to LCCC so that it can continue to pay CFD generators this quarter without increasing the financial burden on suppliers. The government also stated that it intended to reduce electricity suppliers' obligations relating to quarter 2 2020 by 80% of the difference between payments owed to CFD generators and ILR payments from suppliers relating to this quarter, and to increase suppliers' obligations in quarter 2 2021 by the same amount to enable repayment of the government loan.

7.5 This deferral is intended to give suppliers a high level of confidence over the additional cost that they will incur for each MWh supplied in quarter 2 2021, as this amount will be determined and announced in July 2020, enabling them to price this into tariffs in advance with minimal cost risk.

7.6 This instrument will enable LCCC to take into account anticipated receipt or repayment of a government loan when setting the ILR for a quarter or making in-period adjustments. It will also enable LCCC to repay government funding using monies collected from suppliers after the reconciliation process following the relevant period.

7.7 Although the principle objective of the instrument is, as described in paragraph 7.4, to reduce suppliers' obligations in quarter 2 2020 and increase them in quarter 2 2021, they are drafted in a way that the same mechanisms could be used in future quarters if necessary. Amendments are also being made to allow LCCC to take into account any financial assistance from the Government when setting the levy for future quarters. These amendments will allow government to provide similar support in future if similar exceptional circumstances occur.

7.8 The amendments made by this instrument will therefore substantially limit the negative short-term impact on electricity suppliers in GB of the unexpected increase in the costs relating to the CFD scheme during the COVID-19 pandemic.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 The government does not intend to consolidate this instrument with existing legislation at this time.

[2] More information on how the CFD scheme works is available on the LCCC's website: https://www.lowcarboncontracts.uk/how-does-the-cfd-work

10. Consultation outcome

10.1 The policy detailed in this instrument was subject to a one-week consultation, published on 12th May 2020. The government notes that this is a shorter than usual consultation period. It considered whether a longer consultation could be held, noting the time pressure referred to in paragraph 3.1 above. Due to the urgency of acting, the technical and beneficial nature of this legislative amendment, and the need for the instrument to receive approval in both Houses of Parliament before early July when the LCCC will carry out the reconciliation period for the current quarter, it was concluded that a longer period of consultation was not practicable. However, to mitigate the impacts the government took particular care to take additional measures to engage: these comprised alerting stakeholders as soon as possible to the planned change in a bulletin accompanied by a stakeholder bulletin from the LCCC, both published on 24 April; and holding a stakeholder webinar on 15 May in addition to inviting written comments.

10.2 The consultation received 22 responses from a mixture of small, medium and large electricity suppliers, as well as EnergyUK, Citizens' Advice, the Welsh Government and one member of the public. The majority of responses broadly welcomed the support BEIS is providing to electricity suppliers to minimise the immediate shock of additional CFD costs resulting from COVID-19.

10.3 A range of comments were provided across several themes, with the following ones being the most relevant to the Regulations:

- Nine responses argued that repayment should be deferred until at least quarter 2 2021, while seven agreed with the proposal in the consultation that it should be deferred to quarter 1 2021. Reasons cited for preferring quarter 2 2021 included: avoiding the need for retailers to increase prices over the winter in preparation for the higher ILR; reducing financial pressures on suppliers over winter; minimising the impact of seasonality distortions on the market share; and to allow the increased costs to be fully reflected in Ofgem's future energy retail price caps.
- Twelve responses agreed with the proposal that the supplier's obligations should be increased in line with their market share in the quarter when the loan is recovered, rather the current quarter, while three responses disagreed, arguing that it should be based on market share when the loan was made.
- Ten responses agreed explicitly with future proofing the Regulations.

10.4 Taking into account the comments received, government has decided to defer repayment of the increased obligation to quarter 2 of 2021 instead of quarter 1, to ensure that all the additional costs can be reflected in the energy retail price cap, and to avoid creating a disincentive for suppliers to act as a Supplier of Last Resort in the case of insolvencies.

10.5 Government has decided to implement the other proposals relating to how the reduction and increases in individual supplier obligations will be calculated, futureproofing the Regulations and enabling LCCC to pay back the loan, as set out in the consultation.

10.6 The consultation response setting out the government's decisions is published alongside this Explanatory Memorandum[3].

11. Guidance

11.1 Guidance on how the electricity supplier obligation operates is available on the LCCC website[4]. The consultation and government response documents[5] explain how the amendments will take effect and how LCCC will enact them.

11.2 The LCCC provides stakeholder updates[6] and a CFD dashboard[7], which enables suppliers to have sight of the level of shortfall in funds and any changes to the levy rate.

12. Impact

12.1 There is no, or no significant, impact on charities or voluntary bodies. The impact on business is expected to be positive and welcomed. This instrument is intended to ease the burden on licenced electricity suppliers in GB at a time of financial stress due to government's response to COVID-19. It will give electricity suppliers a high level of confidence over the additional costs they will incur for each unit of electricity supplied in quarter 2 of 2021, as this amount will be determined and announced in July 2020. This will enable suppliers to price the additional costs into consumer energy bills in advance with minimal cost risk.

12.2 There is no, or no significant, impact on the public sector.

12.3 A formal Impact Assessment has not been prepared for this instrument because these Regulations come under exemptions for Impact Assessments under the Better Regulation Framework as the instrument relates to financial assistance by a public body. Furthermore, the scale of net impacts from the instrument will be small, as it will defer some payments but will not permanently change what electricity suppliers are required to pay under the CFD scheme. However, an assessment of the impacts was included in the consultation and government response to aid understanding the proposals.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise the regulatory burden on small businesses.

13.3 The basis for the final decision on what action to take to assist small businesses is that the requirement to contribute to the costs of payments to CFD generators applies to all licenced electricity suppliers regardless of size. Suppliers contribute in proportion to their share of the GB electricity supply market. Small electricity suppliers will therefore benefit proportionately from the deferral to repay the additional

[3] The government response is available on the government website: https://www.gov.uk/government/consultations/contracts-for-difference-proposed-changes-to-the-electricity-supplier-obligation-regulations-in-response-to-covid-19
[4] https://www.lowcarboncontracts.uk/cfd-levy
[5] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/884693/cfd-proposed-changes-electricity-supplier-obligation-regs-consultation.pdf
[6] https://www.lowcarboncontracts.uk/publications
[7] https://www.lowcarboncontracts.uk/dashboards/cfd

contributions by the LCCC in respect of quarter 2 of 2020. This measure will be welcomed and will have minimal regulatory burden on small electricity suppliers.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is to consider the impact of this intervention as part of any future reviews of the CFD scheme.

14.2 The Regulations do not include a statutory review clause because it is anticipated that additional financial assistance is very unlikely to be provided, although this futureproofing is catered for in this instrument. The intervention is expected to be one-off unless other exceptional circumstances are experienced in the future.

15. Contact

15.1 Julie Whiting at BEIS Telephone: 0300 068 6194 or email: Julie.whiting@beis.gov.uk can answer any queries regarding the instrument.

15.2 Alex Weir, Deputy Director for Renewables at BEIS, can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Rt Hon Kwasi Kwarteng MP, Minister of State at BEIS, can confirm that this Explanatory Memorandum meets the required standard.