EXPLANATORY MEMORANDUM TO

THE CONTRACTS FOR DIFFERENCE (ELECTRICITY SUPPLIER OBLIGATIONS) (AMENDMENT) REGULATIONS 2026

2026 No. 1151

1. Introduction

1.1 This Explanatory Memorandum has been prepared by the Department for Energy Security and Net Zero and is laid before Parliament by Command of His Majesty.

2. Declaration

2.1 Polly Billington, Minister for Energy Consumers at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

2.2 Marc Sherratt, Deputy Director for Renewables Delivery, at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Ankita Mehra at the Department for Energy Security and Net Zero email: ContractsforDifference@energysecurity.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 Contracts for Difference ("CfDs") are funded by electricity suppliers through a levy, and ultimately by electricity consumers. The Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 ("the Electricity Supplier Obligations Regulations") set out the detailed rules for the levy. This instrument amends the Electricity Supplier Obligations Regulations to broaden the circumstances in which Government funding can be paid into the CfD scheme for the purposes of reducing the levy. In particular this links to the introduction of the British Industrial Competitiveness Scheme ("BICS").

Where does the legislation extend to, and apply?

4.2 The territorial extent of the amendments to the Electricity Supplier Obligations Regulations made by this instrument is England, Wales, Scotland and Northern Ireland.

4.3 The territorial application of the amendments to the Electricity Supplier Obligations Regulations made by this instrument is England, Wales and Scotland.

5. Policy Context

What is being done and why?

5.1 In November 2025, the Government consulted on BICS, under which eligible businesses would be exempt from the indirect costs of certain electricity schemes that

support renewables and ensure security of supply. Under BICS, eligible businesses will be exempt from paying the indirect costs of the Renewables Obligation ("RO"), Feed-in Tariffs ("FiT") and Capacity Market ("CM") schemes.

5.2 The exemption is due to take effect from April 2027 for the RO and FIT schemes, with the Capacity Market exemption following from October 2027. BICS is expected to provide significant reductions in electricity costs for eligible businesses by reducing the costs recovered through their electricity bills. The costs of the RO, FIT and CM schemes are recovered through licensed electricity suppliers and are generally reflected in electricity bills paid by consumers.

5.3 As businesses eligible for BICS will be exempt from contributing towards these costs, implementation of the exemption would otherwise reduce the number of consumers contributing to the costs of those schemes. In the absence of any offsetting measures, this would increase the amount that would need to be recovered from other electricity consumers, including households and non-exempt businesses.

5.4 The Government has confirmed its intention to proceed with the exemption and committed to ensuring that the cost arising from BICS, which would otherwise fall on domestic and other non-exempt consumers, will be offset by a combination of Exchequer funding, wider system savings and the removal of Carbon Price Support from April 2028.

5.5 The Regulations will facilitate the Government's provision of Exchequer funding to offset the impact of the BICS exemption. The CfD scheme is funded through the CfD supplier obligation, by which electricity suppliers make payments to the Low Carbon Contracts Company ("LCCC"). LCCC uses those funds to meet payments to generators and the operational costs of the scheme.

5.6 LCCC calculates an Interim Levy Rate ("ILR") for each quarter. The ILR is the forecast rate suppliers pay on the electricity they supply to fund expected CfD scheme costs. It is based on LCCC's forecast of payments to CfD generators, expected income and electricity supply, with reconciliation afterwards against actual costs and electricity supplied.

5.7 These proposals will allow Exchequer funding received by LCCC to reduce the amount that LCCC needs to recover from suppliers, resulting in a lower ILR and lower reserve amounts than would otherwise apply (and, of course, a lower effective levy rate at the point of reconciliation). The Government intends for the first Exchequer payment to reach LCCC in time for it to be reflected in the levy from 1 April 2027, when the BICS exemption is expected to take effect.

What was the previous policy, how is this different?

5.8 At present, the Regulations provide only limited scope for LCCC to take Exchequer funding into account in relation to the CfD levy. LCCC can only have regard to funding provided using the spending power in section 154(2)(b) of the Energy Act 2013. Moreover, the existing mechanism, introduced during the COVID-19 pandemic, only allows the Government to provide temporary loans to LCCC (having to be paid back three quarters later). This would not be suitable for the proposed BICS funding arrangement.

6. Legislative and Legal Context

How has the law changed?

6.1 CfDs are allocated to renewable electricity generators under Chapter 2 of Part 2 of the Energy Act 2013 and the Contracts for Difference (Allocation) Regulations 2014. Each is a contract between LCCC and a generator under which, essentially, the generator receives a fixed price for its electricity. The Electricity Supplier Obligations Regulations, another SI under Chapter 2, establish the levy arrangements set out above by which LCCC's obligations under CfDs are funded.

6.2 Amendments have been made to Regulations 2 (interpretation of 'SoS funds'), 5 (CfD quarterly contribution) and 7 (estimated cost, income and electricity supply) of the ESO Regulations. These amendments mean that, from LCCC's point of view when making estimates and calculations in relation to the CfD levy, it no longer matters what spending power is used to introduce Exchequer funding into the CfD scheme (change to regulation 2). They also ensure that, while Exchequer funding can still be introduced as loan, it does not have to be (and therefore, in such an instance, would not be repayable) and the terms on which loans may be provided are more flexible (changes to Regulations 5 and 7). Exchequer funding provided to support BICS will not be repayable.

6.3 The Regulations relate indirectly to the Renewables Obligation and Electricity Capacity (Amendment) (British Industrial Competitiveness Scheme Excluded Electricity) Regulations 2026. These make various legislative amendments necessary for BICS.

Why was this approach taken to change the law?

6.4 The Government is using the CfD mechanism to offset the levy burden on non-BICS consumers. Under the existing supplier obligation, electricity suppliers pay LCCC a forecast levy based on the electricity they supply, and these costs are ultimately reflected in consumers' bills. The approach builds on LCCC's established levy and settlement arrangements. It therefore avoids the need for a new funding or settlement framework and minimises the legislative and operational changes required for implementation. It would have been possible to draft a narrower amendment to the Electricity Supplier Obligations Regulations, focussed entirely on BICS. However, that would have added complexity and reduced future flexibility. Parliament will retain the oversight provided for by the spending power used to pay money to LCCC. Section 13 of the Energy Prices Act 2022, which is being used for the BICS-related Exchequer funding, brings with it a requirement for reporting to Parliament (section 14).

7. Consultation

Summary of consultation outcome and methodology

7.1 The changes reflected in this instrument were subject to a four-week consultation[1] from 13 August 2026 to 09 September 2026. The consultation received 13 responses, with the majority from electricity suppliers.

7.2 The government sought views on whether respondents agreed with using the Supplier Obligation framework as a mechanism to deliver the BICS offset and their rationale.

[1] Proposed legislative changes to support implementation of the British Industrial Competitiveness Scheme - https://assets.publishing.service.gov.uk/media/6a7da0749cba0097fdd83277/proposed-legislative-changes-to-support-implementation-of-BICS-consultation-document.pdf

The majority of respondents broadly agreed with the use of the CfD supplier obligation framework to deliver the BICS offset. Many respondents agreed that the use of an established framework is pragmatic, workable or proportionate, and noted that it could avoid the need to create a separate funding and settlement mechanism in advance of the proposed April 2027 implementation date.

7.3 Some respondents raised concerns regarding operational complexity and supplier administration. The Government considers that regular forecast updates and reconciliation are necessary to ensure that Exchequer funding remains aligned with underlying BICS costs as more accurate information on eligibility, consumption and policy costs becomes available. Using the existing CfD supplier obligation framework also minimises the need for suppliers, settlement bodies and Government to establish new charging, settlement or payment processes. The Government therefore considers this to be a proportionate approach which balances forecast accuracy and implementation risks.

7.4 We also sought views on the proposed amendments to the Electricity Supplier Obligations Regulations. Most respondents supported the proposed amendments. A small number opposed the amendments because they disagreed with the use of the CfD supplier obligation framework to deliver the BICS offset or considered that the draft did not contain sufficient safeguards to ensure that the power delivers the intended offset without creating risks for consumers, taxpayers or the integrity of the CfD scheme. The Government considers that the proposed amendments provide the most practical and proportionate means of enabling Exchequer funding to be reflected in the CfD levy calculation. The amendments build on existing concepts and arrangements already used within the supplier obligation framework, minimising the legislative and operational changes required ahead of implementation.

7.5 We also sought views on the proposed use of section 13 of the Energy Prices Act 2022 as the basis for the provision of Exchequer funding to LCCC. The Government notes that the majority of respondents agreed that section 13 of the Energy Prices Act 2022 provides an appropriate legal basis for the provision of Exchequer funding to LCCC.

8. Applicable Guidance

8.1 LCCC publishes quarterly operational metrics and supplier obligation updates on its website, covering current levy rates, exemption criteria and forthcoming regulatory changes. The figures vary with projected generation, electricity demand and market mid-prices to prevent over-collection or funding shortfalls.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because of its low level of impact on businesses. The Department for Business, Innovation, Science and Trade ("DBIST") also published a standalone Impact Assessment in relation to BICS in September 2026[2].

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on businesses, charities or voluntary bodies from the instrument itself. The intended impact of the proposed Exchequer funding is to prevent BICS from having an unfavourable impact on consumers who are not eligible for BICS.

9.3 The legislation does not impact small or micro businesses for the same reason.

9.4 There is no, or no significant, impact on the public sector. BICS will have an incremental effect on LCCC's administrative costs.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The Government consulted on these proposals between 13 August and 9 September 2026 and has published a Government Response[3].

10.2 The approach to monitoring this legislation will entail a review of the effectiveness of legislative changes. This will include reviewing with the LCCC the application of the measures in this SI to determine the extent to which they have fulfilled the policy objectives and may require adjustments.

10.3 The instrument does not include a statutory review clause; the requirement under section 28(2) of the Small Business, Enterprise and Employment Act 2015 to make provision for review does not apply to this instrument as it falls within an exception in section 28(3) of that Act.

[2] The Renewables Obligation and Electricity Capacity (Amendment) (British Industrial Competitiveness Scheme Excluded Electricity) Regulations 2026 - https://www.legislation.gov.uk/ukia/2026/149/pdfs/ukia_20260149_en.pdf

[3] Proposed legislative changes to support implementation of the British Industrial Competitiveness Scheme - GOV.UK - https://www.gov.uk/government/consultations/proposed-legislative-changes-to-support-implementation-of-the-british-industrial-competitiveness-scheme

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 As the instrument is subject to negative procedure and does not amend primary legislation, no statement is required.

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").