EXPLANATORY MEMORANDUM TO

THE CONTRACTS FOR DIFFERENCE (STANDARD TERMS) (AMENDMENT) REGULATIONS 2015

2015 No. 1425

1. This explanatory memorandum has been prepared by the Department of Energy and Climate Change and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument amends *The Contracts for Difference (Standard Terms) Regulations 2014* (S.I. 2014/2012) ("the 2014 Standard Terms Regulations") to allow payments to generators under a Contract for Difference to be suspended under negative price conditions, and to enable the Secretary of State to amend the Standard Terms Notice issued at the beginning of each Allocation round.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 The Energy Act 2013 ("the Act") contains powers enabling the Secretary of State to implement measures to reform the electricity market to encourage low carbon electricity generation and ensure security of supply. The reforms which have been implemented are known as Electricity Market Reform (EMR) and a number of statutory instruments have already been made in relation to CFDs, including:

- The Electricity Market Reform (General) Regulations 2014
- The Contracts for Difference (Definition of Eligible Generator) Regulations 2014
- The Contracts for Difference (Allocation) Regulations 2014
- The Contracts for Difference (Standard Terms) Regulations 2014

4.2. The first CFD allocation round opened in October 2014.

4.3. These Regulations introduce two amendments to the 2014 Standard Terms Regulations. Regulation 3 of the 2014 Standard Terms Regulations has been amended such that the CFD Counterparty is no longer to be obligated to make CFD difference payments in the event of negative electricity prices. This amendment is made in order to comply with the European Commission's State aid decision on the CFD for Renewables that any CFD Contract offered from 1 January 2016 should not allow for CFD payments during such events.

4.4. Regulation 9 has been amended to allow the Secretary of State to reissue the Standard Terms Notice that is issued alongside the announcement of an Allocation Round. The Standard Terms Notice contains tables of non-project specific data to be used in the

completion of a CFD Contract by a CFD Counterparty, and identifies the versions of the CFD Contract standard terms and conditions that are to be used for that Allocation Round. This new provision allows for the amendment the Standard Terms Notice to correct an error within this data, or for the updating of the version of the CFD Contract standard terms and conditions referred to in the notice where new standard terms have since been published. This power is time limited in that it must be exercised no later than twenty working days prior to the Allocation Round commencement date. This serves to ensure that generators have a minimum amount of time to assess the terms that they may be bound by before choosing whether to apply for a CFD

5. Territorial Extent and Application

5.1 This instrument extends to the United Kingdom.

6. European Convention on Human Rights

6.1 As the regulations are subject to negative resolution procedure and do not amend primary legislation, no statement is required.

7. Policy background

7.1 The electricity market reform programme is intended to incentivise investment in low-carbon electricity generation, while improving affordability for consumers, and maintaining energy security. These regulations are concerned with one element of the wider reform package – 'Contracts for Difference' (CFDs).

7.2 CFDs are contracts between a low carbon electricity generator and a Government-owned company, the CFD Counterparty. Under a CFD, the CFD Counterparty will pay the generator the difference between a fixed 'strike price' and a market reference price (or, if the reference price is higher than the strike price, the generator will pay the difference back to the CFD Counterparty). In this way they provide long-term price stabilisation to low carbon plant, allowing investment to come forward at a lower cost of capital and at a lower cost to consumers.

7.3 The intention of the current amendments is to:

- ensure that the Regulations allow for revisions to the CFD Contract to be made to comply with the European Commission's State aid condition on negative pricing;

- allow the Secretary of State to amend the Standard Terms Notice issued at the announcement of an Allocation Round after publication.

8. Consultation outcome

8.1 The policy set out in this instrument was subject to a six week consultation on Changes to the CFD Contract and CFD Regulations, published on 9 March 2015[1], which allowed stakeholders to provide feedback on the proposals. A number of stakeholder workshops were also held prior to the consultation.

8.2 Twenty-five responses were received to the consultation. These responses were supportive of the proposal to allow the Secretary of State to amend the Standard Terms Notice that is issued at the announcement of a new Allocation Round, noting that this additional flexibility is both consistent and valuable, though cautioning against its overuse.

8.3 Stakeholders were concerned by the proposal to suspend CFD payments during periods where the market reference price is negative for six consecutive hours or longer. However, a number of respondents recognised that given the specificity of the European Commission's State aid decision, there was no realistic alternative other than to make the amendments proposed.

8.4 The government response to the consultation has been published to coincide with the laying of the draft Regulations in Parliament. The government response sets out the views of stakeholders and an explanation of the final policy decisions taken.

10. Impact

10.1 The main impact of the changes introduced by this amendment will be on generators choosing to apply for a CFD, who may face some additional risk through the introduction of the negative price condition. They may choose to consider this risk in their application.

10.2 There will be a small impact on the public sector through the changes to settlement systems that the CFD Counterparty will have to make to implement the condition. These additional costs will be reflected through the operational costs levy charged to electricity suppliers.

10.3 An Impact Assessment relating to the wider CFD regime within which this clause sits is attached to this memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website. The impact of this clause is expected to be minor, such that it falls within the costs and benefits within that existing Impact Assessment, published in June 2014, being a function described in detail within the published CFD contract. Recent analysis to reflect changes to assumptions supports the conclusion that CFDs are a more efficient way of delivering decarbonisation ambitions, in comparison to existing policy instruments.

[1]https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/410469/Group_3_consultation_MASTER.pdf

11. Regulating small business

11.1 Given the nature and scale of investment in electricity infrastructure that the CFD scheme aims to encourage and the existence of the small scale FiT, it is unlikely that firms with less than 20 people will apply for support under CFDs. However, the Department has sought to consult as widely as possible to ensure the views of stakeholders have been taken into account in the development of CFDs.

12. Monitoring and review

12.1 Section 5(4) of the Energy Act 2013 requires the Secretary of State to prepare and lay before Parliament a report setting out how the Secretary of State has carried out his EMR functions. The section requires the Secretary of State to report, before 31 December each year and beginning in 2014, on how he has carried out his functions in Part 2 of the Act in order to deliver EMR's objectives. The report must be laid in Parliament and be shared with the Devolved Administrations.

12.2 The first of such reports was laid before Parliament on 6 November 2014. As well as fulfilling the reporting requirement, the EMR Annual Update 2014 provides Parliament and other stakeholders with a forward look of the path ahead and a summary of EMR progress since the Energy Bill received Royal Assent in December 2013.

12.3 In addition, section 66 of the Energy Act 2013, requires the Secretary of State to report to Parliament by the end of 2018 on a number of aspects of the operation of the EMR programme. These aspects include the extent to which the original objectives have been met, whether these objectives are still appropriate and whether they could be delivered in a way that imposes less regulation. This requirement covers CFDs, the Capacity Market and the transitional arrangements from the Renewables Obligation.

12.4 Evaluation will help to provide evidence for whether the EMR programme and its processes are as efficient and effective as possible and on whether the benefits of the programme are being achieved. The Government has commissioned independent contractors with appropriate expertise to provide evaluation of the first CFD allocation, first Capacity Market auction and the Final Investment Decision (FID) Enabling for Renewables process (which awarded Investment Contracts, early CFDs). The outcome of this evaluation will help inform future decisions in relation to the delivery of EMR and DECC's policies more broadly.

12.5 The Government currently envisages that evaluation work over the lifetime of the instruments will include (but not be confined to) an assessment of the extent to which the first round of awards of CFDs under the enduring regime have furthered the UK's low carbon energy objectives at least cost to consumers; the extent to which the FID Enabling for Renewables process has prevented investment hiatus; the extent to which the first Capacity Market auction has met expectations of providing security of supply; an assessment of whether the institutional framework underlying the programme is fit for purpose and an evaluation of the early impacts of the programme. The timing of these reviews and their outputs are still being considered.

12.6 The Government has also committed within its response to continuing to engage with stakeholders and the European Commission on the implementation of the negative prices condition, to explore whether alternative approaches might deliver a better outcome for consumers in the round.

13. Contact

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