EXPLANATORY MEMORANDUM TO

THE CONTRACTS FOR DIFFERENCE (ALLOCATION) AND ELECTRICITY MARKET REFORM (GENERAL) (AMENDMENT) REGULATIONS 2022

2022 No. XXXX

1. Introduction

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

2. Purpose of the instrument

2.1 This instrument relates to the Contracts for Difference (CFD) scheme, the Government's main support mechanism for delivering renewable energy projects.

2.2 The purpose of this instrument is to (i) strengthen the incentive for a developer to deliver its renewable energy project after it is awarded a CFD; (ii) change the Supply Chain Plan requirements so that an approved plan is valid for 9 months and so that all Floating Offshore Wind projects (regardless of size) must have an approved plan when applying for a CFD; and (iii) align regulations with current practice on valuation formula as set out in the Allocation Framework

2.3 In doing so the instrument amends the Contracts for Difference (Allocation) Regulations 2014 (S.I. 2014/2011), and the Electricity Market Reform (General) Regulations 2014 (S.I. 2014/2013).

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is to the United Kingdom other than regulations 2 and 4(1) which extend to Great Britain.

4.2 The territorial application of this instrument is to the United Kingdom other than regulations 2 and 4(1) which applies to Great Britain.

5. European Convention on Human Rights

5.1 The Rt Hon Greg Hands, Minister of State for Energy, Clean Growth and Climate Change has made the following statement regarding Human Rights:

"In my view the provisions of The Contracts for Difference (Allocation) and Electricity Market Reform (General) (Amendment) Regulations 2022 are compatible with the Convention rights".

6. Legislative Context

6.1 This instrument amends the Contracts for Difference (Allocation) Regulations 2014 and the Electricity Market Reform (General) Regulations 2014. Those Regulations

form part of the legislative framework underpinning the CFD scheme under section 6 of the Energy Act 2013 (c.32). The policies in respect of the amendments made by this instrument have been the subject of a consultation (see paragraph 10 of this Explanatory Memorandum) and are made in preparation of the next (i.e., the fifth) CFD Allocation Round, and in particular the decision of the Secretary of State in February 2022 to run annual CFD allocation rounds[1].

7. Policy background

What is being done and why?

7.1 The CFD scheme is intended to incentivise investment in low carbon electricity generation, while ensuring value for money for consumers and maintaining energy security.

7.2 A CFD is a private law contract between a low carbon electricity generator and the Low Carbon Contracts Company (known as LCCC), a Government-owned company that is operationally independent. An electricity generator party to a CFD is paid the difference between the 'strike price' - a pre-agreed price for electricity for the allocation round reflecting the cost of investing in a particular low carbon technology – and the 'reference price' - a measure of the average market price for electricity in the market.

Supply Chain Plans

7.3 Developers of low carbon electricity projects that have a generating capacity of 300MW or more must have a Supply Chain Plan Statement to take part in a CFD allocation round (see regulation 26 of the Contracts for Difference (Allocation) Regulations 2014). The aim of this process is to ensure that generators commit to a range of actions that can improve the competitiveness, productivity and capability of their supply chains. Strengthening supply chains helps to deliver the generating capacity needed to decarbonise the grid and achieve net zero emissions by 2050, as well as driving down renewable energy generation cost over time, contributing to lower costs for consumers. A Supply Chain Plan Statement is provided if a developer can demonstrate to the Secretary of State's satisfaction that the project is likely to make a material contribution to the development of supply chains (see regulation 9 of the Electricity Market Reform (General) Regulations 2014).

7.4 This policy has been in operation for four allocation rounds and was strengthened for Allocation Round Four to boost supply chain competitiveness, productivity and capability. The Government has proposed that from Allocation Round Five Supply Chain Plan policy must go further to incentivise investment in renewable energy supply chains, not least their capacity and effectiveness, considering the scale and speed of renewable energy deployment in the coming years.

7.5 Regulation 3 of the instrument will amend the validity period of a Supply Chain Plan Statement so that it is valid for 9 months (not 12 months) from the date of the notice given by the Secretary of State in regulation 11(2)(a) of the Electricity Market Reform (General) Regulations 2014. The Secretary of State will still be able to determine a longer period if in their opinion there is a compelling reason for the period to be

[1] https://www.gov.uk/government/news/government-hits-accelerator-on-low-cost-renewable-power

longer (see regulation 11(2)(b) of the Electricity Market Reform (General) Regulations 2014). In practice, this means developers will continue to be required to submit individual Supply Chain Plans for each CFD allocation round, which from 2023 will be held on an annual basis. The Government believes this will encourage developers to make new commitments that will strengthen the supply chain and reflects that the questions used in the Supply Chain Plans and the scoring of those questions are subject to change between rounds.

7.6 Regulation 2(3) of the instrument will amend the requirement to provide a Supply Chain Plan Statement so that it applies to all Floating Offshore Wind projects (i.e. of any threshold generating capacity) in regulation 26(5) of the Contracts for Difference (Allocation) Regulations 2014. The 300MW threshold generating capacity will continue to apply to all other eligible projects that are not Floating Offshore Wind (as required by paragraph (a) of new regulation 26(5) inserted by regulation 2(3) of the instrument). Floating Offshore Wind projects are currently too small to be captured by the 300MW threshold. Making this change will mean that all Floating Offshore Wind projects will be required to submit a Supply Chain Plan and have it approved ahead of applying for a CFD. This will allow the Government to support the Floating Offshore Wind industry as it approaches significant commercialisation and deployment.

Non-Delivery Disincentive

7.7 The Non-Delivery Disincentive (NDD) incentivises developers to sign up to and deliver projects once a CFD has been offered and entered into (as set out in regulation 14A of the Contracts for Difference (Allocation) Regulations 2014). Regulation 14A currently provides that if an offer for a CFD has lapsed, or if a CFD was entered into and terminated in certain circumstances, the eligible generator is not permitted to make an application for a CFD in the next allocation round in respect of an excluded site (as defined in regulation 14A(6) of those Regulations).

7.8 Regulation 2(2) of the instrument will amend the current NDD exclusion period in regulation 14A(2) of the Contracts for Difference (Allocation) Regulations 2014 so that an application cannot be made in respect of an excluded site in the subsequent two applicable allocation rounds (i.e. the next two rounds for which it might otherwise have been eligible to apply for). This change will ensure that the NDD is an appropriate period, especially in light of the decision to hold allocation rounds on an annual basis from 2023.

Target Commissioning Window Start Date

7.9 The valuation formula set out in Schedule 2 of the CFD Allocation Framework is used to calculate the budget impact of applications and sealed bids. Previously the Target Commissioning Date (defined in regulation 2 of the Contracts for Difference (Allocation) Regulations 2014) was used in the formula to calculate the budget impact.

7.10 For Allocation Round Four the Government changed this formula in the Allocation Framework and now it uses the Target Commissioning Window Start Date to calculate the budget impact. It is now necessary to ensure that this change is also applied to regulation 51(10)(c) of the Contracts for Difference (Allocation) Regulations 2014 which defines flexible bids (for purposes where there is a pending application) with reference to the Target Commissioning Date.

7.11 Regulation 2(4) of this instrument amends regulation 51(10)(c) of the Contracts for Difference (Allocation) Regulations 2014 to replace the Target Commissioning Date with Target Commissioning Window Start Date. This aligns the Regulations with the Allocation Framework such that flexible bids will be required to have a Target Commissioning Window Start Date not earlier than the date in the applicant's original application (instead of Target Commissioning Date).

8. European Union Withdrawal and Future Relationship

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.

10. Consultation outcome

10.1 All of the policies given effect to by this instrument were subject to the consultation on proposed amendments to Supply Chain Plans and CFD Delivery that ran from 4 February 2022 to 15 March 2022[2]. One online stakeholder event was held during the consultation period to discuss the policy proposals with interested parties.

10.2 The consultation attracted 41 written responses. These responses were from a range of stakeholders, including developers of Renewable Energy projects as well as key component suppliers, trade associations, delivery partners, investors and devolved governments.

10.3 Consultation responses were largely supportive of the proposals to be implemented through this instrument. There was overwhelming support for the proposal to replace Target Commissioning Date with Target Commissioning Window Start Date in the definition of flexible bids in regulation 51 of the Contracts for Difference (Allocation) Regulations 2014.

10.4 The majority of respondents were supportive of the proposals to strengthen the Non-Delivery Disincentive, with only a small number of respondents raising concerns about specific technologies and whether other non-delivery mechanisms would be more effective.

10.5 There was large support for the proposals to amend the validity period of a Supply Chain Plan on the condition that the burden on developers should be minimised as much as possible. We will be ensuring the burden on developers is minimal by allowing applicants to re-use relevant Supply Chain Plan answers from one year to the next in the event they need to re-apply for a CFD in a subsequent year because they did not make a successful bid the first time around.

10.6 Responses were largely in favour of the proposal to include Floating Offshore Wind (FOW) projects that fall under the 300MW threshold in the Supply Chain Plan process. However, most pointed to the need to have a bespoke Supply Chain Plan questionnaire accounting for their smaller size and their being new to the process.

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1052510/cfd-proposed-amendments-scp-cfd-delivery-consultation.pdf

After considering these comments, we are proposing a bespoke, lighter touch questionnaire for the relevant FOW projects, in a consultation[3] on changes to the Supply Chain Plan questionnaire published on 3 May 2022.

10.7 A more detailed analysis of the consultation responses and outcomes can be found in the Government Response[4] to the consultation on proposed amendments to Supply Chain Plans and CFD Delivery.

11. Guidance

11.1 National Grid, which is the body responsible for publishing CFD allocation guidelines and running the CFD allocation process, and the Low Carbon Contracts Company, which administers CFD contracts, publish guidance for potential applicants for a CFD or generators that have entered into a CFD contract. Both organisations will update their guidance as may be required to reflect changes made by this instrument.

11.2 The Department is consulting on and intends to publish in advance of the next CFD Allocation Round, an updated version of the Supply Chain Plan Guidance and Supply Chain Plan questionnaire in order to reflect the changes described in paragraph 7.5 and 7.6 along with a range of other technical changes.

12. Impact

12.1 There is no, or no significant, impact on charities or voluntary bodies.

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

12.3 A full Impact Assessment has not been prepared for this instrument because the measures qualified as De Minimis (i.e. net impact to business is less than £5 million a year):

- The Supply Chain Plans change to widen the scope to include Floating Offshore Wind will have a small administrative burden on businesses. Benefits of this change include increasing the capacity, competitiveness and productivity of supply chains. The change to the validity period has no impact as it remains the case that one Supply Chain Plan is required per CFD round.
- The impact of the Non-Delivery Disincentive on businesses is expected to be minimal. Extending the exclusion period would likely lead to little or no extra cost to industry. However, the benefits could be significant by ensuring an effective deterrent against non-delivery that would constrain our decarbonisation objectives.
- The amendment to the valuation formula was made prior to Allocation Round Four. As a result, industry has already adapted to the change, and we consider the costs of updating this point in the relevant legislation to be zero.

[3] https://www.gov.uk/government/consultations/contracts-for-difference-updating-the-allocation-round-5-supply-chain-plan-questionnaire
[4] https://www.gov.uk/government/consultations/contracts-for-difference-cfd-proposals-for-changes-to-supply-chain-plans-and-cfd-delivery

13. Regulating small businesses

13.1 This legislation applies to activities that are undertaken by small businesses that are eligible to apply for a CFD.

13.2 We do not expect that these Regulations will have a disproportionate effect on small businesses. Therefore, no specific action is proposed to minimise regulatory burdens on small businesses.

14. Monitoring & review

14.1 Section 5(4) of the Energy Act 2013 requires the Secretary of State, before 31st December each year, to prepare and lay before Parliament a report setting out how he has carried out his functions under Part 2 of that Act (which includes the powers used to establish the CFD scheme).

14.2 The Department is due to publish a review under Section 66 of the Energy Act 2013, which reviews the CFD provisions among other aspects of the operation of the Electricity Market Reform programme. The Department is considering future options for review of the CFD scheme.

14.3 In addition, the Department is of the view that the amendments made by the instrument are of relatively low economic impact (i.e. net impact to business is less than £5 million a year) and therefore it would not be proportionate to include a review clause.

14.4 Accordingly, this instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, The Rt Hon Greg Hands, Minister of State for Energy, Clean Growth and Climate Change has made the following statement regarding monitoring and review:

"In my view a review provision is not appropriate because it would not be proportionate taking into account the economic impact of the regulatory provision on business activity, as set out in the Small Business, Enterprise and Employment Act 2015".

15. Contact

15.1 Emilia Nesheva, at the Department of Business Energy and Industrial Strategy, Emilia.Nesheva@beis.gov.uk can be contacted with any queries regarding the instrument.

15.2 Helena Charlton, Deputy Director for Renewable Electricity Delivery, at the Department for Business Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Rt Hon Greg Hands, Minister of State for Energy, Clean Growth and Climate Change at the Department for Business Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.