EXPLANATORY MEMORANDUM TO

THE CONTRACTS FOR DIFFERENCE (DEFINITION OF ELIGIBLE GENERATOR) REGULATIONS 2014

2014 No. [XXXX]

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.

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

2. Purpose of the instrument

2.1 The Contracts for Difference (Definition of Eligible Generator) Regulations 2014 sets out which persons are eligible generators for the purposes of Chapter 2 of Part 2 of the Energy Act 2013 ("the Act").

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

3.1 These Regulations are the first regulations to be made using the powers contained in Chapter 2 of Part 2 of the Act which define an eligible generator. Only an eligible generator may be a party to a contract for difference ("CFD") with the CFD counterparty. The definition provided by these Regulations is applied in the Contracts for Difference (Allocation) Regulations 2014, the Electricity Market Reform (General) Regulations 2014 and the Contracts for Difference (Standard Terms) Regulations 2014. Certain other definitions used in these Regulations, in particular "eligible generating station" and the types of generating station are also applied in the Contracts for Difference (Allocation) Regulations 2014.

4. Legislative Context

4.1 The Act makes provision for Electricity Market Reform (EMR), which enables the Secretary of State to implement measures to reform the electricity market to encourage low carbon electricity generation and ensure security of supply.

4.2 The electricity market reforms will be implemented by a suite of secondary legislation and related documents. The suite includes the following:

- Contracts for Difference (Allocation) Regulations 2014
- Contracts for Difference (Definition of Eligible Generator) Regulations 2014
- Contracts for Difference (Standard Terms) Regulations 2014
- Contracts for Difference (Electricity Supplier Obligations) Regulations 2014
- Electricity Market Reform (General) Regulations 2014
- Electricity Capacity Regulations 2014
- Capacity Market Rules 2014
- Modifications to the Transmission Licence of National Grid Electricity Transmission plc. (NGET) which deal with preventing conflicts of interest; and
- Consequential code and licence modifications

4.3 This instrument needs to be read alongside the Contracts for Difference (Allocation) Regulations 2014 which sets out the detail of how eligible generators can apply for a CFD and how the Delivery Body allocates CFDs and the circumstances in which the Secretary of State may direct that a CFD be entered into with an eligible generator.

5. Territorial Extent and Application

5.1 This instrument applies to the United Kingdom.

5.2 As required by section 24 of the Act the Scottish and Welsh Ministers have been consulted.

5.3 The Department for Enterprise, Trade and Investment are also statutory consultees under section 24(1)(c) of the Energy Act 2013 and have been consulted.

6. European Convention on Human Rights

6.1 Michael Fallon, Minister of State at the Department of Energy and Climate Change has made the following statement regarding Human Rights:

In my view the provisions of the Contracts for Difference (Definition of Eligible Generator) Regulations 2014 are compatible with Convention rights.

7. Policy background

7.1 The EMR programme is intended to incentivise investment in low-carbon electricity generation, while improving affordability for consumers, and maintaining energy security.

7.2 EMR is the Government's response to the following examples of the challenges facing the electricity sector:

- The UK faces very rapid closure of existing capacity as older, more polluting plant go offline;
- The need to transform our generation mix to respond to the challenge of climate change and meet our legally-binding carbon reduction and renewable targets; and
- The expectation that electricity demand will continue to increase over the coming decades.

7.3 These challenges amount to a significant investment challenge, with an estimated £100 billion of further investment needed in the sector up to 2020. Without EMR the market is unlikely to deliver this investment at the scale or pace required. Nor is the market likely to deliver the diverse generation mix needed to meet our carbon reduction and renewables targets or ensure security of supply. EMR has been designed as a set of transitional arrangements which work with the market and address market failures to ensure that low carbon electricity generation is an attractive investment opportunity.

7.4 The key elements of this market reform will be delivered through two new mechanisms to incentivise the required investment. CFDs will support investment in low carbon generation by providing long-term revenue stabilisation to low-carbon plant, allowing investment to come forward at a lower cost of capital and therefore at a lower cost to consumers. The Capacity Market will provide a regular retainer payment to reliable forms of capacity (both demand and supply side); in return for such capacity being available when additional electricity supply is required at times of peak demand. This will reduce the threat of blackouts due to insufficient capacity on the system.

7.5 The Contracts for Difference (Allocation) Regulations 2014 cover what information applicants need to provide, how the budget is set out and allocated, and how the appeals process works. These Regulations set out details of what technologies are eligible for a CFD and provides definitions of these technologies. They also set out who qualifies as an eligible generator for the purpose of Chapter 2 of Part 2 of the Energy Act 2013.

8. Consultation outcome

8.1 The policy set out in this instrument was subject to an 11-week consultation. *Electricity Market Reform: Consultation on proposals for implementation* was published in October 2013 alongside a draft version of this instrument for stakeholders to provide feedback. This built on extensive, earlier consultation on policy issues and the appropriate approach to the allocation of CFDs.

8.2 123 responses were received to the October consultation.

8.3 No comments were received relating to this regulation.

8.4 A more detailed analysis of the consultation responses and outcome can be found in the Government Response to the consultation.

9. Guidance

9.1 There will be no formal guidance issued in relation to these Regulations.

9.2 The Government Response to the consultation informing this and the other instruments set out in paragraph 4.2 has been published to coincide with the laying of regulations in Parliament. The Government Response sets out the views of stakeholders in response to the previously proposed policy positions, and an explanation of the final policy decisions taken.

9.3 Published alongside the Government Response is *Implementing Electricity Market Reform*. This document is intended to provide a comprehensive source of information on the final design of EMR ahead of the first CFD allocation and capacity market auction later this year. The document will provide stakeholders with detail on final EMR policy decisions and set out how these fit within the legislative framework for EMR.

10. Impact

10.1 Applying for CFDs is voluntary. The impact of these Regulations on businesses, charities or voluntary bodies is only applicable if an eligible generator applies for a CFD in respect of an eligible generating station.

10.2 The impact on the public sector is the cost borne by Government of National Grid delivering their EMR functions and those associated with setting up the single counterparty body.

10.3 An Impact Assessment that includes the impacts of this instrument is attached to The Contracts for Difference (Allocation) Regulations 2014 laid in Parliament alongside this instrument and will be published on the legislation.gov.uk website.

10.4 A number of Impact Assessments relating to the broader CFD regime and the EMR programme have previously been prepared and published on the Parliamentary website alongside the Energy Act and its preparatory documents.

11. Regulating small business

11.1 The legislation applies to small businesses but these Regulations only provide for definitions which are used in other legislation, as noted above.

11.2 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 EMR. 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 EMR. In addition, the Department established two working groups to help develop proposals to support the participation of smaller independent generators.

12. Monitoring and review

12.1 Section 66(1)(a) of the Energy Act 2013 requires the Secretary of State to carry out a review of Chapter 2 of Part 2 (i.e. the CFD powers) and as part of that review SoS must consider the objectives of the CFD provisions, assess whether those objectives have been achieved, and whether they remain appropriate, and if so, the extent to which they could be achieved in a way which imposes less regulation.

13. Contact

13.1 Irum Kareem at the Department of Energy and Climate Change Tel: 0300 068 8082 or email: irum.kareem@decc.gsi.gov.uk can answer any queries regarding the instrument.