EXPLANATORY MEMORANDUM TO

THE CONTRACTS FOR DIFFERENCE (MISCELLANEOUS AMENDMENTS) REGULATIONS 2018

2018 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 These Regulations amend two statutory instruments made under the Energy Act 2013 relating to Contracts for Difference (CFDs).

2.2 They amend the Contracts for Difference (Allocation) Regulations 2014 (the Allocation Regulations) by describing a new subclass of "eligible generating station" in respect of which an application for a CFD may be made, subject to a certain "additional qualification requirement" being met (a "remote island wind CFD unit").

2.3 The Regulations also amend the Contracts for Difference (Definition of Eligible Generator) Regulations 2014 (the Eligible Generator Regulations) by:

- removing a requirement for combined heat and power generators to intend to accredit their project under the Combined Heat and Power Quality Assurance (CHPQA) Standard Issue 6; and
- making a minor amendment to the definition of "waste" to make clear that materials which have been intentionally modified or contaminated in order to satisfy the requirements of the existing definition are excluded from the meaning of that term (which also has the effect of implementing a requirement of Directive (EU) 2015/1513 (the "2015 Directive")).

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 Disregarding minor or consequential changes, the territorial application of this instrument varies between provisions.

4. Legislative Context

4.1 The Energy Act 2013 enables the Secretary of State to implement measures to reform the electricity market to encourage low carbon electricity generation and ensure security of supply. One such measure is the CFD scheme, a financial support mechanism for new large-scale renewable energy projects in the UK. The scheme is implemented through secondary legislation and related documents.

Contracts for Difference (Allocation) Regulations 2014

4.2 The Allocation Regulations provide detail regarding how CFDs are to be allocated. These Regulations insert a new defined term into the Allocation Regulations describing a subclass of "eligible generating station" in respect of which an application for a CFD may be made: a "remote island wind CFD unit".

4.3 They also insert an "additional qualification requirement" which an eligible generator making an application in respect of a remote island wind CFD unit must satisfy in order to constitute a "qualifying application" for the purposes of the Allocation Regulations.

Contracts for Difference (Definition of Eligible Generator) Regulations 2014

4.4 The Eligible Generator Regulations set out which persons are "eligible generators" and therefore able to enter into a CFD, including those who intend to carry out generating activity in relation to a combined heat and power (CHP) station.

4.5 These Regulations amend the Eligible Generator Regulations by removing the requirement for an eligible generator in respect of a "dedicated biomass with CHP station" or "energy from waste with CHP station" to intend to carry out generating activity in relation to a CHP station accredited under the Combined Heat and Power Quality Assurance (CHPQA) Standard Issue 6, October 2016.

4.6 As a result of this amendment, an eligible generator in respect of either of these categories of eligible generating station must intend to carry out generating activity in relation to a generating station which is simply a "combined heat and power generating station" (as that term is defined in the Eligible Generator Regulations).

4.7 These Regulations also make a minor amendment to the definition of the term "waste" in the same Regulations.

4.8 The amended Eligible Generator Regulations continue to define "waste" by reference to Article 3(1) of Directive 2008/98/EC. However, the amended definition also makes express that substances will not constitute waste where they have been intentionally modified or contaminated to fall within the definition of waste provided for in Article 3(1) of that Directive.

4.9 This amendment has the effect of making the definition of the term "waste" consistent with the definition of that term provided for in Directive 2009/28/EC (the Renewable Energy Directive) as amended by the 2015 Directive.

4.10 A transposition note in respect of this amendment has been published alongside this memorandum.

5. Extent and Territorial Application

5.1 The Regulations extend to the United Kingdom, other than regulation 2 which does not extend to Northern Ireland. The CFD scheme currently does not operate in Northern Ireland.

5.2 The territorial application of this instrument is to the United Kingdom.

6. European Convention on Human Rights

6.1 Claire Perry, Minister of State at the Department for Business, Energy and Industrial Strategy has made the following statement regarding Human Rights:

6.2 In my view, the provisions of the Contracts for Difference (Miscellaneous Amendments) Regulations 2017 are compatible with the Convention rights.

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 improving affordability for consumers and maintaining energy security.

7.2 A Contract for Difference (CFD) is a private law contract between a low carbon electricity generator and the Low Carbon Contracts Company (LCCC), a Government-owned company. A generator party to a CFD is paid the difference between the 'strike price' – a price for electricity 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.

Remote Island Wind

7.3 The Government recently consulted on a proposal to set a separate administrative (i.e. maximum) strike price for remote island wind CFD units and for those units to be eligible to take part in future allocation rounds as a "Pot 2" technology (such that they compete for available budget with other less established technologies only).

7.4 These Regulations amend the Allocation Regulations by creating a new subclass of generating station in respect of which an application for a CFD can be made: a "remote island wind CFD unit". They also insert an "additional qualification requirement" into the Allocation Regulations which an applicant in respect of a remote island wind CFD unit must satisfy in order to qualify for a CFD. That additional qualification requirement has been designed to ensure that projects which are eligible to make an application as a "remote island wind CFD unit" share the same fundamental characteristics (such that it is appropriate for them to compete for support against other Pot 2 technologies).

7.5 A Government response in relation to the proposal to recognise remote island wind CFD units as a distinct subclass of "eligible generating station" has been published alongside this explanatory memorandum along with an impact assessment.

Updating future CHP efficiency requirements

7.6 The Government recently consulted on options to amend the CHPQA standard with a view to increasing the overall efficiency requirements applying in respect of future CFD supported "dedicated biomass with CHP stations" and "energy from waste with CHP stations". As a consequence of the planned amendment to the CHPQA standard the reference to the CHPQA Standard Issue 6 in the Eligible Generator Regulations will soon be outdated.

7.7 Rather than updating the Eligible Generator Regulations to refer to the replacement CHPQA standard, these Regulations instead remove the requirement for eligible generators in respect of these kinds of eligible generating stations to intend to carry out generating activity in relation to a generating station which is accredited under the CHPQA program.

7.8 The effect of this amendment is that eligible generators in respect of either a "dedicated biomass with CHP station" or "energy from waste with CHP station" must simply intend to carry out generating activity in relation to a "combined heat and power generating station".

7.9 This eliminates the requirement to update a reference to this highly technical industry document via secondary legislation each time that a revised CHPQA standard is published.

7.10 The Department does not consider that this amendment will result in reduced oversight in relation to the efficiency of CFD supported "dedicated biomass with CHP" or "energy from waste with CHP" stations. That is because standard CFD contract terms already include a separate obligation on developers of these technology types to accredit their project under the CHPQA scheme, and compliance with this obligation is tested on an on-going basis. Developers which fail to comply with that requirement are at risk of having their CFD terminated or their payments under the CFD contract withheld. The Government is under a statutory obligation to consult in respect of revised CFD standard terms.

7.11 CFD standard contract terms are updated to refer to the most recently published CHPQA standard in this regard prior to those terms being published in advance of a CFD allocation round (and the Government is under a statutory obligation to consult on proposed revisions to CFD standard terms).

7.12 The Government also intends to include in the Allocation Framework published in respect of future CFD allocation rounds a requirement for applicants to confirm that they are aware of these contractual requirements.

Amendment of definition of Waste

7.13 These Regulations amend the definition of the term "waste" in the Eligible Generator Regulations to make it consistent with the definition of that term provided for in Directive 2009/28/EC (the Renewable Energy Directive) as amended by the 2015 Directive.

7.14 The amended Eligible Generator Regulations continue to define "waste" by reference to Article 3(1) of Directive 2008/98/EC. However, the amended definition also makes express that substances will not constitute waste where they have been intentionally modified or contaminated to fall within the definition of waste provided for in Article 3(1) of that Directive.

7.15 The transposition deadline for the 2015 Directive was 10 September 2017. Future applicants in respect of the CFD scheme will be subject to the requirement set out in the amended Eligible Generator Regulations. The amended definition has already been inserted into existing CFD contracts.

8. Consultation outcome

8.1 The Department for Business, Energy and Industrial Strategy held a 12-week consultation from December 2017 to March 2018 on proposed amendments to the CFD scheme, including those described here. Several stakeholder events were held during the consultation period to discuss the policy proposals with interested parties.

8.2 The consultation attracted around 1,500 written responses, of which 89 were individual replies from a range of stakeholders, including renewable electricity

developers, trade associations, local authorities and members of the public. The remainder were similar responses sent in the context of campaigns, calling for an end to CFDs for all types of electricity generated from burning or gasifying biomass and waste, while also supporting the introduction of higher efficiency standards proposed for new CHP stations supported under the CFD scheme.

8.3 Consultation responses were largely supportive of the proposals to be implemented through these Regulations. The definition of "remote island wind CFD unit" and the associated qualifying requirements have been drafted to reflect a number of practical and technical observations that came to light during the consultation. Four respondents commented on the Government's proposal to amend the Eligible Generator Regulations to remove the reference to the CHPQA standard. All four either agreed with the approach proposed by Government or agreed that the proposal provided sufficient clarity for applicants of "dedicated biomass with CHP" and "energy from waste with CHP" projects. The Government's proposal to amend the definition of 'waste' was supported by all the respondents who commented on that proposal.

8.4 A Government Response setting out a detailed analysis of the consultation responses and the proposals to be implemented through these Regulations is published alongside this Explanatory Memorandum. The Government has also published in parallel updated impact assessments relating to the recognition of Remote Island Wind as a distinct technology in future CFD allocation rounds as well as planned changes to the CHPQA Standard with which future CFD supported "dedicated biomass with CHP" and "energy from waste with CHP" stations will be required to comply.

9. Guidance

9.1 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. Both organisations will update their guidance to reflect the changes made by these Regulations.

9.2 The Department intends to consult on and publish in advance of the next CFD allocation round an updated version of the CHPQA Standard (and related guidance) reflecting the latest CHP efficiency requirements with which it intends to require future CFD supported "dedicated biomass with CHP" and "energy from waste with CHP" to comply.

10. Impact

10.1 Applying for a CFD is voluntary. The impact of these Regulations only applies to potential generators who wish to apply for a CFD in respect of an eligible generating station.

Remote Island Wind

10.2 An impact assessment published alongside this memorandum provides further detail of the expected impacts of recognising remote island wind CFD units as a new, distinct subclass of generating station.

10.3 CFD allocation rounds allocate CFDs by means of a reverse, sealed bid auction. As a result the precise impact of this proposal will depend on a wide range of factors and

is not possible to state with certainty. The analysis underlying the impact assessment published alongside this explanatory memorandum models the impact which recognising remote island wind CFD units as a distinct subclass of eligible generating station may have in relation to a CFD allocation round sharing the key characteristics of the recent second CFD allocation round (including in terms of budget, generating capacity secured, technology mix and clearing prices).

10.4 Under the scenarios tested, the analysis suggests that remote island wind CFD units taking part in such an allocation round could be associated with:

a) a reduction in total support costs of between £0-£1.2bn (2012 prices, PV), assuming that remote island wind projects were to have bid in at a cost competitive price compared to the other less established technologies taking part in the round;

b) reductions to the generation costs within Pot 2 with a range of 0-£500m (2012 prices, PV);

c) positive environmental impacts with a carbon saving valued at between £0-£300m (2012 prices, PV); and

d) unmonetised improvements in air quality due to a shift away from technologies that burn fuel to wind-based generation that does not use fuel.

10.5 Overall, allowing remote island wind CFD units to take part in a CFD allocation round sharing the key characteristics of the recent second CFD allocation round could result in net benefits to society of up to £800m (2012 prices, PV).

Updating future CHP efficiency requirements

10.6 Removing the requirement for eligible generators in respect of "dedicated biomass with CHP" and "energy from waste with CHP" stations to intend to carry out generating activity in relation to a generating station which is accredited under the CHPQA program from the Eligible Generator Regulations is not expected to have any financial impact on public sector business. However, an impact assessment is published alongside this memorandum which estimates the wider impacts of the Government's proposal to increase the efficiency requirements applying to CHP plants securing support in future CFD allocation rounds (see 7.7- 7.13 above).

10.7 The impact assessment estimates the changes may lead to a net benefit to society of between £97m and £409m (2012 prices, present value), assuming a similar level of capacity of dedicated biomass CHP comes forward as in past allocation rounds. These benefits are driven by the potential reduction in fuel consumption (with carbon benefits of £0-5m PV and biomass resource cost savings of £0 - 21m PV) and the potential increase in heat output (with carbon benefits of £165 - 199m PV, and gas resource savings of £174 - 209m PV). Improvements in air quality through a reduction in biomass consumption and a reduction in the amount of gas required to generate heat from additional sources have not been monetised.

10.8 These changes may affect the generating costs of plants that choose to apply for a CFD (and are successful), potentially increasing costs or meaning that more efficient

plants receive support in place of less efficient plants, in accordance with the policy intention that support should only go to plants that demonstrate the best technology and application of CHP. To reflect the possibility of higher costs to generators a range has been estimated of up to £268m.The impact assessment also considers the extent to which costs would need to rise in order to offset the benefits.

Definition of 'waste'

10.9 The impact of this amendment on businesses is only applicable if a generator had intended to apply for a CFD in respect of an eligible generating station and to intentionally modify or contaminate a substance in order to fit within the definition of 'waste'.

10.10 The Government is not aware of any prospective CFD applicant which either intends or intended to do so (and the proposal to amend the definition of the term "waste" was supported by all eight respondents who responded to a recent consultation). An impact assessment has therefore not been prepared for this amendment.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses that are free to apply for a CFD if they are building an eligible generating station.

11.2 Based on feedback received during the consultation, 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.

12. Monitoring & review

12.1 Section 5(4) of the Energy Act 2013 requires the Secretary of State to, before 31st December each year, 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).

12.2 Section 6 of the Energy Act 2013 requires the Secretary of State to, as soon as reasonably practicable 5 years from the date on which the Energy Act 2013 was passed, carry out a review of the provisions of Chapter 2 of Part 2 of that Act. That review will include the objectives of the CFD related provisions, whether they have been achieved, and whether they remain appropriate.

13. Contact

13.1 Oluseye Onabolu at the Department for Business, Energy and Industrial Strategy Telephone: 020 7215 3191 or email: oluseye.onabolu@beis.gov.uk can answer any queries regarding the instrument.