EXPLANATORY MEMORANDUM TO

THE CONTRACTS FOR DIFFERENCE (MISCELLANEOUS AMENDMENTS) REGULATIONS 2021

2021 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 three statutory instruments made under the Energy Act 2013 relating to Contracts for Difference (CFDs).

2.2 They amend the Contracts for Difference (Definition of Eligible Generator) Regulations 2014 (the Eligible Generator Regulations) by removing "biomass conversion station" from the list of "eligible generating stations" that can apply for a CFD.

2.3 The Regulations also amend the Electricity Market Reform (General) Regulations 2014 (the EMR Regulations) by:

- revising and expanding the range of matters to which the Secretary of State must have regard in deciding whether or not to provide a supply chain statement to an applicant or supply chain implementation statement to an eligible generator,
- inserting a new stage in the process where an eligible generator who received a supply chain statement and has been awarded a CFD following an allocation round may apply for a supply chain implementation statement and setting out the particulars that should accompany such an application,
- requiring the Secretary of State to either provide a supply chain implementation statement or refusal and reasons for that refusal, and the circumstances in which the Secretary of State must provide a supply chain implementation statement to an eligible generator,
- extending rules relating to the disclosure of information that may damage commercial interests to include all information associated with the supply chain assessment process.

2.4 The Regulations also amend the Contracts for Difference (Allocation) Regulations 2014 (the Allocation Regulations) by:

- Removing references to "biomass conversion station" as part of other amendments to the Eligible Generator Regulations.
- describing a new subclass of "eligible generating station" that can apply for a CFD, subject to certain criteria being met (a "floating offshore wind CFD unit").
- amending the definition of delivery years to allow allocation rounds to be run for delivery years after 31st March 2026 up to 31st March 2035.

- strengthening the rules around exclusions from an allocation round as a result of an offer of a CFD lapsing or under certain circumstances of termination.
- amending the operation of the budget to provide the flexibility to decide on a round by round basis whether to apply any capacity caps, maxima and / or minima (when expressed in terms of capacity) as a 'soft' rather than as a 'hard' constraint.
- making a number of minor and technical changes including making our powers to revise the budget explicit and including extra scenarios under which the allocation process can commence to make the process more efficient.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument varies between provisions.

3.3 Parts 1, 2 and 3 cover the entire United Kingdom whilst Part 4 only applies to Great Britain.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is to the United Kingdom other than Part 4 which only extends to Great Britain.

4.2 The territorial application of this instrument is to the United Kingdom other than Part 4 which only applies to Great Britain.

5. European Convention on Human Rights

5.1 Anne-Marie Trevelyan, Minister of State at the Department of Business, Energy and Industrial Strategy has made the following statement regarding Human Rights:

"In my view the provisions of the Contracts for Difference (Miscellaneous Amendments) Regulations 2021 are compatible with the Convention rights."

6. Legislative Context

6.1 In advance of the fourth CFD allocation round we consulted on proposals to undertake a package of amendments to the CFD regime intended to ensure that it can operate more effectively and flexibly, in future Allocation Rounds.

6.2 These proposals include amendments to three sets of Regulations:

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

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.

Biomass Conversions

7.3 The Government consulted in March 2020 on a proposal to exclude biomass conversions from future allocation rounds of the CFD scheme. Biomass conversions have played a material role in helping meet the UK's 2020 renewables targets by replacing coal fired power stations with renewable energy generation. However, as electricity generation has become less carbon intensive, we have reviewed the role of biomass conversions.

7.4 These Regulations amend the Eligible Generator Regulations to remove "biomass conversion station" from the list of eligible generators that can apply for a CFD, meaning they will no longer be able to apply for a CFD in future allocation rounds. They also amend the Allocation Regulations to remove references to "biomass conversion station".

7.5 A Government response in relation to the proposal to exclude coal-to-biomass was published in November 2020.

Supply Chain Plans

7.6 Developers of low carbon electricity projects may apply for a supply chain statement from the Secretary of State. A statement is provided if a developer can demonstrate to the Secretary of State's satisfaction that the project will make a material contribution to the development of relevant supply chains. Allocation round CFD applicants with a capacity of 300MW or more are required to present the supply chain statement to National Grid (as EMR Delivery Body) as part of their CFD application. The aim of this policy is to encourage the effective development of open and competitive supply chains and the promotion of innovation and skills in the low carbon electricity generating sector.

7.7 This policy has been in operation for three allocation rounds. However, the Government believes that the current policy approach needs to be strengthened to boost competitiveness and productivity in places which stand to benefit the most, harness innovation, invest in skills, while driving regional growth and progress towards the UK's 2050 net zero target. A consultation published in March 2020 invited views on how the supply chain plan process could be strengthened to help deliver the government's expanded ambitions. A further consultation was published in November 2020 proposing more detailed changes to the Supply Chain Plan policy, which are designed to increase the clarity, ambition, and measurability of developers' commitments, and ensure that those commitments are delivered.

7.8 The Government has decided that from the fourth CFD allocation round, supply chain applications must address a wider set of criteria to support the Government's new ambitions for the development of supply chains. Accordingly, these regulations revise the criteria to which the Secretary of State must have regard when assessing an application for a supply chain statement.

7.9 These Regulations also create a new stage in the process requiring eligible generators who have received a CFD following an allocation round to demonstrate the extent to which they have delivered on the commitments set out in their original supply chain statement. They may do this by submitting a supply chain implementation application to the Secretary of State describing how the establishment or alteration of the generating station is making a material contribution to the development of supply chains. Amendments are made regarding the information that must accompany such an application which, for an eligible generator with a CFD issued pursuant to the Allocation Regulations, must include evidence that they have fulfilled a Milestone Requirement in compliance with the conditions of their CFD.

7.10 Amendments are also made concerning the matters to which the Secretary of State must have regard before providing a supply chain implementation statement to the eligible generator. These regulations also require the Secretary of State to give a notice to the eligible generator which either contains a supply chain implementation statement or refusal and reasons for that refusal. They further require that the Secretary of State must provide a supply chain implementation statement if such a notice has not already been issued within 60 working days of receiving an application.

7.11 These Regulations also extend the confidentiality provisions relating to the disclosure of information that may damage the commercial interests of any other person to include all information associated with the supply chain assessment process.

7.12 Provision of a supply chain implementation statement will enable an eligible generator awarded a CFD to fulfil an Operational Condition Precedent (OCP) under its CFD. The LCCC, as CFD Counterparty, may terminate a CFD if this OCP is not fulfilled by the CFD Long Stop Date. The requirement to fulfil this new OCP will be inserted into the CFD Standard Terms and Conditions for new CFDs awarded from the fourth allocation round and not these Regulations.

7.13 A response setting out the Government's decisions on these matters was published in May 2021.

Floating Offshore Wind

7.14 The Government consulted in March 2020 on proposals to define floating wind as a separate eligible technology to offshore wind, to have a separate administrative (i.e. maximum) strike price and for those units to be eligible to take part in future allocation rounds. It will be able to compete as a "Pot 2" technology (such that they compete for available budget with other less established technologies only).

7.15 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 "floating offshore wind CFD unit". They also insert an "additional qualification requirement" into the Allocation Regulations which an applicant in respect of a floating offshore wind CFD unit must satisfy in order to qualify for a CFD. The additional qualification requirements have been designed to ensure that projects which

are eligible to make an application as a "floating offshore wind CFD unit" can demonstrate they are distinct from traditional fixed bottom offshore wind projects.

7.16 A Government response in relation to the proposal to recognise floating offshore wind CFD units as a distinct subclass of "eligible generating station" was published in November 2020.

7.17 A further consultation was published in November 2020 on a proposal to not extend phasing to floating offshore wind. Phasing allows fixed bottom offshore wind projects to better manage construction risk by dividing the project into several phases. Each phase has its own target commissioning date, target commissioning window and longstop date but share the same strike price. It was determined phasing should not be extended to floating offshore wind because we consider floating wind projects do not face the same construction risks as fixed bottom projects and, for the foreseeable future, floating projects are likely to be small in size, so phasing is not required. We may review this when floating projects increase in size.

7.18 These Regulations amend the Allocation Regulations by including in the list of conditions which an applicant in respect of a floating offshore wind CFD unit must satisfy in order to qualify for a CFD including the fact that the CFD unit must not form part of a phased offshore wind CFD unit.

7.19 A Government response in relation to proposals not to extend phasing to floating offshore wind was published in May 2021.

Extending Delivery years

7.20 The Government consulted in March 2020 on extending the scheme delivery years beyond 31st March 2026. Delivery years are the years in which a project plans to start generating in and will be eligible to bid into an allocation round and each allocation round specifies delivery years which applicants are able to bid into.

7.21 These Regulations amend the Allocation Regulations by amending the definition of delivery years to state delivery years can be set up to 31st March 2035.

7.22 A Government response in relation to extending delivery years was published in November 2020.

Non-delivery disincentive

7.23 The Government consulted in March 2020 on amending the non-delivery disincentive exclusion period to ensure offending sites are excluded from making an application for a CFD in the subsequent allocation round. The Non-Delivery Disincentive (NDD) penalises non-compliant developers by excluding applications for a CFD at the same site for a specified period.

7.24 These Regulations amend the Allocation Regulations by amending the current NDD exclusion period to ensure that generators are prohibited from making a CFD application in respect of an excluded site in the subsequent applicable allocation round (i.e. the next round for which it might otherwise have been eligible to apply). Expressing the exclusion in terms of the subsequent applicable round should provide greater certainty of achieving, and clarity about, the desired outcome, than specifying a time-period.

7.25 A Government response in relation to amending the NDD exclusion period was published in November 2020.

Soft Constraints

7.26 The Government consulted in March 2020 on amending the way the budget operates to provide the flexibility to decide on a round by round basis whether each capacity cap, maximum and/or minimum (where they are expressed in terms of capacity) would be applied as a 'soft' rather than as a 'hard' constraint. If applied as a soft constraint, the application that breaches the relevant constraint would be accepted, subject to conditions.

7.27 These Regulations amend the Allocation Regulations by amending the way the budget operates to provide the flexibility to decide on a round by round basis whether each capacity cap, maximum and/or minimum (where they are expressed in terms of capacity) would be applied as a 'soft' or as a 'hard' constraint. Any conditions that must be met for it to apply as a soft constraint would be specified in the Allocation Framework for the allocation round.

7.28 A Government response in relation to soft constraints was published in November 2020.

Miscellaneous amendments to the Contracts for Difference (Allocation) Regulations 2014

7.29 The Government consulted in March 2020 on a number of administrative amendments to the Allocation Regulations to improve the operation and clarity of the CFD scheme.

7.30 These Regulations amend the Allocation Regulations by:

- omitting clauses which mention a relevant period and an end date for an allocation round to remove the confusion caused by stakeholders believing the end date is when all activities for a CFD round end which is inaccurate as the allocation process will end either when CFD Notifications are issued by the delivery body or when the round is terminated by the Secretary of State.
- an amendment to ensure various key dates (commencement date and application closing window) cannot be amended after they have passed to provide more clarity and certainty to applicants.
- an amendment to ensure 5 days' notice is given when government varies key dates of an allocation round (commencement date and application closing window) to provide more clarity and certainty to applicants.
- omitting the requirement to publish the 'the non-qualification review request date', 'the appeals deadline date' and 'the post-appeals indicative start date' in the CFD Allocation Framework. We consider this change will improve clarity as these dates will still be published but as part of the fuller timeline provided to stakeholders by the delivery partners (BEIS, NG ESO, LCCC and Ofgem), rather than as standalone dates with no context.
- an amendment to allow the timely commencement of the allocation process in the scenarios that all applicants qualify either after NG ESO's initial application review or after NG ESO's second review (non-qualification review).
- an amendment to make it explicit that the overall budget, both monetary and capacity may be varied using a budget revision notice.

7.31 A Government response in relation to these amendments was published in November 2020.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

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 The majority of the policies reflected in this instrument were subject to a thirteen-week consultation, from 2 March 2020 to 29 May 2020. Several stakeholder events were held during the consultation period to discuss the policy proposals with interested parties.

10.2 The consultation attracted around 260 individual written responses, and a further 800+ similar responses coordinated by environmental NGO Biofuelwatch. The 260 individual responses were from a range of stakeholders, including renewable electricity developers, supply chain firms and members of the public. There were also a small number of responses from local and devolved governments and authorities, academics, NGOs and think tanks, and investors. The 800+ similar responses were sent in the context of a campaign, calling for an end to CFDs for biomass conversions, while also highlighting the need to continue to apply the higher efficiency standards and lower greenhouse gas (GHG) thresholds that were put in place for certain new stations supported under the CFD scheme.

10.3 Consultation responses were largely supportive of the proposals to be implemented through these Regulations. A range of comments were provided across several themes, with the following ones being the most relevant to the Regulations:

- Responses to the proposal to extend the date that delivery years could be set were overwhelmingly supportive. The date the definition of delivery years was amended to was changed from 31st March 2030 to 31st March 2035 to reflect observations made by a number of respondents and to allow government further flexibility when running future allocation rounds.
- Responses to the proposal to make biomass conversions ineligible for the CFD scheme were largely supportive. Some responses expressed concerns the removal could have unintended consequences on the development of Bioenergy with Carbon Capture & Storage (BECCS) as this is likely to play a key role in reaching net zero by 2050. Government continues to look at BECCS separately from the role of biomass conversions.
- Responses to the proposals to define floating offshore wind as a separate technology were largely supportive. The definition of "floating offshore 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.
- Responses to the proposal to amend the non-delivery disincentive exclusion period were broadly supportive. The drafting of the exclusion period reflects comments made in response to the consultation that it should explicitly reference the next applicable allocation round rather than a specified period of time.

- The majority of responses supported the proposal to amend the Allocation Regulations to provide the flexibility to decide, on a round by round basis, if each capacity cap, maximum or minimum should be applied as a hard constraint (as in previous allocation rounds) or as a soft constraint, subject to certain conditions being met.
- Responses to administrative amendments to the Allocation Regulations to improve the operation and clarity of the CFD scheme were broadly supportive. Some respondent expressed concerns we were adding new powers to amend the budget (monetary and capacity). However, the government considers we are making explicit existing powers and not adding new powers.
- The consultation also sought views on how the supply chain plan process could be strengthened to inform further policy development. Most responses supported closer alignment with the UKs wider industrial priorities and a focus on delivery. Responses were mixed on the question of implementing stronger compliance measures for failure to implement an approved supply chain plan. Many respondents were doubtful whereas others supported the idea providing there was ongoing engagement between the applicant and government, and applicants would have an opportunity to remedy deficiencies before any penalties were applied. A subsequent consultation was published in November 2020 to further develop these proposals, and details are in paragraph 10.6.

10.4 A more detailed analysis of the consultation responses and outcomes can be found in the Government Response to this March to May 2020 consultation which can be found here: https://www.gov.uk/government/consultations/contracts-for-difference-cfd-proposed-amendments-to-the-scheme-2020

10.5 The supply chain plan policy changes discussed in paragraphs 7.6 to 7.13 and the proposal to not extend phasing to floating offshore wind discussed in paragraphs 7.17 to 7.19 which are reflected in this instrument were not covered by the 2 March – 29 May 2020 consultation. Instead, they were subject to a separate nine-week consultation from 24 November 2020 to 28 January 2021. That consultation attracted around 52 individual responses from a range of stakeholders, including renewable electricity developers and trade associations. There were also a small number of responses from local authorities, consultants, manufacturers, trade unions, NGOs and investors.

10.6 Consultation responses on these proposals to be implemented through these Regulations, provided a range of comments, with the following ones being the most relevant to the Regulations:

- Responses to the supply chain plan proposals outlined in paragraph 7.6 to 7.13 were largely supportive, although included some reservations. Most respondents who expressed a view agreed that the changes proposed to the supply chain process would support the Government's objectives to encourage the growth of sustainable, efficient supply chains and support regional growth, skills and productivity. The main concern highlighted was that decisions by the Secretary of State on whether generators had fulfilled their supply chain commitments and could therefore be awarded or refused a supply chain implementation statement, would come too late in the process when significant investment had already taken place. A refusal by the Secretary of State to provide a supply chain implementation statement at this late stage

would give an eligible generator little time to address any deficiencies in the implementation of their supply chain commitments which could result in the generator being unable to fulfil its Operational Condition Precedent under the CFD and give rise to a CFD Counterparty right to terminate the CFD.

- In response to a proposal from many respondents, and to mitigate this concern and associated investment risks, the Government has decided to bring forward the timing of that decision to an earlier stage in the process which, for an eligible generator awarded an allocation round CFD, will be shortly after they have fulfilled a Milestone Requirement as mandated under the CFD. This broadly coincides with when generators take final investment decisions and decisions on their main supply chain contract packages. Generators will be able to apply for a supply chain implementation statement setting out how they are making a material contribution to the development of supply chains at this earlier stage in the process and receive a decision from the Secretary of State on that basis.
- Responses to the proposal to exclude phasing from floating offshore wind detailed in paragraphs 7.17 to 7.19 were largely unsupportive as respondents claimed they could be subject to similar types and levels of construction risk as fixed bottom offshore, though they agreed projects for the foreseeable future would be small. However, the government intends to proceed with the proposal to exclude phasing from floating offshore wind as we still consider forthcoming projects are likely to be too small to require phasing for the foreseeable future and floating wind does not face exactly the same construction/installation risks as larger fixed bottom projects. We may review this when floating wind projects increase in size.

10.7 A more detailed analysis of these consultation responses can be found in the Government Response to this November 2020 – January 2021 consultation published in May 2021 which can be found here: https://www.gov.uk/government/consultations/contracts-for-difference-cfd-changes-to-supply-chain-plans-and-the-cfd-contract

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

11.2 The Department consulted on and intends to publish in advance of the next CFD allocation round, an updated version of the Supply Chain Plan Guidance in order to reflect the changes described in paragraphs 7.6 – 7.13 and 10.6 along with a range of administrative matters.

12. Impact

12.1 Applying for a CFD 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.

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

12.3 There is no, or no significant, impact on the public sector. The impact on the public sector is any change to the cost borne by Government and National Grid delivering their EMR functions and those associated with setting up a CFD counterparty.

12.4 A full Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

13. Regulating small business

13.1 This 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.

13.2 Therefore, 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 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).

14.2 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.

15. Contact

15.1 Katy Knipe at the Department of Business, Energy and Industrial Strategy Telephone: 0207 215 4072 or email: katy.knipe@beis.gov.uk can be contacted with any queries regarding the instrument.

15.2 Vicky Dawe at the Department of Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 Anne-Marie Trevelyan, Minister of State at the Department of Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.