EXPLANATORY MEMORANDUM TO

THE CONTRACTS FOR DIFFERENCE (STANDARD TERMS) REGULATIONS

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 There are two different ways in which a Contract for Difference (CFD) is offered under the Energy Act: following a direction of the Secretary of State to the CFD counterparty (section 10); or following a CFD notification from the national system operator to the CFD counterparty (section 14). The Contracts for Difference (Standard Terms) Regulations 2014 are concerned only with CFDs on standard terms which are offered following a CFD notification from the national system operator, a 'generic' CFD.

2.2 This instrument consists of regulations that control three aspects of the way in which a 'generic' CFD may be drawn up, offered and publicised. The Regulations set out the provision to be included in standard terms issued or revised by the Secretary of State; governs the way in which an applicant may request a change to the generic CFD terms; and controls the process through which a CFD is completed and offered. The Regulations also require that certain information be published concerning those applicants who successfully enter into a CFD.

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

3.1 None

4. Legislative Context

4.1 The Energy Act 2013 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 Section 11(3) of the Energy Act 2013 provides that standard terms issued or revised by the Secretary of State must be in accordance with provision made in regulations. These Regulations describe the provision to be included in standard terms for the benefit of both Parliament and potential developers and investors.

4.4 In accordance with section 14, these Regulations set out the process for the preparation of the CFD, and for its offer and acceptance.

4.5 Section 15 allows a generator to propose minor and necessary modifications to the standard terms. These Regulations set out the procedure to be followed in making an application for a modification and how the CFD counterparty is to determine an application.

4.6 In accordance with section 19, these Regulations also require the publication or provision of information in order to capture up to date information concerning CFDs that have been entered into, and in particular information relating to any successful modification application.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

5.2 As required by section 24 of the Energy Act 2013 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. Though these Regulations do not apply to them at this point, they have been consulted in order to ensure that their views on the CFD mechanism and design are reflected as it evolves in advance of its applicability to Northern Ireland.

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 (Standard Terms) 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 provide 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 regulations then describe some processes that must be followed whenever 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 Regulations in this instrument control aspects of the way in which a 'generic' CFD on standard terms may be drawn up, offered and publicised. Firstly, they describe the kind of provision that must always be found in any generic CFD. Through a process of consultation and engagement, the Department has identified a number of key areas that are considered essential in order to ensure that the generic CFD remains viable for investors throughout the life of the regime. Inclusion of these areas in the standard terms will therefore form a requirement of these Regulations. In particular, provision required under these Regulations includes a defined process by which the CFD may be amended once it is entered into, protection for parties where a change in law occurs and for termination to be clearly defined and controlled, in particular where payment is owed as a result.

7.6 Secondly, the Regulations govern the way in which an applicant may request a minor and necessary change to the generic CFD terms. The Department expects that the generic CFD will be suitable for a large proportion of applicants without the need for any change. However, where such a change is 'necessary' and of 'minor' effect, the body responsible for administering CFDs may agree to it. The Regulations set out some modifications which will not be considered minor. These include where a change would move essential timelines within the CFD, alter the evidence of financial commitment that a generator must show or increase the administrative cost to the CFD Counterparty by more than a specified amount.

7.7 Thirdly, the Regulations provide for a clear mechanic through which a CFD is to be offered following successful allocation to a generator. This includes defined periods within which a CFD must be offered by the CFD Counterparty and returned by the Generator.

7.8 Finally, the Regulations require certain information to be published concerning those applicants who successfully enter into a Contract for Difference. Transparency is an essential element of the CFD regime, allowing the public to understand the way in which CFDs are used and enabling potential applicants to plan accordingly.

8. Consultation outcome

8.1 The policy set out in this instrument was subject to a 7-week consultation. The consultation document, 'Consultation on Regulations for CFD Contract Regulations (Standard Terms and Modifications) was published in December 2013 for stakeholders to provide feedback.

8.2 14 responses were received to the consultation from a variety of sources including generators, consultancies and trade associations. The proposals made within the consultation were widely accepted, with comment limited to questions of implementation rather than broad policy.

8.3 A more detailed analysis of the consultation responses and outcome can be found in the Government Response to the consultation, including a number of undertakings in line with the comments made.

9. Guidance

9.1 The CFD itself will not be the subject of any explicit guidance. However, the Department will publish explanatory notes to accompany the standard terms issued by the Secretary of State, ensuring that all impacted by it may understand the functioning of its terms.

9.2 In accordance with regulation 5(4), the CFD counterparty must publish guidance on the form of an application for a modification, and the information to be included in any application.

10. Impact

10.1 As a voluntary regime in which developers and generators are not obligated to participate, the elements of the Contracts for Difference addressed by this instrument only apply to those businesses that wish to apply, and its impact is therefore limited accordingly.

10.2 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.

10.3 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 who would be free to apply for a CFD if they were building an eligible generating station. However, the Contracts for Difference (Allocation) Regulations 2014 provide that there are types of application for a CFD which are excluded from Parts 2 to 9 of those Regulations, including where the small scale Feed-in Tariff is available for the generating station, such as onshore wind, hydro, solar PV or anaerobic digestion generation of less than or equal to 5MW.

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 of that Act and as part of that review the Secretary of State must consider the objectives of the CFD provisions within it. The Secretary of State must 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

Greg Dyke at the Department of Energy and Climate Change Tel: 0300 068 8077 or email: gregory.dyke@decc.gsi.gov.uk can answer any queries regarding the instrument.