EXPLANATORY MEMORANDUM TO

THE ELECTRICITY MARKET REFORM (GENERAL) (AMENDMENT) REGULATIONS 2015

2015 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.

2. Purpose of the instrument

2.1 This instrument implements amendments to *The Electricity Market Reform (General) Regulations 2014* (S.I. 2014/2015) to enable the Gas and Electricity Markets Authority ("the Authority") to enter into arrangements with a CFD Counterparty and arrangements with the Secretary of State in order to carry out roles relating to the measurement and sampling of fuel and the affirmation of its continuing compliance with sustainability criteria.

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

3.1 None.

4. Legislative Context

4.1 The Energy Act 2013 ("the Act") contains powers enabling the Secretary of State to implement measures to reform the electricity market to encourage low carbon electricity generation and ensure security of supply. The reforms which have been implemented are known as Electricity Market Reform (EMR).

4.2. The two main mechanisms for reform – the Contract for Difference (CFD) and Capacity Market – are now operational. The first CFD allocation round opened in October 2014 and the first Capacity Market auction took place in 2014. A second allocation round and auction is planned for 2015.

4.3 These mechanisms were implemented by a suite of secondary legislation and related documents. These amendment regulations enable the Authority to enter into arrangements with a CFD Counterparty, currently designated as the Low Carbon Contracts Company Ltd, in order to carry out work relating to Fuel Measurement and Sampling (FMS) and Sustainability.

4.4. The Energy Act also enables the Secretary of State to enter into Investment Contracts. These early CFDs contain equivalent provisions relating to FMS and Sustainability, and these amendments enable agreements to be made between the Secretary of State and the Authority on the same basis as for other, allocated CFDs.

4.5 The Act requires that the Secretary of State makes provision for investment contracts to be treated as a CFD for the purposes of all provision made by or by virtue of Chapter 2 of Part 2 of the Act (Paragraph 16(4) of Schedule 2). However this duty

is subject to the Secretary of State not considering it appropriate in all the circumstances of the case to disapply it (Paragraph 16(5) of Schedule 2). These Regulations both make provision to comply with the duty and set out the extent to which the duty is disapplied. This is achieved in new regulation 17 to be inserted into The Electricity Market Reform (General) Regulations 2014. Regulation 17(1) sets out the extent the duty applies to provision in the Act, and 17(2) deals with application to the Regulations in which it is contained. We would expect that any secondary legislation made under Chapter 2 of Part 2 of the Act to set out (where relevant) the extent to which the duty was applied. For example, the Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 (S.I. 2014/2014) contains provision about the application of the duty to those Regulations (see regulation 2(4) – noting that it is our intention to omit regulation 2(5) as unnecessary due to the insertion of regulation 17(1) into The Electricity Market Reform (General) Regulations 2014).

4.6 These amendment regulations form part of a wider set of amendments being made to the existing suite of EMR secondary legislation. For example, wider amendments are being made which implement provisions required as part of the EMR mechanisms successfully receiving State Aid clearance, implement policies the Department has committed to introducing prior to the second CFD allocation round or Capacity Market auction, and include a number of minor and technical amendments to ensure the drafting gives effect to the previously agreed policy intent. Two of the amendment regulations also reflect the updated levies for the two EMR companies (the CFD Counterparty and the Capacity Market Settlement Body) to recover their operational costs for 2015/16.

4.7 The full set of amendment regulations includes the following:

- The Electricity Supplier Obligations (Amendment & Excluded Electricity) Regulations 2015
- Electricity Capacity (Amendment) Regulations 2015
- Electricity Market Reform (General) (Amendment) Regulations 2015

5. Territorial Extent and Application

5.1 This instrument extends to the United Kingdom.

6. European Convention on Human Rights

6.1 Matthew Hancock, 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 Electricity Market Reform (General) (Amendment) Regulations 2015 are compatible with Convention rights.

7. Policy background

7.1 The electricity market reform programme is intended to incentivise investment in low-carbon electricity generation, while improving affordability for consumers, and maintaining energy security. These regulations are concerned with one element of the wider reform package – 'Contracts for Difference' (CFDs).

7.2 CFDs are contracts between a low carbon electricity generator and a Government-owned company, the CFD Counterparty. Under a CFD, the CFD Counterparty will pay the generator the difference between a fixed 'strike price' and a market reference price (or, if the reference price is higher than the strike price, the generator will pay the difference back to the CFD Counterparty). In this way they provide long-term price stabilisation to low carbon plant, allowing investment to come forward at a lower cost of capital and at a lower cost to consumers.

7.3 For those generators operating fuelled technologies (Dedicated Biomass, Biomass Conversion, Anaerobic Digestion, Advanced Conversion, Energy from Waste, Sewage Gas and Landfill Gas) there are certain obligations under the CFD that relate to the measurement, sampling and sustainability of the fuel used by that generator. These obligations serve to ensure that generators are only paid for energy that is both renewable and sustainable in its origin.

7.4 As a highly technical area of work, it is anticipated that a CFD Counterparty may choose to enter into arrangements with other parties to carry out functions such as those required for FMS and Sustainability. The intent of this policy is to enable the Authority, the body that currently holds expertise carrying out this work, to provide this support by enabling it to enter into arrangements to do so.

7.5 This policy extends to those CFD contracts that have been signed by the Secretary of State, known as Investment Contracts. The intent is to enable the Authority to enter into arrangements with the Secretary of State on the same basis as for a CFD Counterparty, should this be required in order to obtain such information and advice.

8. Consultation outcome

8.1 The policies set out in this instrument were subject to a four week consultation. *Ofgem & Fuel Measuring and Sampling and Sustainability under the CFD* was published on 29 October 2014 for stakeholders to provide feedback on the proposals.

8.2 Fourteen responses were received to the consultation. These responses were supportive of the proposals or proposed minor changes to the policy that fall outside the scope of the regulations themselves.

8.3 Separately, those impacted by the equivalent policy on Investment Contracts were contacted for their views. Four responses were received, all supportive of the proposal that the policy extends to encompass them.

9. Guidance

9.1 The Government Response to the consultation has been published to coincide with the laying of amendment regulations in Parliament. The Government Response sets out the views of stakeholders and an explanation of the final policy decisions taken.

10. Impact

10.1 Applying for a CFD is voluntary. The impact of these amendment 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 and National Grid delivering their EMR functions and those associated with setting up a CFD Counterparty.

10.3 An Impact Assessment relating to the wider CFD regime within which this regulation sits is attached to this memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website. The impact of this regulation is minor, such that it falls within the costs and benefits within that existing Impact Assessment, first published in June 2014, being a function described in detail within the published CFD contract.

11. Regulating small business

11.1 The legislation applies to small businesses who would be free to apply for a CFD if they are 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 (FiT) 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 CFDs. 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 CFDs.

11.3 With regard to this policy, there is no direct additional impact on small businesses, as this policy only relates to arrangements between a CFD Counterparty and the Authority, and not to any other arrangements that might be made between a CFD Counterparty and any other body, including small businesses. This is also the case for Investment Contracts, wherein the arrangements will be solely between the Authority and either the Secretary of State or a CFD Counterparty.

12. Monitoring and review

12.1 Section 5(4) of the Energy Act 2013 requires the Secretary of State to prepare and lay before Parliament a report setting out how the Secretary of State has carried out his EMR functions. The section requires the Secretary of State to report, before 31 December each year and beginning in 2014, on how he has carried out his functions in Part 2 of the Act in order to deliver EMR's objectives. The report must be laid in Parliament and be shared with the Devolved Administrations.

12.2 The first of such reports was laid before Parliament on 6 November 2014. As well as fulfilling the reporting requirement, the EMR Annual Update 2014 provides Parliament and other stakeholders with a forward look of the path ahead and a summary of EMR progress since the Energy Bill received Royal Assent in December 2013.

12.3 In addition, section 66 of the Energy Act 2013, requires the Secretary of State to report to Parliament by the end of 2018 on a number of aspects of the operation of the EMR programme. These aspects include the extent to which the original objectives have been met, whether these objectives are still appropriate and whether they could be delivered in a way that imposes less regulation. This requirement covers CFDs, the Capacity Market and the transitional arrangements from the Renewables Obligation.

12.4 Evaluation will help to provide evidence for whether the EMR programme and its processes are as efficient and effective as possible and on whether the benefits of the programme are being achieved. The Government has commissioned independent contractors with appropriate expertise to provide evaluation of the first CFD allocation, first Capacity Market auction and the Final Investment Decision (FID) Enabling for Renewables process (which awarded Investment Contracts, early CFDs). The outcome of this evaluation will help inform future decisions in relation to the delivery of EMR and DECC's policies more broadly.

12.5 The Government currently envisages that evaluation work over the lifetime of the instruments will include (but not be confined to) an assessment of the extent to which the first round of awards of CFDs under the enduring regime have furthered the UK's low carbon energy objectives at least cost to consumers; the extent to which the FID Enabling for Renewables process has prevented investment hiatus; the extent to which the first Capacity Market auction has met expectations of providing security of supply; an assessment of whether the institutional framework underlying the programme is fit for purpose and an evaluation of the early impacts of the programme. The timing of these reviews and their outputs are still being considered.

13. Contact

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