EXPLANATORY MEMORANDUM TO

THE HYDROGEN PRODUCTION REVENUE SUPPORT (DIRECTIONS, ELIGIBILITY AND COUNTERPARTY) REGULATIONS 2023

2023 No. XXXX

1. Introduction

1.1 This explanatory memorandum has been prepared by The Department for Energy Security and Net Zero and is laid before Parliament by Command of His Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments and the Sifting Committees.

2. Purpose of the instrument

2.1 These Regulations set out the meaning of "eligible" in relation to a low carbon hydrogen producer as required under Chapter 1 Part 2 of the Energy Act 2023 ("the Act"). These Regulations establish the process by which the Secretary of State can direct a hydrogen production counterparty to offer to contract with an eligible low carbon hydrogen producer, and set out requirements that certain information must be published by the counterparty in respect of contracts entered into, as well as requirements on the counterparty to promptly notify the Secretary of State if it is, or considers it is likely to be, unable to perform its functions.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 These Regulations are the first to be made using the powers contained in Chapter 1 of Part 2 of the Act under sections 57(1), 58(2), 66(2), 66(3), 66(4), 66(5) and 83(1) to define an eligible low carbon hydrogen producer, make further provision about directions from the Secretary of State to a hydrogen production counterparty to offer to contract and the publication of information by a hydrogen production counterparty and to require a hydrogen production counterparty to promptly notify the Secretary of State if it is, or considers it is likely to be, unable to perform its functions.

4. Extent and Territorial Application

4.1 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England and Wales, Scotland and Northern Ireland.

4.2 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom. The activities of a low carbon hydrogen producer may take place in, above or below the territorial sea adjacent to the United Kingdom and waters in a Renewable Energy Zone (within the meaning of Chapter 2 of Part 2 of the Energy Act 2004).

5. European Convention on Human Rights

5.1 The Minister, Lord Callanan has made the following statement regarding Human Rights:

"In my view the provisions of The Hydrogen Production Revenue Support (Directions, Eligibility and Counterparty) Regulations 2023 are compatible with the Convention rights".

6. Legislative Context

6.1 The Energy Act 2023 ("the Act") makes provision for the implementation of the Hydrogen Production Business Model (HPBM) which is intended to provide revenue support to overcome the cost gap between low carbon hydrogen and higher carbon counterfactual fuels. The HPBM is designed to incentivise the production and use of low carbon hydrogen, supporting the UK's net zero and energy security ambitions.

6.2 Section 57(1) sets out the overarching power for the Secretary of State to make regulations in relation to revenue support contracts[1] (including the funding of liabilities and costs in relation to such contracts). There are a number of provisions in Chapter 1, Part 2 of the Act which set out the matters which regulations made under the overarching power in section 57(1) may cover.

6.3 The Act gives the Secretary of State the power to designate a person to be a counterparty for hydrogen production revenue support contracts (a 'hydrogen production counterparty'). Under section 66(1) the Secretary of State has a power to, in accordance with any provision made by revenue support regulations, direct a hydrogen production counterparty to offer to contract with an eligible low carbon hydrogen producer. This instrument will define the meaning of "eligible low carbon hydrogen producer" which will enable the Secretary of State to be able to direct a hydrogen production counterparty to offer to contract with an eligible low carbon hydrogen producer.

6.4 This instrument includes an ambulatory reference to the UK Low Carbon Hydrogen Standard ("the Standard") to ensure that eligibility can be determined based on the latest version of that standard. An update will be provided to Parliament via a Written Ministerial Statement whenever the reference to the Standard is updated.

6.5 Section 66(2) of the Act provides for revenue support regulations to make further provision about a direction under section 66(1), in particular about the circumstances in which a direction may or must be given and the terms it may or must specify. Section 83(1) enables revenue support regulations to make provision about the provision and publication of information and advice. This instrument sets out the process which the Secretary of State must follow when issuing a direction to offer to contract, and information about hydrogen production revenue support contracts a hydrogen production counterparty must publish.

6.6 Section 58(1)(b) of the Act states that a revenue support counterparty[2] must act in accordance with any provision included in revenue support regulations, and section 58(2) provides that revenue support regulations may make provision specifying things that a revenue support counterparty may or must do. Given the critical role of a hydrogen production counterparty to effectively deliver a hydrogen production revenue support contract, this instrument will require a hydrogen production counterparty to promptly notify the Secretary of State if it is, or considers it is likely to be, unable to perform its functions.

[1] 'Revenue support contract' as defined in section 57(2) includes hydrogen production revenue support contracts.

[2] 'Revenue support counterparty' as defined in section 58(6) includes a hydrogen production counterparty.

7. Policy background

What is being done and why?

7.1 This instrument concerns the implementation of the HPBM which is intended to support the ambition set out in the British Energy Security Strategy to have up to 10GW of low carbon hydrogen production capacity by 2030 (subject to affordability and value for money), with at least half of this from electrolytic hydrogen. This could support over 12,000 jobs across the hydrogen value chain. Low carbon hydrogen is considered critical to supporting the UK's energy independence and ambition to reach net zero by 2050.

7.2 The HPBM is intended to incentivise the production and use of low carbon hydrogen in the UK through the provision of revenue support in order to overcome the cost gap between low carbon hydrogen and higher carbon counterfactual fuels. Similar to the Contracts for Difference (CfD) scheme, the government's main mechanism for supporting low-carbon electricity generation, revenue support will be delivered through a private law contract between an eligible low carbon hydrogen producer and the hydrogen production counterparty.

7.3 Initial hydrogen production projects will be selected through an allocation process run by the Department before proceeding to bilateral negotiations. Once negotiations are completed, it is anticipated that successful projects would receive an offer to contract from the hydrogen production counterparty, following a direction to do so by the Secretary of State. In the future, the expectation is that hydrogen production revenue support contracts will be awarded by way of a price-based competitive allocation process.

7.4 These Regulations are needed to determine who can be offered a hydrogen production revenue support contract, to set out the process governing how the Secretary of State can direct a hydrogen production counterparty to offer to contract, to set out requirements for what information would need to be made publicly available, and to help ensure the Secretary of State is aware of any potential issues with a counterparty being able to fulfil its role.

Determine the meaning of eligible

7.5 The Act states that only an "eligible low carbon hydrogen producer" can be offered a hydrogen production revenue support contract and section 66(4) requires revenue support regulations to make provision for determining the meaning of "eligible" in relation to a low carbon hydrogen producer.[3]

7.6 These Regulations set out that only new hydrogen production facilities, or existing hydrogen production facilities adding new production capacity, which can demonstrate their proposal for the production of hydrogen is capable of complying with "the Standard" (as may be amended from time to time) at the point of application, would be considered eligible.

7.7 The Standard defines what constitutes 'low carbon hydrogen' at the point of production. The intent of the Standard is to ensure new low carbon hydrogen

[3] A "low carbon hydrogen producer" is defined in section 65(7) of the Act as "a person who carries on (or is to carry on) in the United Kingdom activities of producing hydrogen which in the opinion of the Secretary of State will contribute to a reduction in emissions of greenhouse gases", where "greenhouse gas" has the meaning given by section 92(1) of the Climate Change Act 2008.

production supported by government makes a direct contribution to GHG emission reduction targets under the Climate Change Act. We expect the Standard to be updated over time to ensure it remains fit for purpose and reflects our growing understanding of how new technologies work in practice, including how hydrogen production interacts with the broader energy system.

7.8 Projects will be assessed for eligibility against the relevant version of the Standard at the point of application. However, the Regulations make it clear that projects may need to comply with a later version of the Standard under the terms of the revenue support contract.

7.9 Transitional provisions are provided for the projects that submitted an application before the Regulations commenced or before the Standard was in place. These projects are also required to demonstrate that their proposal for the production of hydrogen would be able to comply with a version of the Standard to be considered eligible.

7.10 It should be noted these Regulations only form one part of the assessment for whether projects could be awarded a hydrogen production revenue support contract. Further eligibility criteria are expected to be set for individual allocation rounds in allocation guidance.

Direction by Secretary of State

7.11 The Secretary of State may, in accordance with any provision made by revenue support regulations, direct a hydrogen production counterparty to offer to contract with an eligible low carbon hydrogen producer under section 66(1) of the Act. These Regulations set out various requirements in respect of a direction, including that it must be in writing, specify a date by when the counterparty must comply with the direction, and specify the period for which the counterparty must keep the offer to contract open for acceptance. A direction will prohibit the counterparty from modifying the terms of the contract offered without prior written consent of the Secretary of State. Additionally, these Regulations set out the circumstances in which a direction ceases to have effect and enable the Secretary of State to revoke a direction before it has been accepted by the producer.

Information Publication

7.12 Given the emergent stage of low carbon hydrogen production in the UK, with no commercial scale projects in operation, it is important that information about their deployment is made available publicly. Sharing information and data in a transparent and open way will help ensure the business model is better understood and enable potential applicants to plan accordingly.

7.13 To that end, these Regulations include provisions mandating a counterparty to publish each hydrogen production revenue support contract entered into pursuant to a direction from the Secretary of State under section 66(1), apart from redactions of confidential information and personal data. To ensure important information is readily accessible, the Regulations also place an obligation on the hydrogen production counterparty to establish and maintain a public register that captures key project information.

Counterparty notification of defaults

7.14 The role of a hydrogen production counterparty is essential in the ongoing management of contracts and administration of payments to projects supported through the business model. To help ensure the smooth operation of the business model, the Regulations require a hydrogen production counterparty to provide prompt notification to the Secretary of State if it is, or considers that it is likely to be, unable to perform its functions as hydrogen production counterparty.

Commencement

7.15 The Regulations will commence on the day after the day on which they are made to enable the first contracts to be awarded as soon as reasonably possible to support government ambitions for the deployment of low carbon hydrogen. Those affected by the Regulations, namely low carbon hydrogen producers and the anticipated hydrogen production counterparty, LCCC, have been aware of the policy for several months through consultation and subsequent engagement.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 There are no plans to consolidate the relevant legislation.

10. Consultation outcome

10.1 The policy set out in this instrument was subject to a 6-week consultation by the Department. "Hydrogen production and industrial carbon capture business models: Consultation in respect of revenue support regulations relating to directions to a counterparty, publication of information and eligibility" was published on 30 March for stakeholders to provide feedback.

10.2 The department received 28 responses to the consultation from organisations and members of the public. The consultation proposals were largely supported by respondents.

10.3 The consultation proposed three options for how to determine the type of production pathways that would be eligible while meeting the definition in the Act for a "low carbon hydrogen producer" as "a person who carries on (or is to carry on) in the United Kingdom activities of producing hydrogen which in the opinion of the Secretary of State will contribute to a reduction in emissions of greenhouse gases", where "greenhouse gas" has the meaning given by section 92(1) of the Climate Change Act 2008. The majority of respondents supported the option of referring to the "live" Standard.

10.4 Some respondents raised concerns that the proposals for publishing information could reveal commercially sensitive information. This has been taken into account in the Regulations where the information required to be published in a contract register has been amended to address this risk.

10.5 Some respondents felt that hydrogen production from hydrogen derivatives and carriers, such as ammonia, should also be eligible for support. Government maintains that given hydrogen derivatives and carriers are produced from hydrogen, its position

is that these pathways do not constitute the production of new hydrogen and therefore does not align with the aim of the HPBM.

11. Guidance

11.1 The Government Response to the consultation informing this instrument has been published to coincide with the laying of these 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.

12. Impact

12.1 Applying for a hydrogen production revenue support contract is voluntary. There is no, or no significant, direct impact on business, charities or voluntary bodies.

12.2 The public sector is impacted in respect of the hydrogen production counterparty, which is expected to be the Low Carbon Contracts Company ("LCCC") a private company limited by shares and wholly owned by the Secretary of State. These Regulations would impose new duties on the LCCC as hydrogen production counterparty, for example with regard to making offers to contract and information publication duties. Additionally, the HPBM will initially be Exchequer funded before transitioning to levy funding.

12.3 A full Impact Assessment has not been prepared for this instrument because we do not foresee any direct impact on business. These provisions do not directly regulate business activity. Any cost impacts related to the familiarisation and compliance with the Regulations would be voluntary.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & Review

14.1 The instrument does not include a statutory review clause, in line with the exemptions under section 28(3)(c) of the Small Business, Enterprise and Employment Act 2015.

14.2 The instrument will however be considered under a wider monitoring and evaluation framework to track progress against the Sixth Carbon Budget and net zero targets.

15. Contact

15.1 Waiman Tsang (waiman.tsang@energysecurity.gov.uk) at the Department for Energy Security and Net Zero can be contacted with any queries regarding the instrument.

15.2 Will Lochhead, Deputy Director for Industrial Carbon Capture and Hydrogen Business Models, at the Department for Energy Security and Net Zero can confirm that this Explanatory Memorandum meets the required standard.

15.3 Lord Callanan, Parliamentary Under Secretary of State for Energy Efficiency and Green Finance at the Department for Energy Security and Net Zero can confirm that this Explanatory Memorandum meets the required standard.