

EXPLANATORY MEMORANDUM TO
THE ELECTRICITY MARKET REFORM (GENERAL) 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 The Electricity Market Reform (General) Regulations 2014 set out a number of general provisions relating to the Contract for Difference (CFD) policy, including:

- a requirement on the Electricity Market Reform (EMR) Delivery Body to provide information in relation to the strike price applicable or to be applicable to any form of low carbon electricity generation under CFDs;
- provisions determining how and when a Supply Chain statement application should be made and what it should cover and setting out the circumstances in which the Secretary of State must not disclose information contained in a Supply Chain statement application; and
- provision to shield National Grid Electricity Transmission plc (NGET), the national system operator and EMR Delivery Body, against liability in damages to third parties for anything done or omitted to be done in the exercise or purported exercise its EMR delivery functions relating to the CFD.

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

- 3.1 These Regulations, together with the other regulations listed below, are the first regulations to be made using the powers in Chapter 2 of Part 2 of the Energy Act 2013 (c. 32) (“the Act”) and the liability shield contained in these Regulations is the first exercise of powers under section 63 (exemption from liability in damages) of the Act.

- 3.2 The Regulations provide that requirements placed on the delivery body, the counterparty body and generators under these Regulations are to be treated as relevant requirements for the purposes of section 25 of the Act. Therefore, a breach can be treated, in effect, as if it were a breach of a licence condition allowing the enforcement authorities to obtain an order to secure compliance, and/or impose financial penalties.

4. **Legislative Context**

- 4.1 The Act makes provision for Electricity Market Reform, which enables the Secretary of State to implement measures to reform the electricity market to

encourage low carbon electricity generation and, amongst other things, 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. This instrument is made under the powers in sections 6(1), 12(3), 16, 19 and 63 of the Energy Act 2013.

5. Territorial Extent and Application

5.1 This instrument applies to the United Kingdom.

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 Electricity Market Reform (General) 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 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.

Part 2 Secretary of State requiring information from the Delivery Body

7.5 Part 2 of this instrument is designed to ensure that the Secretary of State is able to commission advice and analysis from the EMR Delivery Body (NGET) to inform strike prices. In turn, to ensure that the EMR Delivery Body has the best data available to provide such advice and analysis, Part 2 enables the EMR Delivery Body to, where appropriate, collect information from the CFD counterparty and from CFD generators. The delivery body must have sought to obtain information from the CFD counterparty body before seeking information from a CFD generator.

7.6 An EMR Delivery Body is also required to keep data which it obtains under Part 2 confidential. However, while NGET is appointed as the EMR Delivery Body (as the national system operator), the confidentiality provisions in Part 2 will not apply as separate provision is being made via modifications to NGET's transmission licence (under section 45 of the Energy Act 2013) to address potential conflicts of interest arising as a result of NGET carrying out the EMR delivery role. These licence modifications will include obligations to protect and keep confidential sensitive EMR information.

Part 3 Supply chain statement

7.7 The aim of the policy set out in Part 3 of this instrument is to encourage the effective development of low carbon electricity generation supply chains by imposing a requirement on eligible generators in respect of projects of 300MW or more to demonstrate how they are likely to make a material contribution to the development of relevant supply chains.

7.8 In order to be eligible to apply for a CFD and receive subsidy, the Secretary of State must be satisfied that the Supply Chain Plan in respect of projects of 300MW or more demonstrates that sufficient action is being taken to support the development of the supply chain in the relevant low carbon industry and/or technology.

7.9 Diversifying, broadening and expanding the supply chain and its supporting workforce via innovation and competition and the development of relevant skills, should, in the long term, drive down the cost of low carbon generation. This will result in lower energy costs to consumers and support future low carbon electricity generation.

Part 4 Liability of the national system operator and documents.

7.10 In its role as the EMR Delivery Body, the national system operator, NGET, will be responsible for functions such as: providing analysis to Government to support policy decisions, administering the allocation process for CFDs and administering and running the capacity auctions for the Capacity Market.

7.11 The Energy Act 2013 gives the Secretary of State the power to protect or shield NGET, its directors, employees, officers or agents against a claim for damages made by a third party where NGET has caused the third party loss as a result of carrying out its EMR delivery functions. The Act also requires the Secretary of State to exclude from the scope of any liability shield instances where NGET has acted in bad faith, acted unlawfully (by breaching human rights) or where NGET is in breach of an enforcement order made by the regulator, Ofgem, under its powers in the Electricity Act 1989.

7.12 Part 4 of this instrument shields NGET from liability for damages arising in respect of its delivery functions under the CFD and, in addition, sets out those instances where NGET will not be shielded from damages liability.

8. Consultation outcome

8.1 The policies set out in this instrument were subject to an 11-week consultation. *Electricity Market Reform: Consultation on proposals for implementation* was published in October 2013 for stakeholders to provide feedback.

8.2 123 responses were received to the consultation. These Regulations take account of concerns raised from stakeholders in response to consultation, as described below.

Part 2 Secretary of State requiring information from the Delivery Body

8.3 The majority of responses were broadly supportive of the need for the EMR Delivery Body to have access to the information required to fulfil its analytical and advisory role. Some stakeholders were concerned about the burden this would place on small businesses (if they were required to provide the Delivery Body with information), while some were concerned about the EMR Delivery Body handling commercially sensitive information.

8.4 This instrument sets out how the EMR Delivery Body can acquire the information it needs to fulfil a request made by the Secretary of State for information and/or advice. The Delivery Body can seek information which is relevant to the request made of it by the Secretary of State from the CFD counterparty. If the information is not provided by the CFD counterparty, the delivery body may require

generators who are a party to a CFD to provide information. This approach ensures the EMR Delivery Body can obtain all the information it requires in order to provide advice and analysis commissioned by the Secretary of State in relation to CFD strike prices. It provides for the lowest administrative burden as the information will only be sought from those who are likely to have the information the Delivery Body needs. In most cases we expect that the CFD counterparty will be able to provide the relevant information (as it is already collecting most of the information from generators under CFDs) and therefore information will only be sought from generators where the CFD counterparty is unable to provide relevant information.

8.5 The CFD Counterparty is able to disclose commercially sensitive information to the EMR Delivery Body for use in any analysis commissioned by the Secretary of State. However, this instrument imposes a confidentiality obligation on the EMR Delivery Body (where this body is not NGET, the national system operator, for example if the EMR delivery functions were transferred away from NGET at a future date). While NGET is the EMR Delivery Body, sensitive information relating to EMR will be protected through modifications to be made to the terms of NGET's transmission licence. These modifications will come into force at the same time as the EMR suite of implementing legislation.

Part 3 Supply chain statement

8.6 Most responses were supportive of the supply chain plan policy, recognising a large number of benefits that could come from this proposal. The main concern highlighted was the potential delay this proposal would have on applying for Contracts for Difference – particularly if the assessment process extended past 30 days, or if additional information was required. The draft supply chain plan guidance, see further paragraph 9.3, sets out a clear process such that the assessment process will not delay the application for a CFD in the first year in which CFDs are allocated.

Part 4 Liability of the national System Operator and documents

8.7 The consultation proposed two approaches for the application of a “liability shield” protecting NGET from claims in damages arising as a result of its carrying out the EMR delivery role: either to shield all of National Grid's EMR Delivery Body functions, or to apply it on a function by function basis.

8.8 The consultation responses favoured the latter option, with most responses contending that NGET should be accountable for its actions and incentivised to carry out its role in a responsible manner.

8.9 The approach that the Government has taken is to shield all functions, but with specific exclusions to deal with the concerns of stakeholders. Those exclusions include where the NGET has acted in bad faith, breached the Human Rights Act 1998 or is in breach of an enforcement order made by Ofgem under its powers in the Electricity Act 1989. To ensure that the shield does not have the effect of diluting incentives for good performance by NGET, Government has gone beyond these minimum exemptions to also include exemptions where the NGET has acted criminally, has breached confidentiality, or is in breach of contract.

8.10 The application of the liability shield will not protect NGET from complaints, nor deny people other forms of redress against its decisions. For example, both the Capacity Market and CFD functions will have appeals processes to help resolve issues arising between NGET and others affected by the exercise of its EMR Delivery Body functions. It is important to note therefore that the shield, where applied, will only protect NGET or its directors, employees etc. from liability in damages.

8.11 A more detailed analysis of the consultation responses and outcome can be found in the Government Response to the consultation.

9. **Guidance**

9.1 The Government Response to the consultation informing this and the other instruments set out in paragraph 4.2 has been published to coincide with the laying of 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.

9.2 Published alongside the Government Response is *Implementing Electricity Market Reform*. This document is intended to provide a comprehensive source of information on the final design of EMR ahead of the first CFD allocation and capacity market auction later this year. The document will provide stakeholders with detail on final EMR policy decisions and set out how these fit within the legislative framework for EMR.

9.3 The Government has also published guidance on the Supply Chain Plan Assessment process. This guidance sets out the approaches which the Secretary of State intends to follow and is intended to provide applicants with assistance in considering how to structure their applications for approval of a supply chain plan.

10. **Impact**

10.1 Applying for a CFD is voluntary. The impact of a CFD's standard terms on businesses, charities or voluntary bodies is only applicable if they apply for a CFD for eligible low carbon electricity generation.

10.2 The impact on the public sector is the cost borne by Government of NGET delivering their EMR functions and those associated with setting up the CFD Counterparty.

10.3 An Impact Assessment that includes the impacts of Parts 2 & 3 of this instrument is attached to The Contracts for Difference (Allocation) Regulations 2014. An Impact Assessment that includes the impacts of Part 4 of this instrument is attached to The Contracts for Difference (Electricity Supplier Obligations) Regulations 2014. These were laid in Parliament alongside this instrument and will be published on the legislation.gov.uk website.

10.4 A number of Impact Assessments relating to the broader CFD and Capacity Market regimes and the EMR programme have previously been prepared and

published on the Parliamentary website alongside the Energy Act 2013 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 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 Additionally, 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.

12.3 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. DECC intends to commission independent contractors with appropriate expertise to provide evaluation reports on key aspects of the reforms to help inform key future decisions.

12.4 DECC currently envisages that such reports will include (but not be confined to) an assessment of the extent to which the first round of award of CFDs under the enduring regime have furthered the UK's energy objectives at least cost to consumers, and an assessment of whether the institutional framework underlying the programme is fit for purpose. The timing of these reviews and their outputs is still being considered.

13. Contact

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