

**EXPLANATORY MEMORANDUM TO
THE CONTRACTS FOR DIFFERENCE (COUNTERPARTY DESIGNATION) ORDER
2014**

2014 No. 1709

1. This explanatory memorandum has been prepared by the Department of Energy and Climate Change and is laid before Parliament.

2. Purpose of the instrument

2.1 The Contracts for Difference (Counterparty Designation) Order 2014 designates the Low Carbon Contracts Company Ltd¹ as a counterparty to contracts for difference (a “CFD counterparty”). By designating the Low Carbon Contracts Company Ltd as a CFD counterparty, the company will be required to carry out the functions of a CFD counterparty as conferred upon it by the Energy Act 2013 and related secondary legislation.

3. Matters of special interest

3.1 None.

4. Legislative Context

4.1 The Energy Act 2013 (‘the Act’) 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. At the time this instrument is made, the following draft legislation and related documents have been laid before Parliament:

- 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

¹ A company registered in England and Wales with the company registration number 08818711.

4.3 The Contracts for Difference (Counterparty Designation) Order 2014 is the first use of the Secretary of State's power to designate a CFD counterparty under section 7 of the Act. This power permits the Secretary of State to designate an eligible person as a CFD counterparty. An eligible person can either be a company formed and registered under the Companies Act 2006 or a public authority (including any person whose functions are of a public nature). The designation can only be made with the consent of the person being designated.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is not subject to any Parliamentary procedure and does not amend primary legislation, no statement is required.

7. Policy background

- What is being done and why

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 This instrument is related to the Contracts for Difference (CFDs) regime, which 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 as part of the EMR programme. CFDs are contracts between the CFD counterparty and persons concerned with the generation of low carbon electricity which will provide payments between the parties based on the difference between a "strike price" determined under that contract and the market price of electricity at the time of generation.

7.3 The Low Carbon Contracts Company Ltd is a company formed and registered under the Companies Act 2006. It is a company limited by shares and wholly owned by the Secretary of State for Energy and Climate Change. The Low Carbon Contracts Company Ltd provided its consent to be designated as a CFD counterparty under section 7 of the Act by way of a resolution at a Board meeting on 11 June 2014 at Fleetbank House, 2-6 Salisbury Square, EC4Y 8JX.

- Consolidation

7.4 This instrument is a standalone instrument so consolidation considerations are not applicable.

8. Consultation outcome

8.1 There was no consultation specific to this instrument designating the CFD counterparty. However, in relation to the role of the designated CFD counterparty, the policies set out in the relevant secondary legislation listed in paragraph 4.2 above were subject to an 11-week consultation. Electricity Market Reform: Consultation on proposals for implementation² was published in October 2013 for stakeholders to provide feedback.

8.2 123 responses were received to that consultation. In drafting the relevant secondary legislation the Secretary of State has taken account of comments made by stakeholders in response to the consultation, as described below.

9. Guidance

9.1 There is no guidance specific to this instrument designating the CFD counterparty. However, in relation to the role of the CFD counterparty once designated, there is a Government Response to the consultation referenced in paragraph 8.1 above. 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 a document titled “Implementing Electricity Market Reform”³. 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 auctions 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.

10. Impact

10.1 There is no impact on business, charities or voluntary bodies resulting from the designation of a CFD counterparty.

10.2 There is no impact on the public sector resulting from the designation of a CFD counterparty.

10.3 An Impact Assessment has not been prepared for this instrument as no impact on the public, private or voluntary sectors is foreseen from the designation of a CFD counterparty. However, in relation to the functions of a CFD counterparty, at the time this instrument is made there are impact assessments available at www.legislation.gov.uk for the draft secondary legislation listed in paragraph 4.2 above.

² <https://www.gov.uk/government/consultations/proposals-for-implementation-of-electricity-market-reform>

³ <https://www.gov.uk/government/publications/implementing-electricity-market-reform-emr>

11. Regulating small business

11.1 This instrument does not regulate small businesses.

12. Monitoring & review

12.1 Section 5 of the Act requires the Secretary of State to report on meeting the 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 Act requires the Secretary of State to report to Parliament by the end of 2018 on a number of aspects of the operation of the 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 auction leading to the 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

Michelle Kennard at the Department of Energy and Climate Change Tel: 0300 068 5409 or email: michelle.kennard@decc.gsi.gov.uk can answer any queries regarding the instrument.