

ENERGY ACT 2013

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 2: Electricity Market Reform

Chapter 2: Contracts for difference

Section 6: Regulations to encourage low carbon electricity generation

85. This sets out the Secretary of State's power to make regulations about contracts for difference.
86. A CFD is a contract between a CFD counterparty and an eligible generator which was offered by the CFD counterparty because the legislation has required the CFD counterparty to offer it. Whether a generator is eligible or not will be set out in regulations. The regulations can only make provisions which, in the opinion of the Secretary of State, will encourage low carbon electricity generation. Therefore only low carbon electricity generation will be eligible. This would include renewable generation, nuclear generation and generation using carbon capture and storage.
87. *Subsections (7) to (9)* provide that regulations must be made by statutory instrument and that:
- the first time regulations are made relating to:
 - CFD notification: offer to contract on standard terms (section *14*);
 - Modification of standard terms (section *15*);
 - Information and advice (section *19*);
 - Functions of the Authority (section *20*).
 - Or any regulations relating to:
 - Supplier obligation (section *9*);
 - Direction to offer to contract (section *10*);
 - CfD notifications (section *12*);
 - Allocation of CfDs (section *13*);
 - Payments to electricity suppliers (section *17*);
 - Application of sums held by a CFD counterparty (section *18*);
 - Regulations: further provision (section *21*);
 - Enforcement (section *22*);
 - Limits on costs to be incurred (section *23*).

they must be laid in draft before, and approved by affirmative resolution of, each House of Parliament.

88. *Subsection (10)* provides that regulations relating to Contracts for Difference should not be treated as a hybrid instrument. The regulations are expected to specify a private company and confer functions on it which could be regarded as adversely affecting its private interests (i.e. they would be unable to stop performing functions without amendment to the regulations), raising the possibility that they could be considered hybrid. It is not considered necessary for the regulations to be treated as hybrid because the existing duty to consult before making regulations should provide adequate protection that private interests will be fully considered.

Section 7: Designation of a CFD counterparty

89. This sets out the power allowing the Secretary of State to designate a company or a public authority, with the consent of that person, to act as the counterparty for the CFD. The counterparty will enter into and manage CFDs with eligible generators, and will act as the interface between generators and suppliers.
90. *Subsection (3)* allows the counterparty to be a registered company or a public authority. Whilst it is expected that the counterparty will be owned by Government, any designated counterparty would have access to the same rights (such as to the Supplier obligation) and be bound by the same duties under the legislation, regardless of whether it was a company and / or public authority, or whom it was owned by.
91. Under *subsection (6)* the designation of a company as the CFD counterparty can be revoked by the Secretary of State. Designation will also cease if the CFD counterparty elects to withdraw its consent and gives 3 months prior notice to the Secretary of State of that withdrawal. *Subsections (7) to (10)* deal with the continuity of CFD counterparties. If the designation of a CFD counterparty were to lapse the Secretary of State must as soon as reasonably practicable designate another counterparty and make a transfer scheme under *Schedule 1* transferring all CFDs to that new counterparty. This is designed to ensure that there is always a CFD counterparty and that where a CFD counterparty ceases to be designated the contracts are transferred to a new CFD counterparty.
92. *Schedule 1* sets out the process by which the property, rights and liabilities of the CFD counterparty may be transferred from one counterparty to another, should this prove necessary either because a counterparty no longer wishes to be designated, or because it has become inappropriate for a counterparty to be designated in this role. A scheme may provide for compensation for any property that is required to be transferred where this is appropriate.

Section 8: Duties of a CFD counterparty

93. This section makes it clear that it is a duty of a person who has been designated as a CFD counterparty to comply with the regulations and any direction made under these provisions. This will include the requirement for the CFD counterparty to enter into a CFD with a generator when the Secretary of State has directed it to or the national system operator has given a notification under section 12, and to comply with any requirements designed to ensure it manages the contracts in line with the direction of the Secretary of State. The national system operator is currently National Grid Electricity Transmission PLC.
94. *Subsection (2)* also places a duty on the CFD counterparty to exercise its functions to ensure that it can meet its liabilities under a CFD. Those functions are principally those conferred under or by virtue of *section 9* (Supplier obligation) in relation to the ability of the CFD counterparty to recover sums from licenced electricity suppliers. "Liabilities" in this context includes all liabilities under a CFD. For these purposes, liabilities will exist in respect of any sums that are owed at a particular time by the counterparty under

the CFD, irrespective of whether they have yet become payable in accordance with any payment provisions it contains.

Section 9: Supplier obligation

95. This places an obligation on the Secretary of State when making regulations under section 6 to include provision requiring electricity suppliers in GB and Northern Ireland to make payments to the CFD counterparty so that the body has sufficient funds to make the totality of the payments to generators that are required under CFD contracts. Suppliers may also be obliged to make payments to cover administration costs for managing the CFD counterparty. Payments may also be required in order to enable the CFD counterparty to hold sums in reserve (*subsection (2)(b)*), and to mutualise costs across suppliers to cover those not made by an insolvent or defaulting supplier (*subsection (2)(c)*). *Subsection (4)* enables the regulations to require suppliers to provide collateral.
96. *Subsection (5)* specifies that the regulations will place the CFD counterparty under a duty in relation to the collection (including enforcement) of sums that are owed to generators.
97. *Subsections (6) to (8)* enable the Supplier Obligation to be varied according to the supplier or factors in relation to a supplier (such as the amount of electricity it supplies to particular groups of consumers). It also provides for the CFD counterparty to provide notices to suppliers and to enforce such notices, and for dispute resolution arrangements.
98. *Subsection (9)* clarifies that any sum which the supplier is required to pay the Secretary of State, the investment contract counterparty or the CFD counterparty by virtue of the supplier obligation regulations and which is not paid when it is due under the regulations is recoverable as a civil debt.

Section 10: Direction to offer to contract

99. **Section 10** confers a power on the Secretary of State to issue a direction to the CFD counterparty to offer a CFD to eligible generators in accordance with provisions set out in regulations. It is expected that most CFDs will be allocated to eligible generators by the national system operator, National Grid, in accordance with section 12 and any provision made using the power in section 12. However, where flexibility is needed to vary the terms for particular projects beyond what is permitted by the modification of standard terms process (section 15), the Secretary of State will allocate CFDs using the power conferred under section 10.
100. A contract will only come into being on the agreement of a generator to whom an offer is made by the CFD counterparty.
101. *Subsection (3)* requires that regulations define an “eligible generator” for CFD purposes.
102. *Subsections (6) to (8)* provide that any direction which relates to generating stations in Northern Ireland may not be made without consent of the Department of Enterprise, Trade and Investment. This will enable Northern Ireland Ministers to play a role in being satisfied that the terms to be offered to generators in Northern Ireland are suitable.

Section 11: Standard terms

103. This gives the Secretary of State power to issue and, from time to time, revise standard terms for the CFD (*subsections (1) and (2)*, respectively). This section works in concert with sections 12 to 14 to make up the standard system for CFD allocation, from application to offer of a contract.

104. *Subsection (3)* places the Secretary of State under a duty to issue or revise standard terms in accordance with provision made in regulations. *Subsection (4)* requires the Secretary of State to have regard to the matters listed in section 5(2) when issuing or revising standard terms. *Subsection (5)* places the Secretary of State under a duty to publish standard terms as issued or revised under this section. *Subsection (7)* would allow for different standard terms to be issued for different categories of CFD (for example, for generators in Northern Ireland). *Subsection (6)* enables the Secretary of State to designate particular standard terms as terms which may not be modified under section 15.

Section 12: CFD notifications

105. This sets out how the System Operator is to notify the CFD counterparty of an allocation decision. *Subsection (1)* states that such a notification must specify the eligible generator and “such other information as may be required by the CFD counterparty for the purpose of making an offer under section 14”. *Subsection (2)* prevents a notification from being given if regulations made under section 23 (regarding maximum costs and targets) prevent it. *Subsection (3)* allows for regulations to make further provision about the circumstances in which a notification may or must be given, the kinds of information that must be specified in a notification, and appeals against decisions not to give a notification.
106. *Subsections (4), (5) and (6)* make provision for the involvement of the Department of Enterprise, Trade and Investment in the application of this section in Northern Ireland.

Section 13: Allocation of CFDs

107. This section builds on the power in section 12 and specifies the process by which the Secretary of State may make provision setting out detailed rules about the CFD allocation process. The rules are likely to be applicable to those wishing to apply for a CFD and to National Grid who, as the System Operator, will be acting as the Delivery Body.
108. *Subsection (1)* confers a power enabling the Secretary of State to make provision setting out how CFDs are to be allocated to eligible generators. *Subsection (2)* confers a power for setting the rules of allocation in an “allocation framework” – a document which will sit outside of regulations but be constrained by provision made in regulations. An “allocation framework” will be produced and published for allocation rounds, and include information about when allocation rounds will be held. The “allocation framework” will act as a “rule book” for how allocation rounds will operate. *Subsection (2)(e)* confers a power enabling the Secretary of State to make provision about what must be included in an “allocation framework”.
109. For example, the Secretary of State may decide that it is important to investors to ensure that an “allocation framework” includes information about the budget available for a particular allocation round and may therefore require an “allocation framework” to contain this information when it is produced.
110. *Subsection (3)* confers a power enabling the Secretary of State to set out requirements on the Secretary of State. For example, the Secretary of State may stipulate in regulations for specified notice periods to be adhered to before the start of allocation rounds, and separately restrict the Secretary of State’s ability to amend the allocation framework for those participants already engaged in an open allocation round. These sorts of requirements on the Secretary of State will help to provide certainty to industry that the process will not change without due warning. This is necessary to allow them to engage with the allocation process.
111. The powers in *subsections (4) to (6)* enable the Secretary of State to set out further detail of those areas that an Allocation Framework may provide. These include conferring functions on the System Operator to allow them to carry out the allocation process,

the setting of targets for types or location of generation, the mechanics of competitive allocation, and allowing for calculations and determinations to be made to support the allocation of CFDs. These are all functions which may need to change at short notice, allowing the Government to respond in a timely manner to external factors, to protect budgets and to protect consumers by preventing gaming. Examples of such changes that might be necessary are responding to a sudden change in the costs of a particular technology, or allowing change to the mechanism for competitive allocation in response to lessons learned during operation.

112. *Subsection (7)* allows any allocation framework made to be amended, and *subsection (8)* provides that *subsections (4) to (7)* are subject to any provision in regulations which could set limits on what can be contained in the allocation framework.

Section 14: CFD notification: offer to contract on standard terms

113. This section sets out how the CFD counterparty must act upon a notification from the System Operator to offer a CFD contract. *Subsection (1)* places a duty on the CFD counterparty to offer a contract to the eligible generator specified in a notification, and requires that this offer be on the standard terms, or on the standard terms as modified in accordance with the procedure provided for in section 15.
114. *Subsection (2)* confers a power on the Secretary of State to make further provision regarding matters such as how the CFD counterparty is to apply or complete the standard terms in response to a notification and how the eligible generator to whom the offer is made may enter into a CFD as a result.

Section 15: Modification of standard terms

115. **Section 15** enables the CFD counterparty to agree modifications to the standard terms with generators, on a case by case basis, pre-signature. This flexibility to make such modifications allows a wider range of eligible generators to participate in the CFD regime than would otherwise be the case. This will be because, especially in the early stages of the CFD regime, the standard terms will not be acceptable to some generators for reasons such their specific types of company, financing or debt structure, without such small modifications.
116. This flexibility is constrained in order to reduce the risk of generators using it to negotiate improvements to the standard terms for competitive reasons. *Subsection (3)* specifies that a modification can only be agreed if it is both ‘minor’ and ‘necessary’, as determined by the CFD counterparty, following provision made in regulations. *Subsection (4)* provides for further provision to be made in regulations, including regarding the circumstances in which a generator may request a modification, the procedure to be followed in requesting a modification, and how the CFD counterparty is to make a determination on such a request.

Section 16: Sections 12 to 15: further provision

117. **Section 16** confers a power enabling the Secretary of State to, when making provision under the powers in sections 12 to 15, make further provision enabling calculations and determinations to be made by such persons and in accordance with such procedure as is specified.
118. For example, in relation to section 12, section 16 enables the CFD counterparty to make determinations or calculations about what information should be included in the notification provided by the System Operator. In relation to section 14, section 16 enables the CFD counterparty to determine precisely how the information in the notification should be applied to the contract, and whether a generator’s response to an offer is acceptable. Finally section 16 may also be used in relation to section 15 to enable the CFD counterparty to determine whether a generator has provided sufficient information and evidence that a modification is both minor and necessary.

Section 17: Payments to electricity suppliers

119. **Section 17** enables regulations to require the CFD counterparty to make payments to suppliers. This is designed to enable payments to suppliers where the contracts provide for money to be paid to the CFD counterparty e.g. where the reference price is higher than the strike price.

Section 18: Application of sums held by CFD counterparty

120. This section enables the regulations to make provision about the allocation of sums between generators by the CFD counterparty in circumstances where the supplier obligation is not large enough to meet all of its obligations in full. In making these regulations, the Secretary of State must have regard to the principle that sums should be apportioned in proportion to the amounts which are owed, i.e. that they are pro-rated between generators (*subsection (3)*).
121. *Subsections (4)* and *(5)* enable the regulations to make provision about the use of sums a CFD counterparty holds and for the circumstances where monies received should or should not go to the Consolidated Fund.

Section 19: Information and advice

122. **Section 19** enables the regulations to make provision to ensure that information and advice required to make the scheme work is provided to the bodies requiring it at appropriate points, including from generators and suppliers, as well as from the Northern Ireland system operator and Authority for Utility Regulation for the purpose of allowing the CFD to operate in Northern Ireland. It enables regulations to make provision governing the use and protection of information so received to ensure it is handled in an appropriate manner.
123. It will also allow the Secretary of State and the Regulator to monitor the scheme and for the Secretary of State to require advice from the national system operator, the CFD counterparty body and the Regulator necessary for making decisions about the running of the scheme.

Section 20: Functions of the Authority

124. **Section 20** enables the regulations to confer functions upon the Authority (the regulator for the electricity markets in Great Britain) to provide advice to and make determinations for the parties to CFDs. This could include, for example, monitoring obligations under the contract such as biomass sustainability and determining whether such obligations have been met, where the Authority will be exercising the role of expert determination in relation to the contract.

Section 21: Regulations: further provision

125. This section enables the regulations to make provision to require the CFD counterparty to enter into arrangements or to offer contracts for purposes connected to a CFD, or to specify things that the CFD Counterparty can or can't do. This provision only regulates the behaviour of the CFD counterparty and does not enable the Secretary of State to vary any CFD without the consent of the generator in question.
126. *Subsection (1)(c)* enables regulations to make provision about the making of directions to the counterparty. This will enable specific directions to be given in relation to particular contracts or matters (such as where a generator has proposed a variation to the contract and the Secretary of State wishes to require the counterparty to agree to it).
127. *Subsection (3)* places a duty on the Secretary of State. The regulations that he or she makes must include such provision as he or she considers necessary to ensure that the CFD counterparty can meet its liabilities under CFDs. As set out in relation to section 8 above the reference to liabilities means all sums which are owed under a CFD.

Section 22: Enforcement

128. **Section 22** enables the obligations of suppliers under regulations made under this Chapter to be enforced by the Authority in Great Britain, or the Northern Ireland Authority for Utility Regulations in Northern Ireland, as if they are relevant requirements. This means that a breach can be treated, in effect, as if it were a breach of a licence condition allowing the enforcement authorities to get an order to secure compliance, and/or impose financial penalties.
129. It also enables the system operator's functions to be enforced by the Authority.

Section 23: Limits on costs to be incurred

130. This enables the Secretary of State to make regulations setting out a limit on the cost of the scheme.
131. It also includes powers for the Secretary of State to instruct the national system operator that the maximum cost has been reached and prevent them from giving a notification to the CFD counterparty if the Secretary of State believes it may cause the maximum cost to be breached.

Section 24: Consultation

132. This section requires that the Secretary of State must consult licensed suppliers in Great Britain and Northern Ireland, the national system operator and the Authority before making or amending secondary legislation. The Department of Enterprise, Trade and Investment in Northern Ireland, and Scottish and Welsh Ministers are also required to be consulted.

Section 25: Shadow directors, etc.

133. This makes it clear that, in exercising their regulatory controls over the CFD counterparty, neither the Secretary of State nor the national system operator could be deemed to be in any way managing or controlling the CFD counterparty in such a way that would class them as, for example, "shadow directors" or principal to the CFDs (in other words that the CFD counterparty is not the agent of either the Secretary of State or the national system operator).

Section 26: Licence modifications

134. This sets out the Secretary of State's power to modify transmission and distribution licences, the standard conditions of such licences and documents maintained in accordance with conditions of such licences (such as industry codes) to allow the CFD counterparty to be provided with services (such as settlement services).
135. The powers will be used to confer consequential functions upon the national system operator to enable it to administer the CFD scheme as well as providing services to the CFD counterparty. It will also be used to make provision about settlement of payment obligations under CFDs and enable licensees to assist with the enforcement of obligations under contracts. Section 64 makes further provision about licence modifications.