

Draft CfD contract and allocation process published

The Government has published further detail on the implementation of the new Feed-in-Tariff Contract for Difference (CfD), supporting low carbon power generation which forms a major part of its Electricity Market Reforms. In addition to draft CfD contract terms, more information has been provided on the allocation process and how it will apply to individual technologies. This briefing gives a run down on this latest stage in the development of the CfD.

The Department of Energy and Climate Change (DECC) continues to work with stakeholders on the technical and implementation aspects of the CfD. New documents published on 7 August contain additional information on, and explanation of, the allocation process and methodology, and a more developed set of draft CfD contractual terms¹. These largely reflect the policy positions announced in June 2013² but some new announcements have been made and we give further details below.

CfD Allocation Methodology

Eligibility

The Eligibility criteria will be technology-specific. As well as using a qualifying low carbon technology, projects will need to have secured planning permission and accepted a grid connection offer. There may be other requirements for some technologies, e.g. biomass.

Projects will need to meet a certain minimum size threshold, expected to be 5MW (the figure below which Projects are eligible for the microgeneration feed-in tariff)³. Also, "larger projects" will have to obtain government certification that their "supply chain plan" meets a defined standard. The definition of larger project and the relevant standard are still being worked up and will be published later in the year.

Contract Allocation

DECC has decided that the process for allocation of CfD contracts will be split

Key issues

Further detail on CfD allocation published:

- "First Come, First Served" allocation basis until 50% of budget used, then move towards auctioning
- Investment commitment milestones, target commissioning windows and longstop dates published for renewable generation
- 30% capacity reduction below level specified in application will be permitted (10% of which without penalty)

Draft detailed CfD terms published:

- Bespoke drafted contracts may see reduction in strike prices on refinancing
- Qualifying changes in law may lead to reduction in strike prices

¹ The full suite of documents can be found at: <https://www.gov.uk/government/publications/electricity-market-reform-contracts-for-difference>.

² See our briefing: "[More detail emerges on Electricity Market Reform – July 2013](#)".

³ This figure may be raised to 10MW under the Energy Bill.

into 3 phases.

Initially, CfD contracts will be allocated on a "first come, first served" (FCFS) basis. As long as applicants meet the eligibility requirements, they will be offered a CfD contract. DECC estimates that it will take 60 working days from application to allocation for renewable generation projects.

Once 50% of the CfD budget⁴ has been allocated, "allocation rounds" will begin. These would run twice a year and would then continue for all subsequent delivery years.

A first stage of allocation rounds will see all eligible applicants receiving CfDs. At the point when it appears the balance of the budget for a delivery year might be exceeded, the Delivery Body (National Grid, the system operator), will check whether the Government is prepared to authorise an increased budget. If not, a "constrained allocation process" will be triggered. This will involve CfDs being allocated on the basis of a sealed-bid auction process to reward the least expensive projects. It is not clear how the transition from FCFS allocation to allocation rounds will work. Generators and investors will be keen to ensure that this is a transparent and predictable process.

Applicants will be able to appeal against decisions on eligibility and contract allocation. This will initially involve a review by the Delivery Body, with a subsequent appeal to Ofgem. In order to protect applicants, further allocation of CfDs will not take place until completion of an appeal (this freeze would appear to apply to allocation round applications only).

As previously announced, CfDs will be entered into with the CfD Counterparty, which will be a private limited liability company owned by the Government.

Delivery Incentives

Further detail has been given on the three primary incentives for generators to plan and achieve their projects in a timely way:

1. *Substantial Financial Commitment Milestone:* Generators will need to provide evidence of financial commitment to proceed with the project and this has to be provided within 1 year of signing the contract. The types of qualifying evidence are technology-specific.
2. *Target Commissioning Window:* The agreed contract duration (e.g. 15 years for renewable generation projects) will begin at the end of this technology-specific period. Generators will need to build and commission their projects and satisfy all relevant conditions precedent by this date since they will not qualify for CfD payments until the conditions are satisfied.
3. *Longstop Date:* The CfD Counterparty will have rights to terminate the CfD contract unless the project is commissioned and other conditions precedent are satisfied by the Longstop Date. This date is again technology-specific.

DECC has set out the proposed requirements for the Substantial Financial Commitment Milestone, the Target Commissioning Window and the Longstop Date for the various renewable technologies. We have set these out in the Annex to this briefing.

Phased projects will have tailored provisions. For example, phased support for offshore wind projects will be available for projects under 1500MW where 35% of capacity has been commissioned in the first phase of the project. Individual Target Commissioning Windows would be set for each phase and each phase would receive the strike price applicable to the first phase.

⁴ The budget will come under the Government's Levy Control Framework. The Government has yet to decide whether there will be minimum or maximum levels of deployment or budget for individual technologies; this is to be announced in December 2013.

Capacity Adjustment

DECC has now decided to give additional flexibility to generators to provide lower capacity than proposed in their application as follows. Capacity can be reduced by:

- 5% before the Substantial Financial Commitment milestone - without penalty;
- A further 5% of the original capacity before the Longstop Date - without penalty; and
- A further 20% of the original capacity - but this would reduce the applicable strike price.

CfD Contract Terms

DECC has now developed the detailed CfD heads of terms published in 2012 into more detailed contractual terms. There are still numerous gaps, however, whilst DECC continues its development work with stakeholders. DECC is seeking views on the mechanics and operation of the terms, but not on the policy positions set out in them.

Some new features are incorporated into these contract terms. We describe key elements below.

Termination rights

As a result of significant feedback, events allowing the CfD Counterparty to terminate the CfD have been reduced and now include only:

- (a) Failure to achieve initial conditions precedent within the deadline, failure to meet the Significant Financial Commitment Milestone, or satisfy relevant conditions precedent, by the Longstop Date.
- (b) A Qualifying Change in Law preventing completion of construction or permanently preventing generation (under (a) and (b), there is no entitlement to a termination payment, although compensation may be due under change of law provisions); and
- (c) Key breaches of the contract: e.g. insolvency, fraud or metering non-compliance (the generator will be required to make a termination payment).

Market Reference Price adjustment

In order for the CfD to operate efficiently, the approach to establishing the market reference price for the CfD price needs to move with changes in circumstances in the wider market. DECC is currently working on how to build changes to market reference pricing into the CfD drafting to take account, in particular, of EU Market Coupling Arrangements, changes in relevant indices used in the market, and changes to volumes of electricity being traded on different platforms. DECC recognises that submission to an independent expert or panel of experts might be needed to agree the changes to be incorporated at the appropriate time.

Refinancing

The Government's June 2013 policy announcement noted that larger projects might have their strike prices adjusted in the event that project refinancing reduces project costs⁵. In the latest developments, DECC has suggested that this would only apply to projects that have individually negotiated CfDs. This will, in particular, include CfDs for new nuclear projects, but potentially also biomass, hydro, tidal and CCS projects. Other renewable generation projects, even larger projects, should therefore be safe from this prospect.

⁵ See our July 2013 briefing – see footnote 2 above.

Change in Law and Compensation

The CfD heads of terms had provided for circumstances in which Qualifying Changes in Law would lead to compensation to the generator (normally through an increase in the strike price). DECC is now suggesting that Qualifying Changes in Law which benefit the generator could lead to a downward adjustment to the strike price. This is likely to concern generators and investors as to the circumstances in which this might be applied and the potential for disagreement that could arise.

DECC is also considering removing the market-based compensation that generators receive when system operator action (in balancing or resolving transmission constraints) affects generators.

Payment

The CfD terms provide for a billing statement to be given to the generator, at the latest, 5 Business Days following the end of the relevant invoice period. No date for payment to the generator has yet been set. Conversely, where a payment has to be made by the generator back to the CfD Counterparty, it must be made within 7 Business Days from the statement date.

Next Steps

DECC is now seeking views from stakeholders on the mechanics and operation of the draft CfD terms and these should be made by 2 September 2013.

DECC will be formally consulting on the CfD allocation process during Autumn 2013. It then expects to publish the final CfD contractual terms and allocation process by December 2013. DECC still intends to introduce the CfD in Summer 2014.

On 7 August, the Government also published its policy response to the call for evidence on the Supplier Obligation. The Supplier Obligation is the mechanism by which the CfD Counterparty will be funded. The Government intends that it will be a statutory obligation on electricity suppliers to pay in accordance with their market share. The Government will publish more detailed proposals for the Supplier Obligation in Autumn 2013.

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Annex

Delivery Incentives for Renewable Generation Projects*

* Extract from 'Electricity Market Reform: Contract for Difference – Allocation Methodology for Renewable Generation – DECC¹©Crown Copyright 2013

Technology	Target Commissioning Window (TCW) (in years)	Longstop Date (period following TCW) (in years)	Substantive Financial Commitment Milestone
Advanced Conversion Technology (ACT) (with or without CHP)	1	1	<ul style="list-style-type: none"> ■ Construction contracts (signed EPC contract covering the supply and installation of gasifier <ul style="list-style-type: none"> ➤ or pyrolyser; or signed supply agreement for the gasifier or pyrolyser; or signed framework agreement for gasifier or pyrolyser supply and binding purchase order referencing the particular project. ■ Environmental permit received and pre-operational conditions discharged ■ Financial Investment Decision (FID) / Financing secured
Anaerobic Digestion (with or without CHP)	1	1	<ul style="list-style-type: none"> ■ Construction contracts (Binding commitment for supply of major equipment i.e. signed EPC contract covering the supply and installation of digester; or signed supply agreement for the digester; or signed framework agreement for digester supply and binding purchase order referencing the particular project..) ■ Environmental permit received and pre-operational conditions discharged ■ Financial Investment Decision (FID) / Financing secured
Biomass Conversion	1	1	<ul style="list-style-type: none"> ■ Construction contracts (signed EPC contract covering the existing plant conversion contract; or signed supply agreement for the existing plant conversion; or signed framework agreement for plant conversion and binding purchase order referencing the particular project.) ■ Environmental permit received and pre-operational conditions discharged ■ Financial Investment Decision (FID) / Financing secured
Dedicated Biomass (with/without CHP)	1	1	<ul style="list-style-type: none"> ■ Binding commitment for supply of major equipment as evidenced by signed EPC contract covering: <ul style="list-style-type: none"> ➤ the supply and installation of furnace and boiler island; or ➤ signed supply agreement for the furnace and boiler island; or ➤ signed framework agreement for furnace and boiler island supply; and binding purchase order referencing the particular project ■ Environmental permit received and pre-operational conditions discharged
Energy from Waste with CHP	1	1	<ul style="list-style-type: none"> ■ Financial Investment Decision (FID) / Financing secured ■ Environmental permit received and pre-operational conditions discharged

Technology	Target Commissioning Window (TCW)	Longstop Date (period following TCW)	Substantive Financial Commitment Milestone
Geothermal (with or without CHP)	1	1	<ul style="list-style-type: none"> ■ Financing secured, supporting the drilling of a project's first well; and ■ A signed contract with a drilling contractor to drill the first well
Hydroelectricity	1	1	<ul style="list-style-type: none"> ■ Signed EPC contract covering the civil works for the major scheme components; or signed civil works contract for the major scheme components; or signed framework agreement for civil works and purchase order referencing the major scheme components for the particular project ■ Financial Investment Decision (FID) / Financing secured (as evidenced by signed loan agreement) ■ Key project consents (50MW – 300MW) – DCO; and ■ Other key project consents as included in consents register not obtained at eligibility stage obtained to allowing the project to be constructed ; ■ <50MW - Submissions to Local Planning Authority and ■ corresponding confirmation from regulator that conditions discharged
Landfill Gas	0.5	0.5	<ul style="list-style-type: none"> ■ Construction contracts (signed EPC contract covering the supply and installation of engines; or signed supply agreement for the engines; or signed framework agreement for engine supply and binding purchase order referencing the particular project) ■ Environmental permit received and pre-operational conditions discharged ■ Financial Investment Decision (FID) / Financing secured
Offshore Wind	1	2	<ul style="list-style-type: none"> ■ Major construction contracts signed (Signed EPC contract covering the supply and installation of the wind) ■ Turbine groups; or signed supply agreement for the wind turbine groups; or signed framework agreement for wind turbine group supply and binding purchase order referencing the particular project] ■ Financial Investment Decision (FID) / Financing secured (as evidenced by signed loan agreement) ■ Crown Estate lease signed ■ Energy Yield Assessment ■ Key Project consents (DCO and other key project consents as included in consents register not obtained at eligibility stage obtained to allowing the project to be constructed)
Onshore wind	1	1	<ul style="list-style-type: none"> ■ Financial Investment Decision (FID)/Financing secured (as evidenced by signed loan agreement) ■ Major construction contracts signed covering 50% of build cost (turbine - i.e. turbine contracts, EPC contract covering supply and installation of the wind turbine groups; or signed framework agreement for wind turbine group supply and binding purchase order referencing the particular project) ■ Key Project consents (DCO and other key project consents as included in consents register not obtained at eligibility stage obtained to allowing the project to be constructed)

Technology	Target Commissioning Window (TCW)	Longstop Date (period following TCW)	Substantive Financial Commitment Milestone
Sewage Gas	1	1	<ul style="list-style-type: none"> ■ Construction contracts (Binding commitment for supply of major equipment i.e. Signed EPC contract covering the supply and installation of engines; or signed supply agreement for the engines; or signed framework agreement for engine supply and binding purchase order referencing the particular project.) ■ Environmental permit received and pre-operational conditions discharged ■ Environmental permit received and preoperational conditions discharged ■ Planning permission and Environmental permit reconstruction conditions discharged ■ Financial Investment Decision (FID) / Financing secured
Solar PV	0.25	1	<ul style="list-style-type: none"> ■ Financial Investment Decision (FID) / Financing secured ■ EPC contract signed covering supply and installation of PV panels; or signed framework agreement for PV panel supply and binding purchase order referencing the particular project. ■ Energy yield assessment
Tidal Range	1	2	<ul style="list-style-type: none"> ■ Financial Investment Decision (FID) / Financing secured (as evidenced by signed loan agreement) ■ Signed EPC contract covering the civil works for the major scheme components; or signed civil works contract for the major scheme components; or signed framework agreement for civil works and purchase order referencing the major scheme components for the particular project ■ Energy yield assessment ■ Key project consents (DCO and other key project consents as included in consents register not obtained at eligibility stage obtained to allow the project to be constructed) ■ Crown Estate Lease signed
Tidal Stream	1	2	<ul style="list-style-type: none"> ■ Financial Investment Decision (FID) / Financing secured ■ Signed EPC contract covering the supply and installation of turbines; or signed supply agreement for the turbines; or signed framework agreement for turbine supply and binding purchase order referencing the particular project ■ Energy yield assessment ■ Crown Estate Lease Signed ■ Financial Investment Decision (FID) / Financing secured
Wave	1	1	<ul style="list-style-type: none"> ■ Financial Investment Decision (FID) / Financing secured ■ Binding commitment for supply of major equipment (e.g. signed EPC contract covering the supply and installation of generation engines) ■ Energy Yield Assessment

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