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UK GOVERNMENT ANNOUNCES FUTURE CONTRACTS FOR DIFFERENCE AUCTIONS

The UK Government has announced on 23 July 2018 that the next Contracts for Difference (CFD) auction will open by May 2019, with the parameters for this auction to be released later this year. The Government plans to run subsequent auctions approximately every 2 years during the 2020s, and it is expected that these auctions will together utilise the previously announced budget of £557 million. Minister for Energy and Clean Growth Claire Perry stated that new auctions "*could see 1-2 gigawatts of new offshore wind every year in the 2020s*". Onshore wind is, however, likely to be excluded.

Key issues

- The next CFD auction will open by May 2019.
- Subsequent auctions are to be held approximately every two years after that.
- Onshore wind is likely to be excluded from future CFD auctions.
- The total allocated budget for the CFD rounds in the 2020s has been set at £557 million.

OVERVIEW

The UK Government has reconfirmed the CFD regime as the cornerstone of its policy to cost-effectively decarbonise electricity generation in the UK and contribute to meeting its emissions reduction and renewable energy targets through competitive auctions.

The UK now has just over 7GW of operational offshore wind capacity, with around 6GW more capacity in the pipeline. The Government's future CFD auctions could lead to the deployment of a further 16GW of new capacity, which would generate roughly 20% of UK power needs, according to RenewableUK, the trade body representing the renewable energy industry.

The CFD auctions in the 2020s will likely be reserved for "Pot 2" technologies only, which are the less established low carbon technologies. These include:

- Offshore wind;
- Onshore wind on remote islands;
- Biomass with CHP;
- Advanced Conversion Technologies;
- Anaerobic Digestion;
- Geothermal; and
- Wave and tidal stream.

Is the budget big enough?

The total budget reserved for the auction in 2019 and the subsequent auctions in the 2020s has been set at £557 million. Some may question whether that budget would be sufficient to cover more than three or four auctions considering that the second allocation round (in 2017) resulted in the award of CFDs worth £167m. However, two key recent developments may offer the Government comfort in its ability to stretch the budget to include auctions every two years in the 2020s.

Firstly, the costs of renewables technologies have decreased dramatically, especially for offshore wind as a result of larger and more efficient turbines. In 2015, the lowest price achieved in the CFD auctions for an offshore wind project was £114.39/MWh, whereas in 2017 both Hornsea II and Moray East cleared at £57.50MWh. While we cannot expect such dramatic falls in price at every auction, it is clear that due to technological, operational and financial developments, lower levels of support are now needed for each GW of power procured. This is reflected in the Government's commitment to reducing support over time (and ultimately to phasing it out).

Secondly, competition in the auctions is increasing over time. In the last auction in 2017, due to the high level of competition on price between developers, the Government was able to secure its desired level of capacity with only 60% of its pre-allocated budget.

OFFSHORE WIND EXPECTED TO DOMINATE

The Government has indicated that only less established technologies will be able to compete in future CFD auctions. This means that onshore wind, one of the cheapest forms of renewable energy in the UK, will be excluded as it is now considered to be an established technology.

Offshore wind is therefore expected to continue to be the dominant renewable technology as it is expected to win the majority of capacity in future auctions. In the 2017 auctions, it accounted for over 95% of total capacity awarded. Given the impressive price reductions achieved by the offshore wind industry, it does not seem likely that technologies such as geothermal, wave or tidal energy will be able to compete.

When announcing the new CFD auctions, Minister Perry praised the fact that the offshore wind industry had made substantial investments into UK-based services and manufacturing, "*creating thousands of skilled jobs*". The Government also promotes the ancillary benefits of the development of local industry through the "supply chain plan" requirements offshore wind developers must submit to participate in auctions. As other countries, such as France, China and the USA start to develop their own offshore wind energy resources, this could be an additional boost for the network of UK offshore wind services and manufacturers.

"SUBSIDY FREE" CFDS IN THE FUTURE?

Despite the Government's announcement setting the CFD policy for the next decade or so, it is worth considering whether further cost reductions, at least in offshore wind, could lead to a change in the underlying nature of the support awarded through CFD auctions.

The topic of "subsidy-free" CFDs has been gaining traction within the offshore wind industry following reports from economic consultancies such as Aurora Energy Research. While not fully subsidy free as the name suggests, the premise is to offer revenue stabilisation to offshore wind developers set at a price below wholesale market levels, effectively operating as a floor price. Aurora's research suggests that this could offer enough certainty to placate lenders' bankability concerns. This could then do away with the current fixed price that is above market rates.

FINAL REMARKS

The announcement clearly demonstrates the Government's commitment to the continued deployment of renewable electricity generation to meet its own emissions targets and to support investment and job creation in the UK's offshore wind energy industry. The announcement was widely welcomed by the renewables industry. It comes at a time of policy uncertainty, following dynamic developments in the energy market and the impending legislative and regulatory changes in preparation for the UK's withdrawal from the EU.

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228244-1-11-v0.10