RENEWABLE ENERGY CONTRACT FOR DIFFERENCES NEW SUPPLY CHAIN RULES: FROM ASPIRATION TO COMMITMENT

The UK government's press release described Allocation Round (AR4), which opened on 13 December 2021 in the UK, as the biggest ever bid round for renewable energy contracts for differences (CfD).

Bidders proposing to develop large offshore wind projects will have until 14 January 2022 to address the triple challenges of (i) offering a competitive CfD price, (ii) making the economics work with the high prices bid for options to develop wind farms in the separate Crown Estates Offshore Wind Leasing Round 4 and (iii) demonstrating commitment to their supply chain plans (SCPs) approved by the government at pre-qualification.

Tighter economics

The CfD was developed to support renewable energy, by smoothing out the revenue stream from the unpredictable UK electricity market. This is achieved through a contract providing for the generator to receive a payment equal to the amount by which the energy price falls below a “strike price” (a figure bid by a generator in the CfD auction process) and make a payment, if the energy price is above the strike price.

The right to enter into such a contract is auctioned by a government company, the Low Carbon Contracts Company (LCCC), the entity entering into the CfD contract with successful bidders. Following the last auction, AR3, the LCCC announced that strike prices bid were below the forecast market power prices. The LCCC celebrated the benefit to UK energy consumers, who ultimately meet the cost of payments to generators under the CfD in their utility bills.

Whether this trend can continue, though, remains to be seen, given the significant sums paid for the Crown Estate options, as well as the cost and risk of complying with the new SCP rules.

Tighter supply chain obligations

The stated objectives of the SCP were adjusted for AR4 from *competition, innovation* and *skills development* in AR3 to *green growth, infrastructure, innovation* and *skills*. Accompanying this change was the introduction of a new submission template with detailed categories and scoring.

Although the UK Department for Business, Enterprise and Industrial Strategy (BEIS) was looking for a strong local content element in AR3, the requirement was not spelled out. In AR4, though, local content was addressed specifically in the revised template: 175 out of the 500 marks for *green growth* (and a total of 2000) were allocated to UK content and other priorities may also have favoured supply chains with a local focus, such as achieving a low carbon footprint.

A change yet to be seen in practice is the more serious consequence of failure to deliver on the SCP. Whereas shortcomings in implementing the AR3 SCP were highlighted in a *Post Build Report* which could then prejudice a developer in a future project, there is a requirement in AR4 for a Supply Chain Implementation Report Certificate (Certificate) as a condition precedent to any payment being made to the generator under the CfD, coupled with a termination right if the condition is not met by a longstop date.

Who will be affected?

Generators which are successful in AR4 will be subject to the BEIS process for monitoring compliance with their SCPs, both before and after obtaining the necessary Certificate.

BEIS’s stated policy at the pre-qualification stage was to mark SCPs on the quality of information provided and level of ambition demonstrated in them. Bidding teams working on large projects will have responded by putting together impressive SCPs, no doubt in close consultation with contractors, service providers and suppliers.

But bidders are seldom able to conclude detailed contract terms, even with key providers - on whom compliance with the SCP will depend.

There is therefore likely to be significant contractual and negotiation work for successful generators to do, as bid teams hand projects over to delivery teams. This will not only impact on the generators themselves, but contractors, services providers and suppliers (and their supply chains) will also be expected to step up to the challenge of meeting difficult negotiating parameters in a tight time-frame.

Not only will BEIS be scrutinising the process, but funders will also have a keen interest in seeing compliant, risk sensitive contracts put in place as quickly as possible, so that CfDs become unconditional as soon as possible. Time and resource will be needed by all concerned, as well as close working between bid teams, project delivery teams and legal teams.

Our thanks to Dr Michael Warner of CLCI for many useful discussions on the Contract for Differences Supply Chain Plan. Responsibility for content is, of course, ours.

Future briefings will consider whether there is a risk that the new rules fall foul of international trade obligations.

Diana France and her partners and colleagues in the Energy and Resources group at HFW have extensive experience of leading and working in cross-functional teams, to ensure that contracts address the complex issues which arise in the industry.

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