Department of Energy & Climate Change

Expert group

Contract for Difference

DECC, Energy Markets

4 February 2013

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Agenda

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Introduction and Overview

- Purpose of the session

Re-cap from previous session

Inflation indexation

Change in law compensation

Preparing for next Expert Group meeting

Closing remarks; questions and comments

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Inflation indexation

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Setting the scene

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The Operational Framework in November 2012 confirmed the Government's view that the CfD should include:

- Some element of inflation indexation
- Linked to a general measure of inflation
- Applied on an annual basis

There are some key questions outstanding:

- Which general inflation index should be used?
- What percentage of the strike price is it appropriate to index?
  - Should this differ by technology?
- How do you deliver this provision through the contract?

Choice of index

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CPI	RPI	Basket of indices
• Better measure of macroeconomic inflation • Relevant to a wide range of investors • Governed by regulations	• Familiar measure used under the RO	• Potentially closer correlation to costs • Difficult to standardise • Administratively burdensome • More open to manipulation

Considerations on proportion of index

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- Link to actual uncontrollable inflatable costs of developers
- Ensuring appropriate balance of risk across the contract
- Standardisation of approach and ease of administration
- Securing desired investment from range of investors
- Delivering value for money to consumers

Options on proportion to index

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Partial indexation with % varying by technology

- Preferred approach under PFI guidance

Partial indexation with common % across all technologies

- Standardised

Full indexation

- Attractive to wider range of investors

Implementing inflation provisions

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- How is the strike price referenced in the contract – an actual figure, or reference to an external document?
- What is the date from which indexation should apply – contract signature or strike price publication?
- What point is indexation applied – calendar yearly or anniversary of strike price publication?
- What data source is used – how long a time delay is required to ensure accurate figures?
- Does the formula provide for downwards as well as upwards indexation?
- How is discontinuation, material change or replacement of the index addressed?

Work ongoing / next steps

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- Seeking evidence from investors on the impact on their financing costs of different approaches to inflation
- Commissioning technical advice on the proportion of project costs typically exposed to inflation (by technology)
- Developing the technical aspects of the contract to deliver the policy intent
- Welcome input from the Expert Group on these areas

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Change in law compensation

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CfD Design: When a qualifying change in law necessitates capital expenditure, what are consumers compensating generators for?

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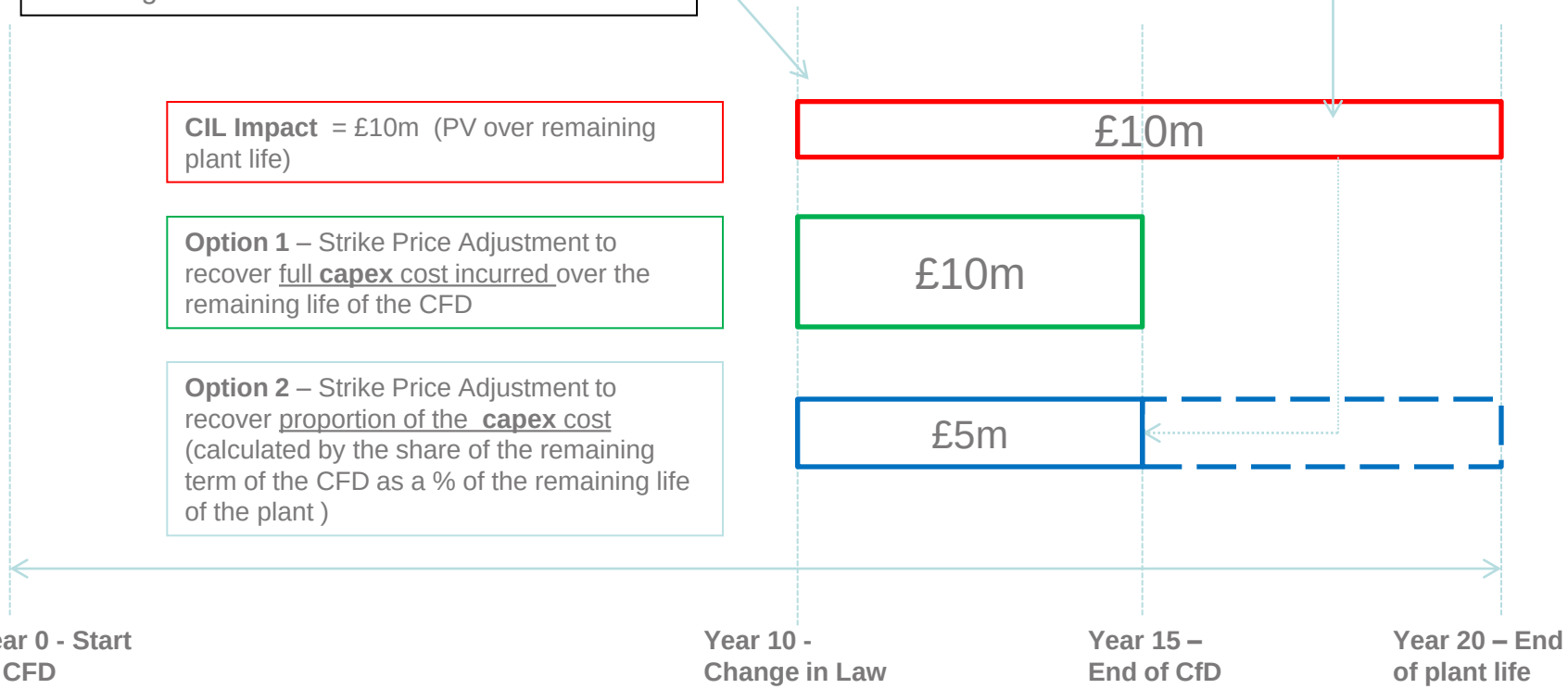
Change in Law requires additional capex (that qualifies for compensation) and gives rise to a financing issue.

Additional £10m capex amortised over remaining life of plant

CIL Impact = £10m (PV over remaining plant life)

Option 1 – Strike Price Adjustment to recover full **capex** cost incurred over the remaining life of the CFD

Option 2 – Strike Price Adjustment to recover proportion of the **capex** cost (calculated by the share of the remaining term of the CFD as a % of the remaining life of the plant)



- what are the pros and cons of each approach?
- how can developer/consumer needs be met?
- how should this be implemented in the CfD?

NB. generators would receive compensation for the Opex impacts of changes in law for the remainder of the CFD term.

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Future Expert Group sessions

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AOB

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