



Department  
of Energy &  
Climate Change

# Annex D

## Institutional Framework: Delivering EMR

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# Executive Summary

1. In May 2012 alongside the draft Energy Bill, we published a description of the institutional framework that will deliver Contracts for Difference (CfD) and the Capacity Market as part of the Electricity Market Reform (EMR) Programme. Subject to the passage of the Energy Bill, the roles of the key players in the institutional framework are as follows:
  - Government will be responsible for the policy approach and for policy costs, which includes key decisions such as strike prices or auction volumes for the CfD, and the amount of capacity to contract through the Capacity Market. Government will also be responsible for defining the System Operator's delivery role;
  - the System Operator (SO) (within National Grid) will have a role defined by Government providing evidence and analysis to inform Government's decisions on key policy parameters and administering the EMR mechanisms, for example running capacity auctions for the Capacity Market, assessing eligibility for CfDs, and reporting to the Government on delivery;
  - Ofgem will continue to regulate the SO, as well as the wider market, overseeing the performance of the SO in its role as delivery body for CfDs and the Capacity Market, to ensure value for money and incentivise effective performance; and
  - a CfD counterparty, a new company to be set up and owned by Government, will be responsible for offering CfD contracts with projects deemed eligible by Government or the SO against criteria set by Government, and for managing and settling those contracts in line with the contract terms.
1. Further detail on this framework is set out in **chapter 1** (see below for more on the CfD counterparty). This chapter also provides information on the Government's work, jointly with Ofgem, to assess the scale and extent of possible conflicts of interest arising from the SO taking on the delivery role.
2. In May we published an outline of the governance and accountability framework that will be put in place to ensure that EMR is delivered in line with the programme's aims and objectives. In **chapter 2** of this annex we give further detail of this framework, and set out what remains to be done as we move towards implementation of EMR.
3. The Energy Bill provides for a payment model for CfDs revised in light of the feedback from stakeholders and the recommendations of the Energy and Climate Change (ECC) Committee. The revised model consists of:
  - a private law contract between the generator (of each low-carbon project) and a newly established CfD counterparty, which will manage the contract over the contract's lifetime;

- a revenue raising power which will enable the counterparty to raise funds from licensed suppliers to meet the payments to generators under the CfDs;
  - the counterparty, or an agent on its behalf, calculating what is owed and settling payments between suppliers and generators; and
  - the counterparty being a limited, not-for-profit company, wholly owned by Government.
4. What this means for the operation of the CfD and the impact on suppliers and generators is explained in detail both in the EMR Overview document and Annex A - the CfD Operational Framework. As with the SO's EMR delivery function, it will be important to set up a robust governance framework for the counterparty. This, plus detail on the form and ownership of the CfD counterparty is set out in **chapter 3** of this document.
  5. The design of the institutional framework is critical to effective implementation, and we have undertaken a great deal of stakeholder engagement over the past year in the design process. Further detail on how stakeholders will be involved in the next phase of work is outlined in **chapter 4**.
  6. Government has been working closely with National Grid's EMR team since the beginning of 2012 to prepare for the implementation of the reforms. In particular we have been working together to define the analytical requirements for the first delivery plan in advance of the call for evidence which was issued on 9 October 2012 (more detail on this is provided in Annex E). Further detail on what remains to be done is set out in **chapter 5**.

**Figure 1: Summary of the EMR institutional framework design**

Design area	Current position
<b>Accountability and governance framework</b>	<ul style="list-style-type: none"> <li>• We continue to work with Ofgem to develop an accountability and governance framework for the System Operator's delivery of the EMR functions. The framework will be set out in secondary legislation and be consulted on in autumn 2013 prior to laying before Parliament in early 2014.</li> <li>• Subject to the will of Parliament, secondary legislation will enter into force in mid 2014.</li> </ul>
<b>Conflicts of interest</b>	<ul style="list-style-type: none"> <li>• A joint DECC-Ofgem project to assess the potential for conflicts of interest arising from the System Operator taking on the EMR delivery role is underway.</li> <li>• A consultation<sup>1</sup> has been published alongside the Energy Bill which identifies potential conflicts of interest and the range of available mitigating measures.</li> <li>• A joint DECC-Ofgem report will be published in the first half of 2013. We are taking powers in the Energy Bill to be able to act to mitigate any conflicts of interest by the time that EMR becomes operational.</li> </ul>
<b>CfD counterparty</b>	<ul style="list-style-type: none"> <li>• We will set up the body which will act as the counterparty to the CfD contracts in time for it to start signing CfDs by mid 2014.</li> <li>• Detail on the roles, functions and controls of the body will be developed and set out in secondary legislation, which will be consulted on in autumn 2013.</li> </ul>

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<sup>1</sup> [http://www.decc.gov.uk/en/content/cms/consultations/coi\\_emr/coi\\_emr.aspx](http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx)

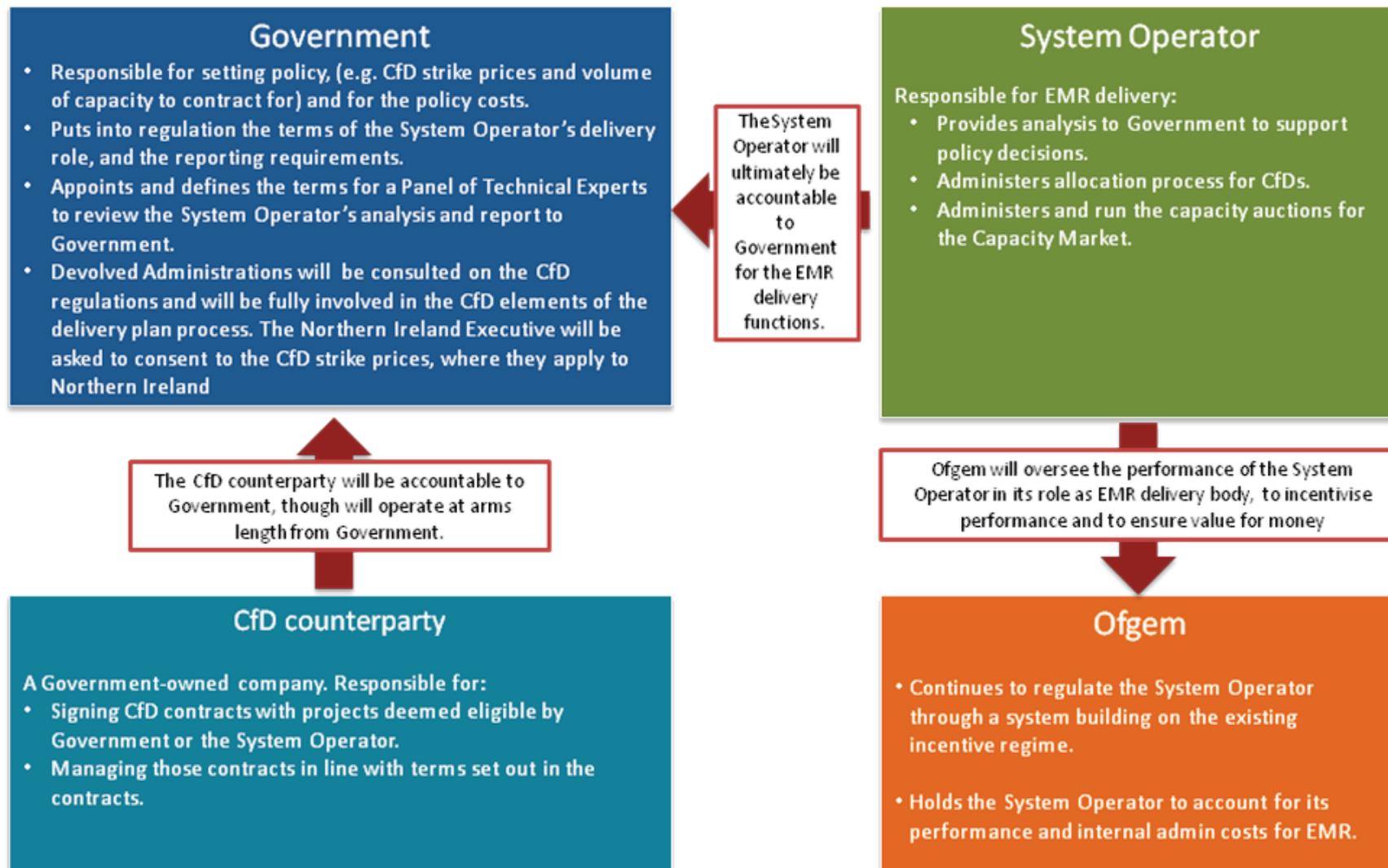
# 1. Institutional framework

## Overview of the framework

7. Putting in place the right institutional framework is critical to the successful delivery of EMR, in particular to ensuring the industry confidence necessary to secure the required levels of investment. The roles and responsibilities of the institutions involved in delivering the EMR framework are as follows:
  - **Government** will be responsible for the policy and for policy costs – this includes taking decisions on key parameters such as on CfD strike prices while they are administratively set or the information needed to support future competitive CfD award processes, the reliability standard for the Capacity Market and the volume of capacity to contract. As EMR will extend across the UK, Government will work closely with each of the Devolved Administrations in taking these decisions. The Government will also work with other bodies, such as the Committee on Climate Change and Ofgem, as appropriate.
  - the **System Operator** will administer the allocation process for generic CfDs and run capacity auctions for the Capacity Market. It will also provide evidence and analysis to inform the Government's decisions on policy parameters such as the CfD strike prices for renewables while administratively set, and the amount of capacity to contract in a Capacity Market. In order to carry out the analysis for the Single Electricity Market in Northern Ireland effectively, the SO will work with the SO Northern Ireland (SONI) and the Single Electricity Market Operator (SEMO).
  - **Ofgem** will oversee the performance of the SO in its role as the EMR delivery body, to incentivise efficient performance and to ensure value for money. As the independent energy regulator, Ofgem will also continue to regulate the SO and the generation, distribution and supply companies. Similarly, the Northern Ireland Authority for Utility Regulations (NIAUR) will continue to regulate the electricity market in Northern Ireland as before.
  - the **CfD counterparty** will be a new company owned by Government. It will be responsible for signing CfD contracts with generators for projects deemed eligible by Government or by the SO against criteria set by Government, and for managing and settling those contracts in line with the contract terms.
8. The framework, set out in figure 2 below, ensures Government control. At the same time it makes use of Ofgem's expertise and existing systems for managing the performance of the SO.

9. Further detail on the accountability and governance arrangements of the CfD counterparty are set out in **chapter 3**.

**Figure 2: Outline of the EMR institutional framework<sup>2</sup>**



<sup>2</sup> Arrows denote accountability between parties.

## The System Operator: the right choice to deliver EMR

10. The System Operator (SO) is responsible for making sure that electricity supply and demand stay in balance and the system remains within safe operating limits. The SO role is defined by the SO conditions of the transmission licence. In addition to these licence requirements, the SO must meet minimum standards and obligations as set out in legislation, such as its obligation under the Electricity Act 1989 to develop and maintain an efficient, coordinated and economical system of electricity transmission and to facilitate competition in the supply and generation of electricity.
11. The Government has previously outlined the strong reasons why the SO within National Grid is best placed to take on the role of delivering EMR, weighed against the criteria in the EMR White Paper published in July 2011 (p11)<sup>3</sup>. In particular:
  - There are strong synergies with the current role of the SO and delivery of both the CfD and the Capacity Market, for example with its current work balancing the electricity system;
  - The SO is at the heart of UK energy market, so uniquely placed to understand the impacts on the electricity system of different generation mixes;
  - The SO already has the relevant technical expertise and commercial and financial skills necessary to deliver the CfD in the UK and Capacity Market in Great Britain, as well as to provide evidence and analysis to Government to inform its decisions on key rules and parameters. The SO is currently building upon this expertise in order to prepare for delivery;
  - Delivery of the CfD and the Capacity Market by a single organisation will ensure a coherent approach to the two mechanisms and, combined with the SO's current roles, will provide value for money; and
  - The SO's administration of the Capacity Market follows the example of implementation in many other markets.

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<sup>3</sup> [http://www.decc.gov.uk/en/content/cms/legislation/white\\_papers/emr\\_wp\\_2011/emr\\_wp\\_2011.aspx](http://www.decc.gov.uk/en/content/cms/legislation/white_papers/emr_wp_2011/emr_wp_2011.aspx)

## Potential for conflicts of interest

12. The Government recognised in the Technical Update to the White Paper (published in December 2011)<sup>4</sup> that conferring the EMR delivery role on National Grid could create conflicts of interest with its existing role and interests. We have heard the concerns raised by some industry stakeholders and the ECC Committee about this issue.
13. The Government takes these concerns very seriously. Since the beginning of 2012, DECC has been working jointly with Ofgem to assess the scale and extent of possible conflicts, and issued an open letter to industry in March 2012. The project has continued and alongside the introduction of the Energy Bill, DECC and Ofgem have published a public consultation<sup>5</sup> which identifies potential conflicts of interest and the range of available mitigating measures. Stakeholder responses to this consultation and further analysis of the issue will inform the final joint report in spring 2013.
14. As set out in the consultation document, the Government fully intends to take whatever steps prove necessary to mitigate any conflicts of interest. In defining the EMR delivery role we have sought to minimise potential conflicts by, for instance, limiting the SO's level of discretion and ensuring processes are scrutinised and transparent.
15. National Grid is already subject to strict controls, though existing legislation and licensing arrangements, to ensure appropriate separation between its businesses through a robust licence and code regime enforced by Ofgem. In addition, National Grid and DECC signed in May 2012 a Memorandum of Understanding<sup>6</sup> and a legally binding agreement dealing with the Management of Information<sup>7</sup> (MoI). Together, these documents are designed to reduce the potential for conflicts of interest and to ensure appropriate governance frameworks are in place between DECC and National Grid for EMR delivery.
16. Further to these existing arrangements, we are also seeking powers in the Energy Bill to enable further action to be taken should it prove necessary, including the possible application of a range of business separation measures within National Grid. Any action must be proportionate and be fully supported by the evidence collected through the joint DECC-Ofgem report.

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<sup>4</sup> <http://www.decc.gov.uk/assets/decc/11/meeting-energy-demand/energy-markets/3884-planning-electric-future-technical-update.pdf>

<sup>5</sup> [http://www.decc.gov.uk/en/content/cms/consultations/coi\\_emr/coi\\_emr.aspx](http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx)

<sup>6</sup> [http://www.decc.gov.uk/en/content/cms/news/nat\\_grid\\_mou/nat\\_grid\\_mou.aspx](http://www.decc.gov.uk/en/content/cms/news/nat_grid_mou/nat_grid_mou.aspx)

<sup>7</sup> <http://www.decc.gov.uk/assets/decc/11/meeting-energy-demand/energy-markets/6384-national-grid-decc-management-of-information.pdf>

17. More details are given in the consultation on potential conflicts of interest and a range of mitigation measures.<sup>8</sup>

## Contingency powers for delivery

18. The Government is putting in place a robust institutional framework based on the SO as the EMR delivery body. However, we cannot predict what may happen over the life of EMR so it is prudent to have contingency plans in place so that investors can be confident that EMR will continue to operate with minimal disruption in the unlikely event that the SO is unable to continue to deliver.
19. We are therefore seeking powers in the Energy Bill that will allow Government to transfer the EMR functions away from the SO to an alternative delivery body, in extremis, if required. Any alternative delivery body will be decided by Government and we are examining a range of potential candidates, including Ofgem.
20. In partnership with Ofgem, we have been considering how a transfer process would happen, the steps that would need to be taken and the powers Government would need to make it happen quickly and efficiently. This contingency planning will enable us to smoothly transfer the delivery of EMR to the new body with the minimum disruption and uncertainty for stakeholders.

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<sup>8</sup> [http://www.decc.gov.uk/en/content/cms/consultations/coi\\_emr/coi\\_emr.aspx](http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx)

## 2. Framework for EMR Delivery

### Role of the System Operator: Delivery

21. The Government will set the EMR delivery functions of the System Operator (SO) in secondary legislation, which will become 'relevant requirements', enforceable as if they were conditions of the SO licence. The secondary legislation will prescribe the EMR functions that the SO must carry out, in order that the Government has certainty about what will be delivered and that Ofgem has a clear basis on which to manage the performance of the SO in its delivery role. The legislation will also, where appropriate, limit the SO's level of discretion and ensure processes are scrutinised and transparent. This will also minimise the risk of potential conflicts of interest arising. A summary of the roles is provided in Figure 3 below, and further detail is provided in the consultation on Synergies and Conflicts of Interest arising from the System Operator delivering the EMR functions<sup>9</sup>.
22. The following is a brief description of the different EMR delivery functions the SO will carry out, and examples of requirements that may be placed on the SO in secondary legislation:
  - the SO will carry out analysis for the delivery plan. The legislation could require that when commissioned to do so by the Secretary of State, the SO will carry out the analysis in line with the terms set in the commission. The commission terms could include the exact analysis required, and the process that the SO must follow in the production of the analysis, and the deadline by which it must be completed.
  - the SO will run the allocation process for CfD contracts, assessing the applications it receives against eligibility criteria set out in legislation. The legislation could require the SO to assess applications and respond to applicants within a given time period.
  - the SO will run the capacity auction and once complete will provide the results to Government. The legislation could require the SO to provide this information to Government and Ofgem within a given time period from auction close.

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<sup>9</sup> [http://www.decc.gov.uk/en/content/cms/consultations/coi\\_emr/coi\\_emr.aspx](http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx)

**Figure 3: A summary of the SO's EMR delivery role<sup>10</sup>**

	<b>Capacity Market (assuming Capacity Market is initiated)</b>	<b>Contracts for Difference</b>
<b>Analysis</b>	<ul style="list-style-type: none"> <li>Collecting evidence and conducting analysis and modelling to inform key Ministerial decisions on whether and how the Capacity Market will run, in particular how much capacity to contract for. This will be set out in the delivery plan and annual updates if the Capacity Market is initiated.</li> </ul>	<ul style="list-style-type: none"> <li>Collecting evidence and conducting analysis and modelling to inform key Ministerial decisions on the level of support for technologies. This will inform the delivery plan and annual updates.</li> </ul>
<b>Allocation</b>	<ul style="list-style-type: none"> <li>Carrying out the pre-qualification process to determine participation in any capacity auction.</li> <li>Running a competitive auction for providers of capacity.</li> </ul>	<ul style="list-style-type: none"> <li>Instructing CfD counterparty to issue contracts based on assessment of eligibility criteria set by Government, within budgetary limits set by Government</li> <li>Running a competitive allocation process, where Government has decided to move to competitive processes. Any competitive process will be designed and set out by Government.</li> </ul>

<sup>10</sup> For the detail of the processes, see Annex A and C to the EMR Policy Overview:  
[http://www.decc.gov.uk/en/content/cms/meeting\\_energy/markets/electricity/electricity.aspx](http://www.decc.gov.uk/en/content/cms/meeting_energy/markets/electricity/electricity.aspx)

<b>Operational</b>	<ul style="list-style-type: none"> <li>Monitoring progress of capacity providers against milestones to assess if all the agreed capacity will be provided in the target year.</li> <li>Monitoring delivery of plant during the delivery year e.g. providing information on whether plant is available at times of system stress</li> <li>May have a role in imposing penalties according to pre-defined rules set by Government or Ofgem for non-delivery of capacity.</li> </ul>	<ul style="list-style-type: none"> <li>Monitor take up of contracts to inform analysis provided as part of annual updates to delivery plan</li> <li>Provide information or analysis to inform Ministerial decisions on the move to allocation windows (following initial first come first served stage)</li> </ul>
<b>Secondary trading and/or secondary auctions</b>	<ul style="list-style-type: none"> <li>Carrying out the pre-qualification process for any new potential capacity providers and receiving information on new holders of traded capacity agreements.</li> <li>Running secondary auctions if additional capacity or technology specific capacity should be required mirroring processes in primary auction.</li> </ul>	
<b>Changes to rules and/ or mechanism design</b>	<ul style="list-style-type: none"> <li>Providing analysis which may result in CM rule changes by Government or Ofgem. The SO may make technical rule changes. Other changes, for example those relating to auction or penalty regime rules may be subject to approval by either Government or Ofgem.</li> </ul>	<ul style="list-style-type: none"> <li>Providing analysis which may result in CfD rule changes by Government</li> </ul>

23. The SO will ultimately be accountable to Government for the functions that Government has conferred on it, and Government will have the power to amend or remove these functions. Government will engage with the Devolved Administrations in Scotland, Wales and Northern

Ireland in drafting the secondary legislation and how best to reflect their role in this process, respecting individual devolution settlements.

## Role of Ofgem: Performance management of the System Operator

24. Ofgem will use its existing powers and duties as regulator to oversee and manage the System Operator's (SO's) performance in delivering the EMR functions. In particular Ofgem is able to take enforcement action in the case of a licence breach or breach of a relevant requirement and set financial rewards to incentivise efficient performance.
25. As regulator of the gas and electricity markets, Ofgem enforces and supervises licence holders' compliance with their licence conditions and relevant requirements in legislation. This is achieved through monitoring of companies and, if necessary, investigations if the regulator has reason to believe conditions or requirements are not being met. If companies are found to be in breach of licence conditions or relevant requirements, options available to Ofgem include:
  - where appropriate, accepting a commitment from the company to take steps to put things right, in lieu of taking stronger enforcement measures;
  - issuing enforcement orders to make companies comply with their obligations; and/or
  - imposing financial penalties to reflect the circumstances of the case. Ofgem has the power to fine up to 10 per cent of the licensee's turnover.
26. The system of licence conditions and relevant requirements enforced by an independent economic regulator has been in place since the gas and electricity industries were privatised over twenty years ago. It is well understood by the industry, and creates a disincentive on companies to breach licence conditions or relevant requirements, as they seek to avoid the financial and reputational costs that result. There were nine significant breaches of licence conditions and relevant requirements in the period April 2011-March 2012, with fines imposed by Ofgem on a range of different suppliers, distributors and traders totalling nearly £20 million in the period.
27. Ofgem is also responsible for setting the revenue controls for the SO. In July 2012, Ofgem published initial proposals for the first transmission revenue control and external SO incentives to reflect the new RIIO (Revenue = Incentives + Innovation + Outputs) model, which places greater emphasis on incentives to drive the innovation needed to deliver a sustainable energy network. Through this revenue control process, Ofgem sets the outputs that the SO is required to deliver and the revenue it is able to earn for delivering these outputs efficiently. The SO is able to recover its costs through the charges that it levies on users of the system: the generators and suppliers. The revenue control therefore dictates the amount that the SO can recover through these charges. The process includes:
  - targets on outputs and costs, with corresponding penalties or rewards for under or over performance. This gives the SO the incentive to take economic and efficient actions, and allows flexibility for the SO to decide how best to achieve or outperform the target.

- scrutiny and challenge of the SO's costs. The protection of consumer interests lies at the heart of the regulator's role. Through the revenue control process Ofgem aims to enable the SO to play a full role in delivering a sustainable energy sector, in a way that provides value for money for existing and future consumers. Ofgem provides scrutiny of the SO business plan at the time of setting the revenue controls, in addition to annual assessments and on-going scrutiny over the revenue control period. The revenue control that Ofgem proposes introducing from April 2013 will run for 8 years (previous revenue controls were usually around 5 years). Public scrutiny is also provided by publishing the SO's business plans for stakeholder views.
28. Using the above powers, once the EMR delivery functions are made relevant requirements, Ofgem will scrutinise the SO's costs of delivering the EMR functions to ensure they are providing value for money, and take action to enforce the requirements in the case of a breach. Ofgem can also consider allowing the SO revenues for efficient costs for EMR delivery and any related output targets. If appropriate this could include setting financial and reputational incentives to encourage efficient delivery or to address any potential conflicts of interest. Ofgem must regulate independently of Government, and so will take final decisions on what incentives to set, and what costs the SO will be able to recover. This must be consistent with the role and parameters Government has set out in secondary legislation.
29. If Government came to the view that the SO was not delivering the EMR functions effectively, it could, depending on the issue concerned:
- provide feedback to the SO, for the SO to consider;
  - provide its view to Ofgem, for Ofgem to consider in its performance management of the SO;
  - change the terms of the SO's delivery role or reporting requirements, for example set shorter deadlines for delivery functions to be completed. This would be done through secondary legislation, so would need approval from Parliament; and
  - as a last resort, transfer delivery functions to another body and/or put in place a new cost recovery regime for the EMR delivery functions.

## Role of Government: Policy decisions, oversight of policy delivery and effectiveness

30. As it is Government that sets EMR policy, Government must retain oversight of policy effectiveness. This means Government will need to know whether the policy is achieving what was intended, and that the SO is delivering as required. To this end, Government will set the requirements in legislation, enforceable as relevant requirements, for the SO to provide information to Government. A summary of delivery information will be provided annually, with more frequent, detailed reporting on, for instance, the cost and number of CfDs allocated.
31. Alongside this reporting, it is likely there will also need to be an agreement in place between Government, including the Devolved Administrations, and the SO about how the two organisations will work together. This could cover, for example:
  - a. timetable for regular meetings to report on progress;
  - b. internal governance structures;
  - c. escalation procedures;
  - d. timetable for delivery.

### Role of Devolved Administrations

In May 2012 we set out the important role that the Devolved Administrations (DAs) will play in EMR. The Government agreed with the Scottish and Welsh Governments that they should be consulted on the CfD regulations and fully involved in the delivery plan process (see Annex E to the EMR Policy Overview). The Northern Ireland Executive will be asked to consent to CfD strike prices or set different strike prices for Northern Ireland to reflect the different market arrangements. Any additional costs resulting from different strike prices in Northern Ireland will not be socialised across the UK and will therefore be met by Northern Ireland consumers.

The DAs already have a clear role in the EMR Programme governance through their membership of the EMR Steering Board. Additionally, the DAs are and will continue to be involved in the delivery plan process, currently underway, through which the key decisions for EMR delivery will be taken. More detail on the delivery plan process and the role of the DAs in that process is included in Annex E.

When EMR is in 'steady state' the role of the DAs will follow the principles agreed for the first delivery plan (set out in Annex E), but the detail of the process may change. We recognise that it is important for industry certainty that the DAs' role in EMR is as transparent as possible. The principles of the working arrangements established under the first delivery plan (including the DA consultation group) could be applied to other areas of EMR where DAs have a role.

### 3. CfD Counterparty

32. As set out in the CfD Operational Framework (Annex A to the EMR Policy Overview), the draft Energy Bill published in May 2012 contemplated a framework whereby the CfD would be a statutory instrument setting out obligations on suppliers and generators enforceable by the parties as if the obligations were contractual. However, the Government has listened to the strong concerns raised by industry and the Energy and Climate Change Committee over whether the proposed model would support the required levels of investment, or whether a framework which is broadly similar to a conventional bilateral contract with a single counterparty would be preferable.
33. In light of these concerns, we are introducing a new body which will consist of:
- a bilateral private law contract between the generator (of each low-carbon project) and a newly established CfD counterparty, which will manage the contract over its lifetime;
  - a revenue raising power which will enable the CfD counterparty to raise funds from licensed suppliers to meet the payments due to generators under the CfDs;
  - the CfD counterparty, or a settlement agent on its behalf, calculating what is owed and settling payments with suppliers and generators; and
  - the CfD counterparty will be a limited company, wholly owned by the Government.
34. The agreed principle that the CfD should be a UK-wide mechanism with a UK-wide counterparty should deliver efficiencies in administration costs and, for example, enable payments to be managed across the UK more efficiently.
35. The Government considered other alternatives, including a company owned by the System Operator (SO), or a company owned by the private sector. However, a Government owned company arrangement reflects the need for Government to ensure that its policy is being delivered appropriately and responsibly, and reduces the need for more complicated controls over a body that is either already in existence or owned by a third party. The body has to be trusted by both suppliers and generators in order to perform effectively and inspire trust within the investor community – all of which are made more difficult if the right relationship with Government is not achieved.
36. Further detail on the functions of the counterparty is set out in Annex A to the EMR Overview document.
37. The CfD counterparty will be a limited liability company owned by Government, although for Government's classification purposes it will be considered a public sector body as it will be

set up and owned by Government, delivering a Government policy through the signing and management of CfD contracts, and it will have an ongoing relationship with the Government.

38. The Government will design the generic CfDs and set out the criteria against which the SO must judge whether a project is eligible for a CfD. Once the SO has allocated a contract, under the terms of the legislation the CfD counterparty will be under a duty to offer (and therefore enter into) those contracts.
39. Some investment contracts may be agreed through the FID Enabling process with developers who need to take final investment decisions ahead of full implementation of EMR. The expectation is that these would initially be entered into by the Secretary of State, but would be transferred to the CfD counterparty once the CfD regime is fully established.
40. As the CfD counterparty is the signatory to these contracts, it is bound by the terms of the CfD. It is, however, important that the CfD can adapt, where appropriate, to changing market and regulatory circumstances. The CfD will set out such circumstances and the processes to be followed, giving visibility to those applying for CfD as to the extent of these potential changes. The counterparty will not be able to change the terms of the contract.
41. More broadly the contract will confer on the CfD counterparty functions and rights to take decisions, for instance on whether a generator has met conditions precedent, or on when a generator is required to post collateral, or when to request information from a generator in respect of a project. Whilst the CfD counterparty will be bound to act within the parameters of the contract, in practice many of these cases will necessarily require it to exercise a degree of discretion in making a decision or enforcing a right.
42. Before the CfD scheme is implemented, the Government will therefore consider what further guidance is necessary to the counterparty body on how it takes decisions in respect of CfD contracts. The Secretary of State should not have any powers to impose a settlement on the parties to the contract. Instead, this will include consideration of circumstances where the counterparty body may be required to consult, or seek the consent of, Government before taking such decisions or, possibly, in some prescribed circumstances, where Government may direct the counterparty to take a decision in relation to the contract. Any guidance to, or requirement on, the counterparty body to consult, or seek the consent of, the Secretary of State, or any ability of the Secretary of State to direct the counterparty body, will not affect the rights of the generator to have recourse to independent resolution of the dispute in accordance with the procedures in the contract.
43. There will be a clear accountability framework prescribing the relationship between the CfD counterparty and the Government. The outline of this framework is:
  - the Energy Bill provides for the designation of the CfD counterparty as the entity to enter into CfDs with generators and sets out the framework within which the CfD counterparty will be required to enter CfDs that are allocated by the delivery body or the Government;

- secondary legislation will set out the detail of the supplier obligation arrangements which will be used by the CfD counterparty to fund its payment obligations to generators under CfDs;
- as a private limited company, the CfD counterparty will need to adopt articles of association. The Secretary of State will draft the articles of the company. The company's articles could not be amended without the Secretary of State's consent in his capacity as sole shareholder of the CfD counterparty;
- we will clearly set out in advance the roles of the CfD counterparty and the parameters within which the counterparty body is to fulfil its functions in relation to the CfDs and will consider the best mechanism to do this;
- the Government currently envisages appointing the chair and a minority of the board of directors and processes will be developed with regard to the appointment of the remainder of the board;
- the CfD counterparty will administer the CfDs once they have been entered into, within the parameters provided for in the governance structure outlined above and the terms of the contract.

## 4. Next steps

44. As outlined in this document, further work is required to prepare the System Operator (SO) for the delivery of the EMR mechanisms in 2014, to set up the CfD counterparty, and to ensure an appropriate accountability and governance framework is in place for both bodies. The Government will:
- continue to work closely with the SO to enable delivery of the CfD and the Capacity Market. This includes securing the required analysis from the SO to inform the draft delivery plan (see Annex E for more detail), as well as ensuring that the right systems and processes are put in place for delivery.
  - continue to develop an accountability and governance framework for the SO, which will be published for consultation as part of the secondary legislation from October 2013 onwards. Subject to the will of Parliament, secondary legislation will enter into force in mid 2014.
  - set up the CfD counterparty. More detail on the roles, functions and controls of the body will be developed and consulted on as part of the secondary legislation from October 2013 onwards. Subject to the will of Parliament, secondary legislation will enter into force in mid 2014. This will ensure that the counterparty will be in a position to sign contracts by this time.
  - continue to work with Ofgem to assess the potential for conflicts of interest from the SO taking on the EMR delivery role. A joint DECC-Ofgem report will be published in spring 2013, informed by the consultation published alongside the Energy Bill<sup>11</sup>, which will inform decisions on mitigating actions. Mitigating actions, if shown to be necessary, will be taken forward either by Government or Ofgem. We are taking powers in the Energy Bill to be able to act to mitigate any conflicts of interest, if necessary through a combination of secondary legislation and/or licence changes. The intention is that any mitigation necessary will be implemented in time for EMR being operational in 2014. In addition, we will continue to minimise the potential for conflicts of interest to arise as we develop the EMR roles and processes.

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<sup>11</sup> [http://www.decc.gov.uk/en/content/cms/consultations/coi\\_emr/coi\\_emr.aspx](http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx)

## 5. Stakeholders

45. Throughout the design of the institutional framework to deliver EMR, Government has worked closely with a wide range of stakeholders to gather views and evidence, test the viability of options and to instil confidence in the final outputs. This engagement will continue following the introduction of the Energy Bill as we go on to design and implement the institutional framework.
46. The institutional design has benefitted particularly from the input of the Institutions Expert Group, made up of senior representatives from a wide range of bodies within the wider electricity sector, including energy firms and consumer groups. The group has met at least monthly since May 2012 and has provided helpful and detailed input into the design of the accountability and governance framework for delivery, the proposed arrangements for the set up to the CfD counterparty, the delivery plan process (outlined in Annex E of the EMR Overview Document) and the analysis underpinning the joint DECC-Ofgem report into conflicts of interest. The group will continue to play a vital role, for instance in providing expertise and feedback on the design of secondary legislation, and will provide an interface for DECC to keep stakeholders informed of EMR progress.
47. While we will continue to work with stakeholders as outlined in the EMR Overview document and outline transitional plan at Annex F, there will be numerous opportunities for stakeholders to provide input formally, including:
- The consultation on Synergies and Conflicts of Interest arising from the SO taking on the EMR delivery role<sup>12</sup>;
  - Consultation on the requirements that will be set out in secondary legislation, expected October 2013 onwards;
  - Consultation on the draft delivery plan, expected July 2013, as outlined in Annex E.
48. As explained in the public commission to National Grid for its analysis for the first delivery plan (see Annex E), National Grid will also engage stakeholders at appropriate points during the analytical process, in order to:
- provide clarity and transparency to stakeholders over the analytical process being followed;
  - gather and share information at the appropriate times;
  - help stakeholders understand the formation of the analysis which will be used to inform the EMR delivery plan in 2013;

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<sup>12</sup> [http://www.decc.gov.uk/en/content/cms/consultations/coi\\_emr/coi\\_emr.aspx](http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx)

- facilitate effective engagement from stakeholders in Government's public consultation on the analysis informing the draft delivery plan in July 2013, and
- share information where appropriate, for example information that is not sensitive or confidential for any parties involved (including industry, Government or National Grid).

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