



Department for
Business, Energy
& Industrial Strategy

Contracts for Difference Allocation Round 4

Government response to consultation on
further drafting amendments to the CfD
contract



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Introduction

Context

The Contracts for Difference (CfD) scheme is the Government's main mechanism for supporting new, low carbon electricity generation projects in Great Britain. Since March 2020, we have consulted, and published our decisions, on a series of changes to the CfD scheme and contract terms in preparation for Allocation Round 4 (AR4), which will open to applications from developers of renewable technologies on 13 December 2021.

On 4 October 2021, the Government published a consultation that invited views on further technical amendments to the CfD Standard Terms and Conditions for AR4 to ensure that the contract continues to function as originally intended and to reflect the UK's position in a number of specific areas relevant to the CfD scheme following the UK's exit from the EU. The draft CfD Standard Terms and Conditions were published alongside the consultation, with the proposed drafting changes shown as tracked amendments. The consultation closed on 31 October 2021. This document summarises the responses received and sets out the Government's decisions on the changes proposed in the consultation.

Overview of consultation proposals

We invited views on proposed changes to reflect the UK's exit from the EU and to align the contract terms with the UK's policy on subsidy control. This involved removing references to EU State aid rules and making several consequential adjustments, including changes to several contract definitions and updating former EU legal references to ensure continuity of essential legal provisions. The consultation also clarified our intention to retain for AR4 the existing rules that prohibit CfD developers from cumulating other forms of subsidy or aid with CfD subsidy. In addition, the consultation invited views on changes to the contract that would end compensation for generators who pay towards the cost of balancing the transmission network if Ofgem take a decision, expected in early 2022, to remove this liability from generators. Finally, we sought views on an extension to the time that successful applicants will have to fulfil their Initial Conditions Precedent obligations on signing a CfD contract, from 10 business days to 20 business days. The October 2021 consultation document¹ is available via the link given in the footnote below.

Engagement with the consultation proposals

The consultation attracted eleven written responses, including three through Citizen Space. Of the responses, seven were from developers of renewable generating stations and two were

¹ <https://www.gov.uk/government/consultations/contracts-for-difference-allocation-round-4-further-changes-to-the-cfd-contract>

from related trade associations. The remaining responses were from a private company and a crown dependency government. Several comments were received on issues that were outside the scope of the consultation and which are not addressed in this Government response.

Next steps

The final CfD Standard Terms and Conditions, the generic CfD Agreement and the contract variants for AR4, with the exception of the Private Network Agreement, are published alongside this Government response. The application window for AR4 opens on 13 December 2021 and will close on 14 January 2022. The shortest and longest timetables and other details for AR4 are set out on the dedicated AR4 portal².

The Government has decided to publish a draft version of the Private Network Agreement. This is due to the fact that suggestions as to its drafting put to the Government in very recent days require a further consideration of certain aspects of that version of the Agreement. Further information will be provided in due course.

² <https://www.cfdallocationround.uk/>

Explanation of changes to the CfD Standard Terms for Allocation Round 4

Regulation 4(1) of the Contracts for Difference (Standard Terms) Regulations 2014 (as amended) requires that where the Secretary of State publishes revised standard terms in compliance with section 11(5) of the Energy Act 2013, the Secretary of State must also publish an explanation of why the revisions have been made.

This government response, together with the government response published on 7 May 2021³, explain why revisions to the standard terms have been made for AR4.

In this respect, 'standard terms' includes Version 4 of the CfD Standard Terms and Conditions, the CfD Agreement and the corresponding versions of the Phased (Apportioned Metering) Terms, Phased (Single Metering) Terms, Private Network Terms and Unincorporated Joint Ventures Terms, which are published on the same date as this response.

³ <https://www.gov.uk/government/consultations/contracts-for-difference-cfd-changes-to-supply-chain-plans-and-the-cfd-contract>

Subsidy Control

The drafting changes proposed in the consultation related to subsidy control are intended to align the contract with the UK subsidy control regime. The drafting changes are intended to ensure that the terms of the CfD contract reflect our international obligations following the UK's exit from the EU.

Proposals

Questions 1-2 of the consultation focused on the general approach to removing EU-related terms and other obsolete references from the contract and replacing them where appropriate with “subsidy” and “subsidy control”.

Question 3 of the consultation proposed that a new definition of “subsidy” should be inserted into the contract. The new definition of “subsidy” cross-refers directly to the definition of “Subsidy” in the Subsidy Control Bill and our intention is that the final definition of “Subsidy” in the contract will reflect the definition in the Subsidy Control Act, subject to Parliamentary approval in due course.

Question 4 of the consultation welcomed views on the proposed amendments to the contract to update some of the terminology in relation to the cumulation provisions, in order to reflect the UK's new subsidy control policy. Given that UK public authorities will now grant subsidy rather than State aid, the Government proposed to add the term ‘subsidy’ to the categories of public support that generators awarded a CfD contract may not cumulate with CfD subsidy. We also proposed to remove a redundant provision from the contract which allows cumulation between State aid or Union Funding and CfD subsidy to occur where this is “expressly authorised” by the “State Aid Competent Authority”, which was effectively the European Commission.

Responses to the consultation

Responses to these questions were drawn from renewable energy generators, trade bodies and a private company.

Views on proposals and Government response

There was broad support amongst respondents to the questions on the general proposed approach to remove EU-related terms and other obsolete references and replacing them where appropriate with “subsidy” and “subsidy control”. There was general agreement with the

proposed treatment of “Subsidy Control Rules”, “Subsidy Control Competent Authority” and the cumulation provisions outlined in the draft Standard Terms and Conditions published alongside the consultation document from all respondents.

In regard to the proposal to use the definition of “subsidy” contained in the Subsidy Control Bill for the purposes of the CfD contract, there was agreement in principle from all respondents. However, several respondents had comments relating to the Government’s proposal to rely on a definition contained in a Bill which may lead to the definition changing prior to being formally set into law. Each of the respondents on that point suggested that the cross-reference to the legislation should be kept under review until the Act enters into force. There were also concerns expressed as to a potential delay to the passing of the Subsidy Control Bill such that it is not enacted on time prior to the signing of the CfD contracts. In light of this eventuality, one respondent suggested that the Government should consider including a bespoke definition within the contract.

Policy response:

The Government has decided to remove EU-related terms and other obsolete references from the contract and replace them with the terms “subsidy” and “subsidy control”. The Government has also decided to adopt the characteristics contained in the definition of “Subsidy” as set out in the Subsidy Control Bill for the purposes of the CfD contract.

We acknowledge that there is uncertainty as to how the definition in the Act might eventually be worded. We have not adopted a direct copy-out approach from the wording set out in the Subsidy Control Bill and have also ensured that the proposed wording of the contract definition of “Subsidy” is sufficiently flexible. It is our intention, however, that the definition of “Subsidy” in the contract reflects the final subsidy control regime as it emerges through the parliamentary process. We anticipate that there will be a bespoke UK Subsidy Control regime in place in domestic law prior to CfD contracts being signed.

In making our decision to adopt a cross-reference to the Subsidy Control Bill, we noted that the definition of “Subsidy” in the Subsidy Control Bill is underpinned by and consistent with the subsidy control principles and obligations contained in international agreements, such as the UK-EU Trade and Co-operation Agreement (TCA), given that these principles must be and will be implemented and embedded within the design of the UK subsidy control system in domestic law. We have therefore kept in mind these same principles in our own drafting and these are aspects of the definition in the Bill which we have confidence are not likely to alter significantly in principle. Not only is our proposed definition consistent with how the term is already defined in the TCA, but it also mirrors what was previously proposed as part of the subsidy control consultation⁴ which concluded in June 2021.

The Government will closely monitor the progress of the Bill through Parliament and, if necessary, will consider the impact on the CfD contract of any alterations to the definition

⁴ <https://www.gov.uk/government/consultations/subsidy-control-designing-a-new-approach-for-the-uk>

of “Subsidy” within the Bill and/or delay to the implementation of the Bill. In the eventuality that the Bill is not enacted as law on time or does not become law, we will review our position, keeping in mind the subsidy control principles and obligations as above, and consider the options available to us. These options include the possibility of creating a bespoke definition of “Subsidy” within the contract without the current cross-reference to the Bill. The current proposed text of the definition will therefore remain in square brackets within the CfD Standard Terms and Conditions until the final form of the definition is confirmed in due course.

Amendments to certain contract definitions

The Government proposed that several definitions in the Standard Terms and Conditions need to be amended as a result of the UK leaving the European Union.

Proposals

Question 5 of the consultation welcomed views on the proposed amendments to contract definitions in the draft Standard Terms and Conditions published alongside the consultation document.

Specifically, we proposed that references to complying with European Union law be removed from the definition of “CfD Counterparty Permitted Purposes” and “Generator Permitted Purpose”. We proposed to delete the reference to “European Union” from the definition of “Competent Authority”. We proposed that the definition of “Law” be amended to reflect the fact that the European Communities Act 1972 has been repealed by the European Union (Withdrawal) Act 2018 while ensuring, as far as possible, that the aspects of law applicable in Scotland and Wales (or parts thereof) and relevant to the CfD, that have now become unrestricted by EU law or fall within devolved competence, are preserved within the definition.

Responses to the consultation

There were five responses to this question, from renewable electricity developers and a private company.

Views on proposals and Government response

All respondents to this question were supportive of the proposed amendments to remove the redundant phrases and the proposed amendment to the definition of “Law” and other definitional changes. Comments drew attention to a small number of typographical errors in the draft Standard Terms and Conditions. In addition, clarification was requested as to whether the reference to “CfD Counterparty Permitted Purposes” in the final sentence of paragraph 20 of the consultation document should have referred to “CfD Counterparty Restricted Purposes”.

Policy response:

The Government has decided to amend the definitions in the contract as proposed. We are grateful to respondents for drawing attention to several typographical errors, and these have been corrected where appropriate in the final Standard Terms and Conditions published alongside this Government response. We also confirm that the reference to

“CfD Counterparty Permitted Purposes” in the final sentence of paragraph 20 of the consultation document should have referred to “CfD Counterparty Restricted Purposes”.

Contract provisions derived from EU legislation

The consultation sought views on the proposed treatment of EU legal references in several provisions in the contract to ensure that the provisions continue to apply in the context of the UK's legal framework following on from Implementation Period Completion Day.

Proposals

Question 6 welcomed views on the proposed treatment of provisions in the contract that are derived from EU legislation. These provisions include the GB Day Ahead Hourly Price, used to set the market reference price for intermittent CfD technologies, and a range of biomass sustainability requirements in Annex 7 of the Standard Terms and Conditions, many of which transposed requirements of the 2009 EU Renewable Energy Directive (RED) in respect of the CfD contract.

Responses to the consultation

Three renewable electricity developers responded to this question in the consultation.

Views on proposals and Government response

All respondents to this question were supportive of the proposed treatment of provisions in the contract that are derived from EU legislation. It was suggested that the capitalised version of “Subsidy” should be used in paragraph 2.6 of Part B, Schedule 1 of the Standards Terms and Conditions.

Policy response:

The Government has decided to treat provisions in the contract that are derived from EU legislation as proposed.

Consistent with our approach to the treatment of EU legal references in the CfD Standard Terms and Conditions, we have also decided to retain the provisions of the definition of “waste” in the CfD Agreement and its relevant variants (i.e. the Private Network Agreement and the Unincorporated Joint Ventures Agreement). The definition was previously derived from the requirements of the 2008 Waste Framework Directive 2008/98/EC. However, given that Directive 2008/98/EC is not retained EU law, we have inserted a new definition into the Agreement (and its variants) based on the definition in

Directive 2008/98/EC as it stood at the end of Implementation Period Completion Day, to read as follows:

“Waste” means any substance or object which the holder discards or intends or is required to discard; substances that have been intentionally modified or contaminated to meet that definition are not covered by this definition.”

We agree that the references to subsidy in paragraph 2.6 of Part B, Schedule 1 should be capitalised and the Standard Terms and Conditions have been amended accordingly.

Balancing Services Use of System Charges

The Government sought views on its intention to amend the contract to remove balancing system charges from the existing Strike Price indexation formula in the CfD Standard Terms and Conditions in the event that Ofgem remove the liability on generators to pay these charges.

Proposals

Generators with a CfD who pay Balancing Services Use of System (BSUoS) charges are protected against increases in the cost of these charges over and above the Initial Balancing System Charge set in the contract before actual balancing charges are known. The CfD strike prices for these generators are adjusted annually for changes in balancing system charges and this is applied to both existing and new CfD contracts. This adjustment is designed to make the CfD contract broadly long-term neutral to changes in balancing system charges, which are outside of generators' control.

Question 7 sought views on illustrative drafting amendments to the CfD Standard Terms and Conditions to reflect a possible future decision by Ofgem to remove generators' liability to pay BSUoS charges. The consultation proposed inserting an alternative annual strike price indexation adjustment formula for both Intermittent and Baseload technologies (in Conditions 14 and 20 respectively of the Standard Terms and Conditions). This alternative formula would remove the Initial Balancing System Charge from the annual strike price adjustment of projects that secure a contract in AR4 and would otherwise be liable to pay BSUoS charges, meaning that these generators would no longer receive compensation for BSUoS charges as part of their strike price from the date the current charging arrangements on generators cease to apply.

The proposed new strike price adjustment formula would apply if Ofgem decide to remove generators' liability to pay BSUoS charges, and the new provisions would apply from the date that Ofgem's decision has effect. Ofgem have indicated that, were the change implemented, April 2023 would be an appropriate target for it to come into effect. The existing annual strike price indexation adjustment formula will continue to be used, and generators will continue to be protected from increases in BSUoS costs, if Ofgem decide not to remove BSUoS charges from generators, i.e. if generators remain liable to pay BSUoS charges.

Responses to the consultation

There were nine responses to the consultation which addressed this proposal, all of which came from renewable electricity generators and trade bodies.

General views on the proposal

While no suggestions were received for amendments to the proposed contract drafting, the majority of respondents did not agree that BSUoS charges should be deducted from final strike prices after the auction. Most respondents suggested that deducting the Initial Balancing System Charge from the strike price after contracts are awarded will oblige applicants whose projects would usually be liable to pay BSUoS charges (mostly transmission-connected projects) to price the cost of these charges into their bids. It was suggested that this could increase the CfD bid price of these projects, relative to projects that are not required to pay BSUoS charges (mainly distribution-connected projects) and put those projects that would have to pay these charges at a competitive disadvantage in the auction. It was suggested that the main impact would be felt in Pot 1 where transmission and distribution-connected projects are in direct competition.

Most respondents felt that not all bidders are aware of the Government's intention to adjust the clearing price after the AR4 auction concludes for transmission-connected generators if BSUoS charges are later removed from generators. Many respondents recommended that the Government should issue very clear communications to all potential bidders at the earliest opportunity to clarify how the BSUoS charges will be treated for AR4 as a way of alleviating the current uncertainty.

Most respondents pointed out several possible consequences if the drafting proposals are not changed and projects (mainly transmission-connected) include BSUoS charges in their bids. These include that:

- This could result in higher clearing prices as the 'pay as clear' auction mechanism risks cheaper distribution-connected projects receiving the higher clearing price, as no deduction will be applied to them within the contract;
- Higher clearing prices could reduce the amount of capacity that can be procured within the budget and could be detrimental to the speed and cost at which the Government achieves its capacity ambitions for 2030 and beyond;
- Higher clearing prices could also mean higher costs for consumers and give the impression that the costs of renewables have increased;

As an alternative option to the current proposal, most respondents suggested that BEIS should exclude the Initial Balancing System Charge from the AR4 auction from the outset. The primary justification given for this was that it was perceived that Ofgem were very likely to decide to remove BSUoS charges from generators. This perception was based on Ofgem's indication in their response to the publication of the final report of the second BSUoS Task Force on 10th December 2020⁵ that they agreed with the Task Force's recommendation that BSUoS should be recovered from Final Demand (i.e. suppliers) only.

⁵ <https://www.ofgem.gov.uk/publications/ofgem-response-publication-final-report-second-balancing-services-use-system-bsuos-task-force>

There was a general acknowledgement among respondents who addressed this question that if the Government removed the Initial Balancing System Charge from AR4 before Ofgem decide their approach to BSUoS charges, it may be seen as pre-empting and potentially influencing Ofgem's decision as independent regulator. To mitigate this risk, most respondents suggested that the Government could include a clause in the CfD Standard Terms and Conditions to reinstate the BSUoS charges in the event that Ofgem do not confirm their indicated position. Another suggestion was that the Government should update the budget valuation formula to exclude the effect of BSUoS charge costs and consider increasing the budget to counteract this adjustment.

A small number of respondents suggested that removing BSUoS charges from AR4 would not require adjustments to the auction pot budgets, parameters or administrative strike prices (ASPs) or the design of AR4. This is because an adjustment to just one of many cost factors, for just one category, would not warrant a change to the ASP values, and an adjustment to a cost assumption for just one category would not require a change to the budget level.

Policy response:

The Government has carefully considered the responses to this consultation question. We have decided to implement the proposed drafting amendments to the CfD Standard Terms and Conditions in respect of an alternative strike price adjustment formula to account for the possible removal of BSUoS charges from generators, should Ofgem make this decision. The Government understands that Ofgem will issue a consultation on their recommended approach and announce a decision in due course.

If Ofgem decides that generators should no longer pay BSUoS charges, regardless of when this decision is taken, the strike prices of those successful projects liable to pay these charges will be adjusted downwards after contracts are awarded. This would be done through the annual strike price adjustment undertaken by LCCC to account for the fact that BSUoS is no longer due to be paid.

To provide greater clarity about how this downward adjustment would be undertaken, we have added a new definition, "Base Year Initial Balancing System Charge", to the Standard Terms and Conditions. This definition introduces a formula that deflates the value of the Initial Balancing System Charge from current to 2012 prices. The resulting value ("lbase") will then be deducted from the Initial Strike Price using the formulae in Conditions 14.8 and 20.8 of the Standard Terms. The description of "lbase" in Conditions 14.8 and 20.8 has also been amended accordingly. An explanatory note containing illustrative examples showing how the annual strike price will be adjusted for the Initial Balancing System Charge in the scenarios where Ofgem removes BSUoS charges from generators or decides to continue with the current policy, will be published on the AR4 microsite.

The Government acknowledges the concerns expressed by several respondents, including that if Ofgem decide to remove BSUoS charges from generators, not all bidders are likely to be aware of the intention to adjust strike prices downwards after the auction

for those projects that would usually pay BSUoS charges. To address this, the Government is therefore providing as much information and explanation as possible about our approach in this Government response and in statutory documents relating to Allocation Round 4. We will also continue to engage closely with industry to raise awareness further on how BSUoS charges will be treated in the forthcoming allocation round. This will help alleviate the uncertainty and enable potential applicants make the appropriate commercial decisions for themselves.

As highlighted by a number of respondents, the Government believes that any change to the Standard Terms (for example, to adjust the Initial Balancing System Charge to £0, as proposed by some respondents) could be interpreted as prejudging or seeking to influence a decision which has yet to be taken by Ofgem in its role as independent regulator. In this context, and given that a decision by Ofgem is subject to further consultation, the Government believes it is right for the allocation round to proceed based on current known BSUoS policy at the point of publication, as per our proposals.

In line with this, an assumption around BSUoS charges being paid by relevant generators has been incorporated when setting auction parameters, including monetary budgets and Administrative Strike Prices (ASPs). Whilst precise prices and capacities secured through a competitive auction are always uncertain, the Government has confidence that parameters in Allocation Round 4 have been set at a level sufficient to minimise the risk of securing less capacity than is needed to remain on track for our decarbonisation commitments.

The Government acknowledges concerns raised by some generators around a risk that developers not usually liable to pay BSUoS may benefit from a competitive advantage in pots where there is a mixture of connection types (primarily Pot 1), and, depending on the auction outcome, may receive a strike price greater than their true costs.

CfD auctions are structured as 'pay-as-clear', which is designed to generate competition by incentivising bids that reflect minimum viable prices. The inherent nature of a pay-as-clear auction means that in any given round, projects could receive a strike price above their individual bids and the costs that they face.

The extent to which this is the case will depend on the uncertain outcome of the competitive auction process, which the Government does not seek to predict. The outcome depends on a variety of uncertain factors, including the full range of costs and revenues faced by each individual project, commercial decisions made by bidders, and the level of competition within the auction itself.

Other comments relevant to BSUoS

Several other comments were submitted on other issues relating to BSUoS:

- Our attention was drawn to information⁶ published on the website of National Grid (Electricity System Operator) concerning a BSUoS billing error in 2020/21, in which NG(ESO) underbilled BSUoS by £44m, with a request to clarify whether this error has been reflected in the value set for the Initial Balancing System Charge for AR4.
- The point was put forward that the Initial Balancing System Charge should not be based on the last 6-12 months of actual BSUoS costs as this sampling period is not representative of current market conditions or future predicted energy prices. It was suggested that the Initial Balancing System Charge should instead be calculated based on a more stable steady-state forecast composed of a longer historical dataset.
- A typographical error was pointed out in Condition 20.4, which should have cross-referred to Condition 20.8 rather than Condition 14.8.

Policy response:

The Government is grateful to respondents for these additional points.

With regard to the BSUoS billing error by National Grid (Electricity System Operator), the Initial Balancing System Charge for AR4 of £4.29 accounts for part of the BSUoS overcollection (£10m) that was recovered by NG(ESO) from April 2021, during the Initial Balancing System Charge Window, i.e. from 01/10/2020 to 30/09/2021, as set out in the AR4 Standard Terms Notice. NG(ESO) have confirmed that they will recover the balance of £33m between 1 October 2021 and 31 March 2022. This amount has not been accounted for in the AR4 Initial Balancing System Charge because it falls outside the period for calculating this charge.

With regard to the point about the BSUoS sampling period for use in calculating the Initial Balancing System Charge, the Government believes that it is appropriate to calculate this Charge for AR4 on the basis of the average net BSUoS charge paid by generators in the year leading up to the opening of the allocation round, as in all previous allocation rounds. The Initial Balancing System Charge and the Initial Balancing System Charge Window are specified in the Standard Terms Notice published for AR4. If Ofgem decide that generators should continue to pay BSUoS charges, generators will continue to be protected against increases in BSUoS costs through a strike price adjustment in the usual way.

The typographical error in Condition 20.8 has been corrected in the final version of the Standard Terms and Conditions.

⁶ <https://www.nationalgrideso.com/industry-information/codes/connection-and-use-system-code-cusc-old/modifications/cmp373-deferral>

Additional minor and technical change

The Government sought views on the proposed extension of the Initial Conditions Precedent (ICP) deadline from 10 Business Days to 20 Business Days, to reflect the larger number of applications anticipated compared to previous allocation rounds.

Question 8 sought views on the proposed extension of the ICP deadline from 10 Business Days to 20 Business Days. In order to fulfil the ICPs, a generator must provide: (1) a Legal Opinion confirming their legal capacity and authority to enter into the CfD; (2) a 'Know Your Customer' form which enables the LCCC to be satisfied as to the legal identity, ownership and control of the generator; (3) a Facility Description providing details of the assets comprising the Facility and a map or plan of the Facility; and (4) a description of any Electricity Storage Facility, including details of any assets which are intended to be located within the Facility site or used by or associated with the Facility.

The Government confirmed in March 2020 that Pot 1 technologies, including onshore wind and solar PV, will be eligible to participate in AR4. We are anticipating that this will result in a larger number of applications than in previous allocation rounds and proposed the change to facilitate the efficient administration of the delivery of the ICPs.

Responses to the consultation

Eight consultation responses, mostly from developers, addressed this proposal. The majority of these responses supported this proposed change. No objections were raised. One respondent suggested that continuing to add additional days to the timeline is unnecessary for larger projects and that if a project wished to submit documentation in a shorter period of time, it should not be impeded by the extension to the deadline.

Policy response:

The Government has decided to extend the ICP deadline from 10 Business Days to 20 Business Days. The Government confirms that this extended deadline will not prevent a successful developer from submitting documentation to the LCCC in a shorter period of time should they wish to do so.

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