

Contracts for Difference Allocation Round 5

Government response to consultation on
drafting amendments to the CfD contract



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Any enquiries regarding this publication should be sent to us at:
enquiries@beis.gov.uk

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Introduction

Context

1. The Contracts for Difference (CfD) scheme is the Government's main mechanism for supporting new, low carbon electricity generation projects in Great Britain. The fifth CfD allocation round, Allocation Round 5 (AR5), will open to applications from developers of renewable technologies on 30 March 2023.
2. On 19 December 2022, the Government published a consultation that invited views on changes to the CfD Standard Terms and Conditions and Private Network Agreement for AR5. The draft CfD Standard Terms and Conditions and Private Network Agreement were published alongside the consultation, with the proposed drafting changes shown as tracked amendments. The consultation closed on 5 February 2023. This document summarises the responses received and sets out the Government's decisions on the changes proposed in the consultation.
3. On 7 February 2023, the Government announced the creation of a new Department for Energy Security and Net Zero. References in the contract to 'DESNZ' refer to this new department, or, where the context requires, to either of its predecessors the Department of Energy and Climate Change or the Department of Business, Energy and Industrial Strategy.

Overview of consultation proposals

4. We invited views on proposed changes to clarify that the flexibility in the contract for generators to delay their CfD Start Date should not be used to maximise electricity generation revenue prior to starting their CfD contract. We proposed updated interest rate calculations for repaying cumulated Subsidy, following the UK's exit from the EU, and removed BSUoS (Balancing Services Use of System) charge clauses, reflecting Ofgem's 2022 decision that these charges will no longer be levied on generators. We also proposed a simplification of data provision requirements for generators, and updated definitions in the CfD Private Network Agreement to ensure better alignment with regulations. Finally, we proposed an update to the contract to reflect new supply chain plan requirements for floating offshore wind projects.
5. Alongside the proposed changes, we included an assessment of the likely impact of the changes. Our final assessment of the impacts of changes to the contract terms to prevent generators delaying their Start Date for commercial gain is set out in the 'Final Assessment of Impacts' Annex published alongside this Government response.
6. The December 2022 consultation document is available via the link given in the footnote below.¹

¹ <https://www.gov.uk/government/consultations/cfd-contract-changes-for-allocation-round-5>

Engagement with the consultation proposals

7. The consultation attracted 28 written responses, including 6 through Citizen Space. Of the responses, 19 were from developers of renewable generating stations and 5 were from related trade associations. The remaining 4 responses were from a supply chain company, a consumer group, an investment fund manager and an electricity supplier. Several comments were received on issues that were outside the scope of the consultation and consequently they are not addressed in this Government response.

Next steps

8. The final CfD Standard Terms and Conditions and Private Network Agreement, together with the generic CfD Agreement and other contract variants for AR5, are published alongside this Government response. The application window for AR5 opens on 30 March 2023 and will close on 24 April 2023. The shortest and longest timetables are set out on the dedicated AR5 portal.²
9. In light of the Retained EU Law (Revocation and Reform) Bill, consequential amendments to the references to retained EU Law in the contract may be needed if the Bill comes into effect prior to AR5 CfD contracts being signed. The hyperlinks to some EU Law definitions in the contract have been removed, as we believe they are not essential and may become inoperative during the CfD term.

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

Explanation of changes to the CfD Standard Terms for Allocation Round 5

10. 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.
11. This Government response explains why revisions to the standard terms have been made for AR5.
12. In this respect, 'standard terms' includes Version 5 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.

Preventing CfD Start Date delays for commercial reasons

The Government proposed several amendments to the contract terms relating to conditions for the CfD Start Date to be reached, and the format of the CfD Start Date Notice, in order to prevent delays to the CfD Start Date for commercial reasons.

Proposals

13. The drafting changes proposed were intended to clarify that the flexibility in the contract for generators to delay their CfD Start Date should not be used to maximise electricity generation revenue prior to starting the CfD contract.
14. Questions 1-2 of the consultation focused on the approach to amending the CfD Standard Terms and Conditions to prevent generators delaying the CfD Start Date for commercial reasons. This would be achieved by requiring the Start Date occur within 10 business days of the Start Date Notice or Unilateral Commercial Operations Notice (UCON; see paragraph 15) being issued once the electrical output of the facility had reached a specified threshold level. The Start Date Notice would itself be issued within 10 business days of the Operation Condition Precedents (OCPs) being completed or the UCON being given after the CfD Counterparty considers commercial operations have started.
15. Questions 3-4 of the consultation considered the proposal that once a specified generation threshold is reached, LCCC could, if necessary, unilaterally deem that commercial operations had begun. LCCC could then issue a UCON indicating that it considers commercial operations have begun, thereby triggering a requirement for the Start Date Notice to be issued. Generators would be required to provide actual generation data that would allow LCCC to make this determination. Issuing this UCON would be possible whether or not the generator had completed all remaining OCPs. The underlying rationale for this proposal was that if the generator had begun commercial operations, then the generator should be capable of generating under the CfD scheme.
16. Generators would be required to provide actual generation data that, before the Start Date, would help LCCC to assess whether commercial operations have started, and after the Start Date, would be used in estimating metered output in cases where there was no previous BSC metering data available.
17. The requirement on generators to complete all OCPs would not be waived by the issuing of a UCON, and generators would be liable to make CfD difference payments from this date. LCCC would, however, be able to suspend payment of difference payments to the generator until the OCPs have been fulfilled.
18. Question 5 considered the likely economic impacts of the contract amendments. The initial assessment at consultation stage identified that the contract change would be likely to lead to a medium-term reduction in foregone CfD payments (reduced generator repayments which are refunded to electricity suppliers) from generators

delaying their Start Dates if wholesale electricity prices remained high. However, if generators attempted to offset lost revenue by bidding higher strike prices, then the overall impact on consumers might in fact be neutral or even negative overall. It was noted in our initial assessment that a key benefit of the change is that consumers would be protected against further unexpected spikes in the wholesale price of electricity. Reasonable scenarios also exist however, where a future price spike, under the contract as amended, would lead to a significant net saving for consumers overall.

Responses to the consultation

19. Responses to these questions were drawn from all respondents to the consultation (as set out at paragraph 7).

Views on proposals and Government response

20. Most respondents acknowledged the validity of the policy rationale that generators should not have the option to delay their CfD Start Date for commercial gain, although flexibility should remain to allow for genuine delays. Some respondents agreed with the amendments as currently proposed. However, the majority of respondents disagreed with various aspects of the contract drafting changes intended to achieve this aim, raising in particular the negative impact they could have on generators.
21. Several generators suggested that removing the opportunity to delay their Start Date and thereby benefit from the 'merchant nose' would potentially add significant risk to their business plans. This would make securing finance more difficult or more costly at a time of more general market volatility and uncertainty for the industry, and may make the UK market less attractive for investment. Their reasoning for this view was that LCCC may require the CfD contract to start while projects are undergoing commissioning tests and/or are not actually at full generation capacity, the threshold level being set too low, or that the CfD Start Date should not be set as early as proposed (see paragraphs 14 and 15). An equal number of respondents believed the suggested period was reasonable as proposed.
22. Various alternative suggestions of Threshold Levels were suggested, ranging from 30% of installed capacity estimate (ICE) to 80%, in line with the existing commissioning operation condition precedent (OCP). There were also suggestions that the requirement within the contract that all OCPs (including the commissioning OCP) should be completed as soon as reasonably practicable is sufficient to prevent delays for commercial reasons without requiring these further measures.
23. One respondent requested that 5 business days, rather than 2 business days as proposed, should be allowed for generators to provide actual generation data to assist LCCC to assess whether commercial operations have started and/or estimate metered output when data had not been received pursuant to the BSC.
24. One respondent suggested that the Government could consider assigning generators a specified number of hours under which the CfD strike price applies and allow generators to choose when to apply the CfD rate.
25. There were also suggestions that the opportunity to delay the Start Date for commercial reasons and to generate on a merchant basis was a way for generators to

counteract reduction in profits caused by external factors, such as higher than anticipated interest rates and supply chain costs or the Electricity Generator Levy's application to some revenues until 2028. Several respondents indicated, as our initial analysis suggested, that generators may attempt to recover their 'lost revenue' by placing higher bids at auction rounds, which might then lead to higher strike prices and result in the proposals being net-neutral for consumers (see assessment of impacts). Several respondents requested that the Government factor in the conclusions from the economic assessment when setting the AR5 parameters.

26. Many of the respondents requested confirmation that LCCC would not issue a UCON ahead of the target commissioning window (TCW), so that generators who commission their facility early can generate on a merchant basis. Confirmation was also requested that if the UCON was issued before the generator had fulfilled all its OCPs, any suspended difference payments would be repaid to the generator in full (or in full plus interest) following the completion of the OCPs. There were also calls that the UCON should not be issued before the target commissioning date (TCD), which is the advisory date for start of generation provided by generators with their CfD application. Many respondents also requested that there should be a 10 business day notice period provided to generators before a UCON is issued.
27. Another common response to the consultation was that there should be a dispute resolution process in place to allow generators to challenge the issuance of a UCON and that this process be managed by an external independent expert rather than by LCCC. There were concerns commonly expressed as to the level of responsibility and power granted to LCCC under the current proposals. There were also queries as to how LCCC would define the term "commercial operations" as well as several requests for this term to be formally defined within the contract. There were also requests that guidance should be published by Government and LCCC as to how the UCON process and wider CfD Start Date-related changes would operate in practice.

Policy response:

The Government is grateful for the high levels of engagement with the proposed changes, and the various suggestions of alterations to the proposed approach. We note that there is a majority view that supports the Government's rationale that generators should not be able to delay the CfD Start Date for their commercial gain. We are mindful of the strength of feeling surrounding the impact of the policy proposals if they are implemented as drafted, and the requests for amendments to mitigate these impacts. On that basis, we will proceed with changes to the contract that support our underlying rationale to prevent generators delaying their CfD Start Date for commercial gain. We have however, made some adjustments to the original proposals to address respondents' concerns.

We recognise and acknowledge that these changes are made against a backdrop of challenging economic conditions. Our changes are only intended to ensure that generators who have begun commercial operations begin their CfD contract in a timely manner within their TCW. We can confirm that the intention of the proposals is that the UCON would only be issued by LCCC after the TCW has started. This restriction was included within the proposed drafting, but we have made this more explicit within the revised AR5 contract at Condition 3.26. Generators with a CfD contract will therefore retain their ability to operate their project on a merchant basis before the TCW without interruption, which may allow generators to benefit from a 'merchant nose' (albeit for a limited period) whilst also providing an incentive for earlier commissioning of the facility.

The UCON may be issued before the TCD, which is an indicative date set during the CfD application. We otherwise foresee opportunity for generators to circumvent these rules if they were to set the TCD deliberately late within the TCW.

Detail has been added to the template UCON in Annex 8, including a new requirement (set out in Condition 3.26A) for LCCC to state the date it considers Commercial Operations commenced. Condition 3.21A has also been updated to clarify that if a UCON is issued, the Start Date would be no later than 10 Business Days after that or the date of the Start Date Notice (if later). As proposed, we have amended Condition 3.6 to clarify that the generator should fulfil all OCPs as soon as reasonably practicable, including the Subsidy Control Declaration OCP (which was previously an exception in this regard). We have also adjusted Condition 3.29 as proposed to reflect that, following a UCON, the Subsidy Declaration Operational CP might be fulfilled after the Start Date.

We do not, however, believe the requirement within the contract that all OCPs must be completed as soon as reasonably practicable is adequate to mitigate the risk of generators delaying the CfD Start Date for commercial reasons. This is evident to Government, as to a large extent this requirement exists in current iterations of the contract but has not prevented such activity occurring. As proposed, the requirements in the draft AR5 standard terms relating to the fulfilment of OCPs after the Start Date are confirmed in the final standard terms, given the potential for a UCON to lead to a Start Date that occurs before the OCPs are fulfilled. Condition 3.12 has since been updated to require that LCCC are notified if a OCP is no longer fulfilled by the date of the final OCP (if later than the Start Date). Condition 3.4, which relates to the generator's warranty regarding cumulation of Subsidy, has also since been updated on the same basis. Minor amendments have also been made to the proposed updates to Condition 3.25, which allow for LCCC to issue the Start Date Notice where necessary.

We have retained the provision that LCCC may suspend positive difference payments to generators if the UCON is issued by LCCC before all OCPs are completed, while liability for generators to make difference payments to LCCC will continue. After the completion of all OCPs and associated requirements, any suspended amounts owed to generators will be repaid in full although this will not include any adjustment for inflation or include interest. Minor drafting changes have been made to Conditions 3.36 and 22.5 to clarify this position.

It was not the intention of the proposals that generators which meet the Threshold Level while undergoing genuine pre-commissioning testing of their facility should have to begin their CfD payments. A UCON would only be issued by LCCC if commercial operations are deemed to have started. To remove the risk for generators that the UCON is issued inappropriately, we have amended Condition 3.26 to clarify that a UCON may not be issued if all commissioning tests relating to commissioning an Installed Capacity of at least 80% of the ICE (the Commissioning OCP) have not yet been completed (except to the extent they have not been completed due to a failure to apply a Reasonable and Prudent Standard).

The Required Percentage used in establishing whether a UCON can be issued was set intentionally lower than the Commissioning OCP, to mitigate the opportunity for generators to circumvent these changes by operating commercially below the threshold. However, we recognise that the proposed Threshold Level may unintentionally impact some technologies more than others. Our own considerations during the consultation period support the feedback received from many respondents that the likelihood is too high that the 25% ICE will be reached by generators during testing. To reduce the

possibility of pre-commissioning tests reaching the Threshold Level, we have decided to increase the Required Percentage from 25% to 50% of the ICE for both Baseload and Intermittent technologies. This will ensure a higher threshold of energy output than previously proposed is required before a UCON can be issued.

The Required Number of Settlement Units over which the Threshold Level must be reached before a UCON can be issued is confirmed as 5 units in any period of 28 days for Intermittent technologies, and 12 units for Baseload technologies, as was proposed in the draft AR5 contract. We have also made minor alterations to the definition of Threshold Level to clarify that the calculation includes the number of hours in one Settlement Unit.

We also recognise the clear feedback from many respondents to the consultation that there should be a dispute resolution process in place if LCCC issue a UCON, to allow generators to challenge this decision. As mentioned as a possibility by several respondents, we will rely on the existing dispute resolution process within the contract as the framework for the process to be followed. As recommended by many respondents, in the event of a dispute, we have added a provision that the expert determination procedure will apply to determine a dispute about whether a UCON should have been issued, or its contents.

We have decided not to insert a requirement for LCCC to notify the generator in advance of their intention to issue a UCON. We note that there are already allowances of up to 10 business days between the issuing of the UCON and the Start Date Notice, in which a generator could dispute the issuing of the UCON. We anticipate that LCCC and a generator will have been in dialogue before any formal action is taken, and that it should be apparent to a generator in advance as to whether the LCCC is likely to issue a UCON.

We have inserted a definition of UCON within the contract, with reference to Condition 3.26A, but will not insert a fuller definition of “commercial operations” within the contract as we do not believe this is necessary. Instead, we will continue to rely on the Threshold Level being met to allow LCCC to deem that commercial operations have started, supported by the dispute resolution process, as described above, if generators believe they have not. However, we have, as mentioned above, added a stipulation that LCCC will not issue a UCON if Commissioning Tests relating to Commissioning an Installed Capacity of 80% have not been completed (other than those tests not fulfilled due to a failure to apply a Reasonable and Prudent Standard).

Minor amendments have been made to Conditions 10.3 and 18.3, which as proposed allow for LCCC to estimate metering data (see also amendments to the Private Network CfD Agreement). We will not allow additional time for Actual Generation Output Data to be provided, as we consider the proposed timescales reasonable and necessary for LCCC to operate the scheme effectively.

We indicated in the consultation that consequential amendments to the ‘Billing Statements’ section at Clause 22.3 may be necessary to reflect the changes made elsewhere in the contract. Such conforming adjustments have been made to reflect that, if the Start Date occurs following a UCON, the effectiveness of Condition 22 is triggered by the giving of a UCON rather than the fulfilment of OCPs.

To provide further assurance to generators and investors, Government will work with LCCC to publish guidance in due course that sets out how these new arrangements will be implemented in practice.

Summary of Assessment of Impacts

28. The assessment of impacts has been developed since consultation stage and considers additional potential benefits and costs of the contract change, through further internal analysis and responses received at consultation. However, only internal methodological improvements have changed the estimated net position of the contract change. The consultation stage assessment suggested the contract change could have a neutral or even a negative impact (cost) to consumers, whereas the final assessment concludes the impact of the change is now expected to be neutral to both generators and consumers. The assessment covers the impact of the contract change qualitatively and this approach is viewed as proportionate by Government.
29. The contract changes to prevent generators from delaying their CfD Start Dates prevents foregone CfD payments and reduces the extent of top-up payments made to generators at the end of the CfD contract period. This is a potential benefit to electricity consumers through placing downward pressures on electricity bills. However, generators bidding into AR5 and beyond could have priced into strike price bids the potential upside from merchant generation and post-CfD revenues achieved by utilising the Start Date delay. As a result, any contract change could lead to a corresponding increase in strike prices as generators attempt to offset this 'lost' revenue, resulting in a neutral impact to consumers overall.
30. The final assessment is published in further detail as a technical annex alongside this document. In summary, the assessment covers: a) the potential benefits and costs of the contract change to prevent delayed Start Dates, identified through further internal analysis and responses to the consultation; b) the impact on CfD payments of the contract change and how this now results in a conclusion that a neutral impact to generators and consumers overall is more likely; and c) additional responses to Question 5 of the consultation that are specific to the assessment of impacts.

Amendments to data provision requirements

Simplifications to the generator data provision requirements were proposed to reduce the administrative burden on LCCC and generators.

Proposals

31. Question 6 of the consultation welcomed views on the proposed amendments to Condition 32.1 of the draft Standard Terms and Conditions relating to the data reporting requirements placed on generators.

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32. Specifically, we proposed that the existing requirement to provide a monthly update of the Expected Start Date and Installed Capacity be replaced with a requirement to provide this information at the Agreement Date and monthly for six months prior to the Start Date. We proposed that the requirements to provide a commissioning profile of the facility and Expected Generation Output Data be removed, and the requirement to provide forecast data be removed for intermittent technologies (and only required for baseload technologies upon writing from LCCC, or where the generator is aware of a change affecting the Renewable Qualifying Multiplier or the CHP Qualifying Multiplier).

Responses to the consultation

33. There were 18 responses to this question, all from renewable electricity generators.

Views on proposals and Government response

34. Most respondents to this question were fully supportive of the proposed amendments to simplify data requirements. One respondent indicated their support was conditional on it not impacting LCCC's ability to forecast intermittent and baseload generation.
35. Respondents were in favour of the proposal to update the expected Start Date and installed capacity on the agreement date and at monthly intervals for the six months prior to the Start Date (point 22). There has been support for removing the requirement for the generator to provide a commissioning profile (point 23) and the requirement for the generator to provide forecast data for intermittent technologies (point 24). Support was further noted to remove the requirement to provide expected generation output data (point 25).

Policy response:

The Government has decided to implement the proposed simplifications to the data requirements to align the contract requirements with existing LCCC guidance. An additional drafting adjustment was made to Condition 32.1(B) to refer to the new requirement for the provision of Actual Generation Output Data at 32.1(K). Minor amendments were also made to the drafting of 32.1(C), to improve the accessibility of this clause. LCCC do not anticipate any impact of the changes on their ability to reliably forecast intermittent and baseload generation.

Amendment to Private Network contract definitions

The consultation sought views on amendments and additions to definitions within the CfD Private Network Agreement.

Proposals

36. Question 7 welcomed views on amendments to the definitions within the CfD Private Network Agreement (PNA). Changes to the definitions of “Private Network” and “Private Network Use Agreement” are intended to align with the definitions for those terms given in the Contracts for Difference (Allocation) Regulations 2014, as amended. Terms which contribute to the definition of the term “Private Network Generator”, but which previously were only defined in the CfD Standard Terms and Conditions, have also been added to the list of definitions in the PNA.
37. Alongside these changes, clarification has been made in the Allocation Framework for AR5 that generators applying for a PNA must meet the definition of Private Network Generator given in the PNA contract.

Responses to the consultation

38. Seven renewable electricity developers responded to this question in the consultation.

Views on proposals and Government response

39. All respondents to this question were in favour of the amendments to the definitions with the CfD PNA.

Policy response:

The Government has decided to amend the definitions within the CfD Private Network Agreement (PNA), as proposed. As with the standard terms (at Conditions 10.3 and 18.3), provisions for LCCC to estimate metering data have been added as proposed, given that, if the Start Date occurs following a Unilateral Commercial Operations Notice, they might not have immediate access to all the metering data that would usually be available. Conforming adjustments have since been made to reflect the specific circumstances of a Private Network. Requirements for commissioning and proving tests have also been adjusted to allow for cases where they have not been completed on the Start Date if a UCON was given.

Interest rates for the repayment/recovery of Subsidy

The Government sought views on amendments to the contract to implement a new methodology for calculating interest rates for the repayment or recovery of Subsidy, following the UK’s exit from the European Union

Proposals

40. Question 8 of the consultation sought views on the Interest Rate Methodology proposed within the revised CfD Standard Terms & Conditions. The methodology replaces the Reference Rate Methodology that was previously used, as the EU regulations setting out those methodology requirements have since been revoked in the UK. The Interest Rate Methodology was proposed as the Bank of England Sterling Overnight Index Average (SONIA) Compound rate, plus 1 percentage point, calculated from the date the generator receives the Subsidy to when it is repaid or recovered. This interest rate would only apply when the UK awarding body or Subsidy Control Competent Authority has not defined an interest rate to use in the event of repayment or a recovery order. The definition of Subsidy Control Competent Authority was updated in the contract at Condition 1.1 to clarify that the Competition and Markets Authority and/or the Competition Appeal Tribunal are the relevant authority. The Subsidy Control Rules were updated in the draft contract to clarify they related to subsidy control provisions in the United Kingdom, and to relevant decisions or judgements made by the Subsidy Control Competent Authority.

Responses to the consultation

41. There were 14 responses to the consultation which addressed this proposal, all of which came from renewable electricity generators and their representative trade associations.

General views on the proposal

42. The majority of respondents agreed with the proposal to implement an Interest Rate Methodology based on the Bank of England SONIA Compound rate, plus 1 percentage point.
43. Some respondents were unclear as to why an addition of 1 percentage point would or should be added to the SONIA Compound rate.

Policy response:

The Government will implement the Interest Rate Methodology as the Bank of England Sterling Overnight Index Average (SONIA) Compounded Index value rate.

The Government intends to add 1 percentage point to the SONIA Compounded Index value rate as this rate alone would not cover the administrative costs and underlying risks of when a bank lends to a business rather than another bank or financial institution. The additional percentage point covers these administrative costs and underlying risks which is why we need to include it. This approach is also commonly used across the finance sector, and we believe it mirrors the previous 'Reference Rate Methodology' used by the European Union as closely as possible.

We have amended Condition 32.11 to reflect more precisely that, as proposed, the interest rate would be calculated from the point Subsidy is received by the generator until the Subsidy is repaid. This interest rate would only apply when the UK awarding body or Subsidy Control Competent Authority has not defined an interest rate to use in the event of repayment or a recovery order. A minor adjustment has also been made to Condition 32.11(C) to clarify the new methodology.

Additional changes not subject to consultation

44. The consultation provided an opportunity to register two additional changes to the CfD contract for AR5: the removal of all references to Balancing Services Use of System charges and related terms, following Ofgem's April 2022 decision that generators will not be liable for these charges; and an amendment to the Further Conditions Precedent for Floating Offshore Wind to reflect the policy that all applicants are to be subject to the supply chain plan requirements. There were no responses received in relation to these additional changes.

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