

ENERGY ACT 2013

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 2: Electricity Market Reform

Chapter 4: Investment contracts

Section 44: Investment contracts

185. In keeping with fact that investment contracts are intended to be entered into during a relatively short period of time and are therefore a transitional measure before the enduring regime is fully implemented, the detailed provisions relating to them are contained in Schedule 2 to the Act. This section gives effect to this Schedule.

Schedule 2, Part 1

Paragraph 1: Meaning of “investment contract”

186. This paragraph defines what an “investment contract” must be for the purposes of this Schedule. It does this by laying down, for example, requirements about who the parties are to be to such contracts, about the content of contracts, and requirements about being laid before Parliament. The restrictions here are important because Parts 2 to 4 of the Schedule contain a number of regulation-making powers that may be exercised only in relation to contracts that meet the defining characteristics of “investment contracts”, and Part 5 of the Schedule provides for the Secretary of State to incur expenditure in connection with “investment contracts”.
187. Specifically, in terms of their contents and nature, an investment contract is a contract with an electricity generator (as defined in *sub-paragraph (3)*) which:
- is entered into by the Secretary of State before the 31st December 2015 or if earlier, the date on which regulations are first made under section 10(3) defining an “eligible generator”. An “eligible generator” is the type of person who may benefit from a CFD under the regulations relating to the enduring regime;
 - has been entered into with the consent of the (Northern Ireland) Department of Enterprise, Trade and Investment if it relates to an electricity generating station in Northern Ireland (which is defined to include territorial waters – see *sub-paragraph (3)*, as well as *sub-paragraph (1)(b)*);
 - contains an obligation for the parties to make payments to each other based on the difference between a strike price and a reference price in relation to electricity generated (see *sub-paragraph (1)(c)* and, for a definition of these prices, *sub-paragraph (3)*). Where the investment contract is entered into before the coming into force of Schedule 2, this payment obligation must be expressed to be conditional on Schedule 2 being in force (see *sub-paragraph (2)*).

188. It is worth noting here that an electricity generator is defined in *sub-paragraph (3)* in a way to cover not simply someone who is directly involved in the generation of electricity, but also and more broadly speaking (for example) a person intending, at the time the contract is entered in to, to establish, or participate in the operation of a new or altered electricity generating station, and any person who has an interest in a company consisting of these aforementioned persons. Under Schedule 1 to the Interpretation Act 1978, “person” is defined to include persons corporate, such as companies. If an investment contract is entered into with more than one person, the payment obligation referred to in *sub-paragraph (1)(c)* must be an obligation on a party that is an electricity generator as defined in *sub-paragraph (3)* and the Secretary of State (see *sub-paragraph (4)*).
189. A contract is only an “investment contract” if it has been laid before Parliament, accompanied by a statement meeting the requirements in *sub-paragraph (6)* (see *sub-paragraphs (1)(d)* and *(5)(a)*). However, it is not necessarily the case that the whole contract must have been laid before Parliament in order for it to constitute “an investment contract”. *Sub-paragraph (5)(b)* means that certain confidential or commercially sensitive information which is contained in the contract may be omitted from it when it is laid before Parliament (see also [paragraph 3](#) of the Schedule for the definition of “confidential information”).
190. The statement that must be laid in Parliament together with the contract needs to cover various matters, to provide a measure of transparency about the decision-making process. For example, the statement will need to specify that the Secretary of State considers that payments which would be made under the investment contract which is being laid before Parliament would encourage low carbon electricity generation and that without the contract there is a significant risk of this electricity generation being delayed, or of it not occurring at all. Low carbon electricity generation is defined in *sub-paragraph (7)* to mean electricity generation which in the opinion of the Secretary of State will contribute to a reduction in emissions of greenhouse gases, as defined in section 92(1) of the Climate Change Act 2008. “Greenhouse gases” includes, for example, carbon dioxide and methane.
191. In addition, the Secretary of State must summarise in any statement the regard he or she has had in deciding to enter into a contract to the matters set out in section 5(2) of the Act (see *sub-paragraph (6)(c)*) – namely, the likely costs to consumers of ensuring security of supply to consumers in the United Kingdom, certain statutory targets relating to greenhouse gas emissions contained in the Climate Change Act 2008 and the target relating to the use of renewable energy set out in Article 3(1) and Annex 1 to “the renewable directives” (see the definition in section 5(3)).
192. Finally (though publication here is not a defining characteristic of an investment contract), the Secretary of State is obliged to publish any investment contracts in the form in which they have been laid before Parliament (see *sub-paragraph (8)*).

Paragraph 2: Varied investment contract

193. Since investment contracts are contracts, they may be varied by agreement of the parties to them (though regulations under [paragraphs 14\(2\)](#) and [\(3\)](#) may impose restrictions on a counterparty to agree variations). The effect of the paragraph here is to ensure that if an investment contract is amended by the parties, and the amendment will (in the Secretary of State’s opinion) result in a material increase in the likely costs to electricity consumers, the amended contract must be laid before Parliament in order to constitute an “investment contract” for the purposes of Schedule 2. In addition, when a varied contract is laid before Parliament, it must also be accompanied by a statement as to why the Secretary of State considers the amendment is appropriate, having regard to the likely costs to such consumers.
194. *Sub-paragraph (4)* should be noted because it means that where an investment contract is amended in accordance with its terms, there is no need to lay the amended contract

before Parliament. For example, if the strike price were to be increased in accordance with a procedure set out in the contract following a change of law, then there would be no need to follow the procedures required under this paragraph.

195. As with the case of an original investment contract, an amended contract must be published (see *sub-paragraph (3)*), once confidential information has been redacted from it (as well as in the case of when an amended contract is laid before Parliament – see *paragraph 2(2)(b)* and *(3)*).
196. The purpose of the provision here is to ensure that Parliament is informed of any changes outside the terms of an investment contract that are likely to adversely impact on consumers.

Paragraph 3: Confidential information

197. This paragraph defines the “confidential information” which may be removed from an investment contract or varied investment contract before it is laid before Parliament and published in accordance with *paragraph 1* or *2*.
198. “Confidential information” is defined by reference to the terms of an investment contract. Where an investment contract contains a term that information in the contract should not be disclosed, that information is to be excluded from publication provided that in agreeing this term against disclosure the Secretary of State considered that the information in question either constituted a trade secret, or that the disclosure of the information would be likely to prejudice the commercial interests of any person or constitute an actionable breach of confidence. However, it is not possible (given *paragraph 3(3)(a)*) for the investment contract to cover non-disclosure of the strike price or reference price.
199. In effect what this paragraph means, in conjunction with *paragraph 1(5)(b)* is that, where it comes to laying an investment contract before Parliament, any confidential information (as covered by the contract) must be excluded from publication.
200. It is anticipated that the vast majority of information within an investment contract will be included in the contract that is laid in Parliament and published. However, it is possible that some investment contracts may incorporate information that is commercially sensitive, such as detailed financial information belonging to the electricity generator, the disclosure of which could prejudice their commercial interests. This paragraph therefore allows for such information to be excluded from contracts that are laid in Parliament or published.

Paragraph 4: Interpretation for the purposes of this Schedule

201. This paragraph sets out how certain terms are to be interpreted in this Schedule. For example, it states that “CFD” and “CFD counterparty” should be construed in accordance with provisions in Chapter 2 of Part 2 of the Act (sections 6(2) and 7(2) respectively), and that “electricity supplier” means a person who is a holder of a licence to supply electricity in either Great Britain or Northern Ireland. Definitions for other terms used in the Schedule (and elsewhere in the Act) are to be found in section 151.
202. The paragraph also specifies that references to a CFD counterparty in the Schedule (apart from references in *paragraphs 9(1)(c)*, *9(1)(d)*, and *16*) only apply when the CFD counterparty is acting as a counterparty in relation to an investment contract – in other words, where any property, rights or liabilities under a contract have been transferred to the CFD counterparty by a scheme under *paragraph 16*.

Paragraph 5: Investment contract counterparty

203. This paragraph sets out a power allowing the Secretary of State to designate (by order) a registered company or a public authority, with their consent, to act as the counterparty for an investment contract (an “investment contract counterparty”). Whilst it is expected

that the counterparty will be owned by Government, any designated investment contract counterparty would have access to the same rights (such as to the supplier obligation) and be bound by the same duties under the legislation, regardless of whether it was a company and / or public authority, or whom it was owned by.

204. The property, rights and liabilities under an investment contract entered into by the Secretary of State can be transferred to a person designated as an investment contract counterparty through a scheme under [paragraph 16](#).
205. The designation of a company as an investment contract counterparty can be revoked by the Secretary of State by order, or if the investment contract counterparty elects to withdraw its consent to being designated by giving 3 month's notice. *Sub-paragraph (6)* provides that, as soon as reasonably practicable after a designation ceases to have effect, the Secretary of State must make a transfer scheme under [paragraph 16](#) to transfer the rights and liabilities of any investment contracts to which the person was a party to another counterparty. Additionally, under *sub-paragraph (8)* regulations made under [paragraph 6](#) may specify a period of time for which a person who has ceased to be an investment contract counterparty must continue to be treated as a counterparty for the purpose of regulations under this Schedule. The underlying purpose in the case of *sub-paragraphs (6) and (8)* is to have provision in place to minimise any disruption to obligations under investment contracts, including payments, in the event of a designation of an investment contract counterparty being revoked.
206. As explained in the 'Summary and background' section of the Explanatory Notes to Chapter 4, there will be a duty to transfer investment contracts to a CFD counterparty once one has been designated and certain other conditions have been met. However, in the event that a CFD counterparty is not designated, this paragraph enables another company or public authority to be designated to act as a counterparty for investment contracts.

Schedule 2, Part 2

207. [Part 2](#) principally provides the Secretary of State with regulation-making powers in connection with investment contracts. These powers are very similar to those in Chapter 2 relating to contracts for difference. A general regulation-making power is provided by [paragraph 6](#), with that power being further particularised in other paragraphs in Part 2 and in [paragraph 14\(3\) and \(4\)](#) and [16\(2\)](#) (as well as [paragraph 5\(8\)](#) and in the definition of "electricity supplier" in [paragraph 4](#)). The requirements about who must be consulted before regulations are made are set out in [paragraph 13](#). Regulations are to be made either under the affirmative resolution procedure if they are the first regulations which make provision falling within [paragraph 10 or 11](#), or any other regulations which make provision falling within other paragraphs of Parts 1 to 3 of Schedule 2; see *sub-paragraph (5)*), or the negative resolution procedure for all other regulations (see *sub-paragraph (6)*). [Paragraph 6\(7\)](#) provides that regulations relating to investment contracts should not be treated as a hybrid instrument.

Paragraph 7 – Supplier obligation

208. [Paragraph 7](#) expressly provides regulation-making powers to impose financial obligations on licensed electricity suppliers – supplier obligation(s). Under *sub-paragraph (1)*, regulations may impose obligations on licensed electricity suppliers in GB and Northern Ireland (see the definition of "electricity supplier" in [paragraph 4\(1\)](#)) to make payments to the Secretary of State to meet obligations under investment contracts. *Sub-paragraph (2)* requires that regulations impose obligations on licensed suppliers to make payments to an investment contract counterparty, or a CFD counterparty (see [paragraph 4\(1\)](#) for definitions of these counterparties – hereafter referred to as "counterparties") to meet obligations under investment contracts. Licensed suppliers may also be obliged to make payments for certain other purposes under regulations – for example, to cover costs associated with administering

investment contracts, and to enable the Secretary of State or a counterparty to hold sums in reserve (see *sub-paragraph (3)*), or to mutualise costs across (other) licensed suppliers where another becomes insolvent or defaults. *Sub-paragraph (6)* requires that any regulations under *sub-paragraphs (1)* or *(2)* must include a duty in relation to the collection of payments.

209. Other regulation-making powers expressly include imposing requirements on suppliers to provide collateral to the Secretary of State or to a counterparty (*sub-paragraph (5)*). They also cover powers for regulations to set out how the Secretary of State or a counterparty is to calculate or determine the amounts owed under regulations or the financial collateral to be provided by electricity suppliers (see *sub-paragraphs (7)(b)* and *(8)*). For example, regulations might provide powers to the counterparty to require collateral from suppliers according to such amounts as the counterparty calculates, but to require the counterparty to make its calculation of the amount of collateral required by reference to the size of a supplier or the amount of electricity it provides to certain consumers.
210. *Sub-paragraphs (7)(c)* and *(d)* expressly provide regulation-making powers to make provision about the issuing and enforcement of notices (issued by the Secretary of State or a counterparty) which require the payment of amounts owed under regulations here or the provision of collateral. *Sub-paragraph (9)* covers regulations making connected provision, for example, on dispute resolution about notices and the payment of interest for late payment. Note that the powers in [paragraph 12](#) of this Schedule would allow regulations to make provision for the requirements of notices here to be enforced by the Authority or the Northern Ireland Authority for Utility Regulations as if the requirements were relevant requirements on a regulated person. See the text below for explanation of [paragraph 12](#).
211. *Sub-paragraph (10)* clarifies that any sum which the supplier is required to pay the Secretary of State, the investment contract counterparty or the CFD counterparty by virtue of the supplier obligation regulations, and which is not paid when it is due under the regulations, is recoverable as a civil debt.

Paragraph 8: Payments to electricity suppliers

212. This paragraph expressly enables regulations to require the Secretary of State, an investment contract counterparty, or a CFD counterparty to make payments to licensed electricity suppliers. The underlying purpose of the power is to ensure that regulations can require that payments are made to licensed suppliers (where for example the reference price is higher than the strike price) and in circumstances where regulations are made imposing the supplier obligation under [paragraphs 7\(1\)](#) or [7\(2\)](#).

Paragraph 9: Application of sums

213. [Paragraph 9](#) is concerned with providing regulation-making powers to cover two broad areas. First, to ensure that regulations may make provision about the apportioning of money between generators by the Secretary of State or a counterparty where the amount collected from licensed suppliers is insufficient to collectively meet the liabilities under investment contracts or CFDs in full. In making these regulations, the Secretary of State must have regard to the principle that sums should be apportioned in proportion to the amounts which are owed, i.e. that they are pro-rated.
214. Secondly, *sub-paragraphs (4)* and *(5)* are concerned about conferring regulation-making powers to control how monies received by a counterparty or by the Secretary of State are used – specifically, whether or not they need to be paid into the Consolidated Fund.

Paragraph 10: Information and advice

215. This paragraph allows for regulations to be made imposing requirements about providing information or publishing it, as well as about how information is to be protected (see *sub-paragraphs (1) and (2)(f)*). The paragraph is intended, in part, to ensure that provision can be made in regulations so that there is a sufficient flow of information and advice for the purposes of administering and managing investment contracts. Therefore, for example, the regulations can require information to be provided to the Secretary of State or a counterparty from suppliers or generators (see *paragraph 10(2)(c) and (e)*). In addition the powers will allow provision to be made in regulations to permit the Secretary of State and the regulators in Great Britain and Northern Ireland to gather information together about investment contracts, in order to monitor their use and inform their wider decision-making.

Paragraph 11: Functions of the Authority

216. This paragraph provides an express power for regulations to confer functions, for two purposes, on the Authority (see the definition of “Authority” in section 151). The Authority is the regulator for the electricity markets in Great Britain. However, as a statutory body, it only has power to do those things which legislation confers a power on it to do.
217. The two purposes are to provide advice to, and to make determinations for, the parties to investment contracts. Therefore, for example, regulations could empower the Authority to monitor the performance of obligations under an investment contract relating to biomass sustainability (such as the type or mix of fuels used in an electricity generating station) and to determine for the parties whether such obligations have been met.

Paragraph 12: Enforcement

218. This paragraph provides an express regulation-making power in relation to the enforcement of obligations in regulations made under Schedule 2. Specifically, regulations may permit requirements imposed on suppliers to be enforced by the Authority in GB, or the Northern Ireland Authority for Utility Regulations in Northern Ireland, as if they are relevant requirements imposed on a regulated person.
219. What this means, in effect, is that regulations may treat a breach of a requirement imposed under them as akin to a breach of a licence condition in relation to certain enforcement powers. For example, sections 25 to 27A of the Electricity Act 1989 permit the Authority to make orders to secure compliance with licence conditions, and/or to impose financial penalties for their breach. Regulations could apply these enforcement powers in relation to breaches of requirements imposed under them as if they were breaches of licence conditions.

Paragraph 13: Consultation

220. *Paragraph 13* imposes requirements on the Secretary of State about who he or she must consult before making regulations under Schedule 2 – with *sub-paragraph (8)* expressly providing that any required consultation may take place before or after enactment of the Act.
221. As a broad rule, the Secretary of State is required to consult those persons who will be affected by specific regulations, as well as the devolved administrations in Northern Ireland, Scotland and Wales. For example, electricity suppliers are required to be consulted on regulations under *paragraphs 7, 8, 9 or 14(3)*.

Schedule 2, Part 3

Paragraph 14: Duties and liabilities of an investment contract counterparty and a CFD counterparty

222. This paragraph allows for regulations to tightly define and limit the scope of the behaviour of an investment contract counterparty, or a CFD counterparty which is acting as a counterparty in relation to an investment contract.
223. The regulation-making power is designed to ensure that controls can be imposed on counterparties to ensure that suppliers are properly protected from potential for increased costs due to variation of contracts, whilst still enabling decisions to be made by the Secretary of State to permit variation where it is appropriate to do so. This paragraph only covers regulation of the behaviour of the counterparty and does not enable the Secretary of State, through regulations, to vary any investment contract without the consent of the generator in question.
224. *Sub-paragraph (2)* places a duty on an investment contract counterparty or CFD counterparty to exercise its functions to ensure that it can meet its liabilities under an investment contract. Those functions are principally those conferred under or by virtue of [paragraph 7](#) (supplier obligation) in relation to the ability of the CFD counterparty or investment contract counterparty to recover sums from licenced electricity suppliers. “Liabilities” in this context includes all liabilities under an investment contract. For these purposes, liabilities will exist in respect of any sums that are owed at a particular time by the counterparty under the investment contract, irrespective of whether they have yet become payable in accordance with any payment provisions it contains.
225. *Sub-paragraph (3)(c)* enables regulations to make provision about the making of directions to an investment contract counterparty or CFD counterparty. This will enable specific directions to be given in relation to particular contracts or matters (such as where a generator has proposed a variation to the contract and the Secretary of State wishes to require the counterparty to agree to it).
226. *Sub-paragraph (5)* places a duty on the Secretary of State. The regulations that he or she makes must include such provision as he or she considers necessary to ensure that the investment contract counterparty or CFD counterparty can meet its liabilities under investment contracts. As set out in relation to *sub-paragraph (2)* above the reference to liabilities means all sums which are owed under an investment contract.

Paragraph 15: Shadow directors

227. This paragraph makes it clear that, as a result of exercising any powers conferred by or under Schedule 2 (such as those given by regulations under [paragraph 14\(3\)](#)) over an investment contract counterparty or CFD counterparty, the Secretary of State is not to be regarded as, for example, a director or shadow director of these bodies or an agent of them or their principal.
228. The purpose of this provision is to limit the potential liabilities and duties that could otherwise accrue to the Secretary of State (such as under the Companies Acts or the Insolvency Act 1986) were he or she to be treated, for example, as shadow director of these bodies. This is considered to be appropriate since the powers the Secretary of State will be exercising under the regulations will be exercisable in the public interest.

Schedule 2: Part 4

Paragraphs 16-18: Transfers

229. The above paragraphs provide powers to the Secretary of State, by transfer scheme, to transfer the property, rights and liabilities under an investment contract from the

Secretary of State to an investment contract counterparty or a CFD counterparty, and from one counterparty to another.

230. *Paragraph 16* sets out the broad power to make one or more transfer schemes and contains provision on how schemes are to take effect. This paragraph also introduces a duty to make a transfer scheme to transfer investment contracts from the Secretary of State or an investment contract counterparty to the CfD counterparty once three conditions are satisfied: that the CfD counterparty has been designated, the investment contract provisions in the Act have expired (31 December 2015 or earlier if an eligible generator has been defined under section 10(3)), and supplier obligation regulations under section 9 are in place to collect payments from suppliers. The duty does not apply to the extent that the Secretary of State considers it is appropriate in all circumstances to dis-apply it.
231. *Paragraph 17* particularises the powers to make transfer schemes – for example, a scheme could make provision that in the case of any legal proceedings concerning an investment contract that is transferred, that the new counterparty body is to be substituted as a party (see *paragraph 17(1)(c)*). *Paragraph 18* gives the Secretary of State the power to pay compensation to persons whose interests are adversely affected by a transfer scheme.
232. Supplementary provision is made in section 153 which relates to the powers to make schemes here. For example, powers are conferred to modify schemes.
233. The powers ensure that over the lifetime of an investment contract there is a mechanism in place to ensure that if an existing counterparty ceases to be suitable or willing to act as such, the investment contract can be transferred to another person designated as a counterparty. The Secretary of State is under a duty, by virtue of *paragraph 5(6)* and section 7, to ensure that where a counterparty ceases to be a counterparty, the property, rights and liabilities under any investment contracts are transferred to a new counterparty as soon as reasonably practicable.

Schedule 3: Part 5

Paragraph 19: Licence modifications

234. *Paragraph 19* provides the Secretary of State with powers to modify generation, transmission and distribution licences, the standard conditions of such licences and documents maintained in accordance with conditions of such licences (such as industry codes). There are two purposes for which the powers are exercisable (see *sub-paragraph (2)*) – which relate to the provision of services or enforcement. For example, the powers may be used to make amendments to the Balancing and Settlement Code (BSC) (which is a document falling within *sub-paragraph (1)(c)*) to enable the BSC company to provide settlement services to the Secretary of State, an investment contract counterparty or a CFD counterparty. Or new licence conditions could be imposed to assist in the enforcement of obligations under investment contracts where contractual remedies thought insufficient to provide protection against abuse.
235. The powers to make licence modification here are supplemented by section 64, which also contains requirements of the procedures that need to be followed in connection with modifications.

Paragraph 20: Expenditure

236. *Paragraph 20* provides Parliamentary authorisation for certain items of expenditure by the Secretary of State in connection with investments contracts. The expenditure covered includes expenditure incurred for the purposes of obtaining advice and assistance in relation to investment contracts (for example, to engage technical advisers to assess a generator's construction costs). The paragraph would also authorise, for

*These notes refer to the Energy Act 2013 (c.32)
which received Royal Assent on 18 December 2013*

example, financial assistance given to an investment contract counterparty to assist with set-up costs or costs which the Secretary of State might incur in establishing one.