



Department for
Business, Energy
& Industrial Strategy

CONSULTATION ON THE LOW CARBON CONTRACTS COMPANY'S AND THE ELECTRICITY SETTLEMENTS COMPANY'S OPERATIONAL COSTS 2017/18

Government Response



January 2017

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

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Introduction

1. In the 'Low Carbon Contracts Company and Electricity Settlements Company operational costs 2017/18: consultation on the operational cost levies'¹, published on 28 October 2016, the government sought views on the proposed 2017/18 operational cost budgets and resulting levies for the Low Carbon Contracts Company (LCCC) and the Electricity Settlements Company (ESC).
2. This document sets out the Government Response to this consultation, summarising the feedback received on each of the consultation questions and setting out the government's response to the points raised.
3. The summary of responses focuses on the key issues and themes raised. Although it neither lists nor comments on every point made by consultees, all of them have been analysed by government.

Background

4. LCCC and ESC were established in 2014 to help deliver the Capacity Market and Contracts for Difference (CFDs), which are designed to incentivise the significant investment required in our electricity infrastructure to keep energy supplies secure and affordable, and to help meet our climate change targets.
5. LCCC, as counterparty to CFDs (including the Investment Contracts which have been transferred to LCCC), enters into and manages the contracts with low carbon generators and is responsible for payments thereunder. ESC is responsible for financial transactions relating to the Capacity Market, including making capacity payments to capacity providers, controlling collateral and managing auction bid bonds.
6. The operational costs of both LCCC and ESC are recovered through levies on electricity suppliers. As the amount of these levies will be revised through the amendment of secondary legislation, made under Part 2 of the Energy Act 2013, the Department for Business, Energy and Industrial Strategy (BEIS) is required to consult.
7. The consultation document explained that the total operating costs (including applicable depreciation on capital expenditure), proposed to be recovered through levies, for 2017/18 were **£14,788,000** for LCCC and **£6,241,000** for ESC.

¹ <https://www.gov.uk/government/consultations/low-carbon-contracts-company-and-electricity-settlements-company-operational-costs-201718-consultation-on-the-operational-cost-levies>

Publication and dissemination of the consultation

8. The consultation ran from 28 October to 25 November 2016 with the consultation document published on the government website. A news bulletin, including a link to the consultation document, was sent to approximately 500 stakeholders, including electricity generators, suppliers and consumer groups.
9. In total, two responses were received to the consultation; the organisations that responded are listed in the Annex.

Outcome of the consultation

10. Following analysis of the responses to this consultation, no amendments to LCCC's and ESC's budgets are required.
11. The forecast of gross electricity demand for 2017/18 to be used to calculate LCCC's operational cost levy is confirmed as 282.28 TWh². The resulting levy rate that will be included in regulations is £0.0524/MWh. At the time of the consultation, LCCC forecast a total gross demand of 282.39 TWh. An updated forecast has been provided in this document to be used for the final levy rate calculation. This update makes use of more recent weather and demand data in the forecast model and as a result is marginally different to the original figure presented. There is no impact on the overall levy rate.
12. The total amount per financial year charged to electricity suppliers to fund ESC will be specified in Regulations as £6,241,000.

Next Steps

13. The Energy Act 2013³ provides that Regulations setting the operational cost levies are subject to the 'affirmative' Parliamentary procedure. This means that any amendments to the Regulations have to be debated and approved by Parliament before they are made. Legislation to amend the Regulations to reflect the outcome of this consultation has now been laid before Parliament. The intention is that the new levy rates will come into effect from 1 April 2017.

² This forecast of gross electricity demand is based on a dedicated forecast model developed by LCCC. The model uses statistical techniques taking into account trends in electricity demand and embedded generation.

³ The Energy Act (2013) http://www.legislation.gov.uk/ukpga/2013/32/pdfs/ukpga_20130032_en.pdf

Questions and Responses

Operational costs of the Low Carbon Contracts Company

Consultation question		2 responses
1	Do you have any comments on LCCC's estimated operational costs as set out in this consultation document?	

Summary of responses

14. Both respondents welcomed the opportunity to respond to the consultation and commended BEIS's transparency in consulting on LCCC's proposed budget. It was noted by one respondent that LCCC's estimated costs for 2017/18 are 3% higher than those estimated for 2016/17 as a result of an increase in the costs for software upgrades. However, LCCC was also commended for the net efficiency savings of 4% achieved on operational cost budgets.
15. The same respondent also noted that the estimated cost of professional and legal fees in 2017/18 has increased by more than £500,000 than was budgeted for in 2016/17. The respondent observed that the reasons for this are in part as a result of additional costs relating to management of the Hinkley Point C CFD, and also in procuring external technical and professional advice so that LCCC has access to highly skilled resources when needed. Whilst recognising the potential benefits, the respondent emphasised that such an approach places a premium on strong and effective contracting and outsourcing processes so as to ensure value for money.
16. There was continued support for the sharing of common resources where possible between LCCC and ESC as an appropriate approach to control costs effectively and identify opportunities for operational cost savings.

Government response

17. Government notes the respondents' general points on the increased costs relating to software upgrades; benefits of a transparent approach; continued sharing of resources and LCCC's efficiency savings. In response to the specific point regarding the increase in the costs of professional and legal fees and the approach to procurement, LCCC has in place an effective procurement policy and is required to procure all goods and services, including contracting and outsourcing,

in compliance with the relevant requirements in Managing Public Money⁴, certain Cabinet Office controls and public procurement regulations. The company is therefore required to carry out procurement and project appraisal objectively and fairly, using cost benefit analysis and generally seeking good value for money.

Forecast electricity demand

Consultation question		0 responses
2	Do you have any comments on the forecast electricity demand from which the £/MWh levy rate for LCCC is derived?	

Summary of responses

18. There were no specific responses on this question.

Operational costs of the Electricity Settlements Company

Consultation question		2 responses
3	Do you have any comments on ESC's estimated operational costs as set out in this consultation document?	

Summary of responses

19. One respondent noted that the estimated costs of ESC are 46% higher than the estimated costs for 2016/17 as a result of a one-off software upgrade cost. The respondent observed that this is due to a one-off capital cost and therefore expects this increase will be reversed for 2018/19. The same respondent suggests, where practicable, to phase such one-off costs so as to avoid future volatility in the levy.

20. Both respondents welcomed the opportunity to respond to the consultation and commended BEIS's transparency in consulting on ESC's proposed budget, and as noted above, there was continued support for the sharing of common resources.

⁴ Managing Public Money can be found at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/454191/Managing_Public_Money_AA_v2_-jan15.pdf

Government response

21. As outlined in the consultation, the increase in ESC's budget is due to the estimated cost of software upgrades for the settlement system. These upgrades include revisions to the system required to bring it in line with agreed changes to the Capacity Market regulatory framework⁵ and changes that have recently been consulted on⁶, which will help to clarify and simplify the regulatory framework. If the proposed changes are not taken forward in 2017/18, or the costs have been overestimated and the surplus levy is not required for other purposes, it will be repaid to suppliers in the normal course.
22. It is important to simplify and clarify Capacity Market processes and the regulatory framework to ensure that the market continues to function fairly and efficiently to underpin the security of the electricity supply. Many of the changes must be reflected in the settlement system. As the Capacity Market becomes fully operational and well established, policy, and consequently settlement system, changes should reduce over time. However, as with any IT system there is likely to be an ongoing need for software upgrades to take place. BEIS, Ofgem and ESC look to phase improvements cost-effectively wherever possible.
23. To clarify, the cost of the software upgrades are not being treated as a capital cost. The costs will be expensed in-year and charged in full to the levy in 2017/18. This is different to the treatment of the one-off capital cost of developing and building a settlement system where those costs would be capitalised and recovered through the inclusion of annual depreciation charges in the levy over the useful life of the asset. Government acknowledges that expensing rather than capitalising software upgrades results in costs being recovered in one year rather than over five years, however the overall cost to suppliers is the same. Expensing the costs in year also provides LCCC and ESC with the independence to budget for and fund any necessary software upgrades as part of the annual levy setting process, rather than needing to make a separate approach to BEIS in order to secure capital funding.
24. As government-owned companies, LCCC and ESC are subject to the government's framework for managing public money. The future administrative costs of running LCCC and ESC are therefore subject to this framework and consultation.

⁵ Copies of consultation documents and government responses available at:
<https://www.gov.uk/government/consultations/2015-consultation-on-capacity-market-supplementary-design-proposals-and-changes-to-the-rules-and-regulations>
<https://www.gov.uk/government/consultations/consultation-on-reforms-to-the-capacity-market-march-2016>

⁶ Consultation on state aid cumulation:
<https://www.gov.uk/government/publications/selective-overcompensation-in-the-capacity-market>
Consultation on 'Capacity Market: proposals to simplify and improve accessibility in future capacity auctions':
<https://www.gov.uk/government/consultations/capacity-market-proposals-to-simplify-and-improve-accessibility-in-future-capacity-auctions>

Annex: List of organisations that responded to the consultation

The following organisations responded to this consultation:

EDF Energy
ScottishPower

