Department for Business, Energy & Industrial Strategy

LOW CARBON CONTRACTS COMPANY'S AND ELECTRICITY SETTLEMENTS COMPANY'S OPERATIONAL COSTS 2018/19 – 2020/21

Government Response to consultation

February 2018

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 2018/19 – 2020/21: consultation on the operational cost levies'[1], published on 10 November 2017, the government sought views on the proposed 2018/19 – 2020/21 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 that 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 are responsible for delivering key elements of the Contracts for Difference (CFDs) scheme and the Capacity Market respectively.

5. LCCC, as counterparty to CFDs (including the Investment Contracts which have been transferred to it[2]), enters into and manages the contracts with low carbon generators, awarding top-up payments for qualifying generation. ESC is responsible for all financial transactions relating to the Capacity Market, including making capacity payments to capacity providers and managing supplier credit cover and capacity providers' auction credit cover.

6. The operational costs of both LCCC and ESC are recovered through levies on electricity suppliers as set out in legislation ("the Regulations" [3, 4]). The Energy Act 2013[5] requires that we consult before making any regulations to amend the levies. Previously, operational cost levies for LCCC and ESC have been set a year in advance. In the consultation document we proposed amending the Regulations to allow these levies to be set for more than one financial year in advance and to set levies for the next three financial years.

[1] https://www.gov.uk/government/consultations/low-carbon-contracts-company-and-electricity-settlements-company-operational-costs-2018-2019-to-2020-2021

[2] Investment Contracts which have been transferred to the LCCC are treated, by virtue of regulation 2(4) of the Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 as CFDs for various purposes. Any reference to CFDs in this document is to be treated as including any such Investment Contracts.

[3] Regulation 23 of the Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 (as amended).

[4] Regulation 9 of the Electricity Capacity (Supplier Payment etc.) Regulations 2014 (as amended).

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

Publication and dissemination of the consultation

7. The consultation ran from 10 November to 8 December 2017 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.

8. In total, 3 responses were received to the consultation; the organisations that responded are listed in the Annex. Respondents welcomed the opportunity to review and respond to the proposed operational cost budgets for LCCC and ESC and commended BEIS's transparency in consulting on these.

Outcome of the consultation

9. Following analysis of the responses to this consultation, no amendments to the budgets proposed for LCCC and ESC are required.

10. The estimated operating costs for LCCC, the forecast of gross electricity demand to be used to calculate its operational cost levies and the levy rates that will be included in regulations are confirmed in table 1.

Table 1

Year	Estimated costs (£m)	Forecast electricity demand (terawatt hours (TWh))[6]	Levy rate (£/megawatt hour)
2018/19	16.519	289.66	0.0570
2019/20	17.020	287.69	0.0592
2020/21	17.485	284.59	0.0614

11. At the time of the consultation, LCCC forecast a total gross demand of 290.50 TWh for 2018/19, 288.68 TWh for 2019/20 and 285.83 TWh for 2020/21. Updated forecasts, as set out in Table 1, have been used for the final levy rate calculations and result in marginally higher levy rates.

[6] 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, which is connected to the distribution network rather than the transmission grid. It also considers the long-term variability of weather

12. The total operational costs budget (the “settlement costs levy”) to be charged to electricity suppliers to fund ESC will be specified in regulations as £7.629m for 2018/19, £7.554m for 2019/20 and £7.502m for 2020/21.

Next Steps

13. The Energy Act 2013 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, subject to the will of Parliament, the 2018/19 levies will come into effect from 1 April 2018, and that the 2019/20 and 2020/21 levies will come into effect from 1 April 2019 and 1 April 2020 respectively.

Questions and Responses

Setting levies for the next three financial years

Consultation question	3 responses
1	Do you have any comments on our proposal to amend the Regulations to allow levies to be set for more than one financial year in advance? And our proposal to set levies for the next three financial years?

Summary of responses

14. All three respondents welcomed BEIS's proposal to amend the Regulations so that operational costs levies for the LCCC and ESC can be set more than one financial year in advance. They also supported the proposal to set levies for the next three financial years (i.e. 2018/19, 2019/20 and 2020/21). Respondents considered that this offers electricity suppliers and other stakeholders better visibility of these costs and will provide electricity suppliers with greater cost certainty for a longer period. It was also acknowledged that setting the levies over a three year period will reduce the administrative burden on the LCCC and ESC and save parliamentary time.

15. One respondent recognised that there is some increase in the risk of over or under recovery of the levies if forecasting them further ahead meant that they were less accurate but considered that the benefits of greater visibility outweigh this risk.

16. Another respondent thought having set the levies for three years ahead, it would be important for BEIS to communicate the process for setting the costs, and the costs themselves, for 2021/22 and beyond in a timely manner. It was suggested that this would help ensure that businesses did not face uncertainty about levy costs, following a period of relative certainty.

Government response

17. BEIS has decided to proceed with setting levies for the next three financial years. Subject to the will of Parliament, the amending regulations will come into force before the beginning of the 2018/19 financial year.

18. BEIS agrees with stakeholders that the benefits of setting the levies more than a year in advance can outweigh the potential risk of inaccuracy. The Companies are experienced at setting their budgets and the process has undergone challenge and scrutiny with a focus on striking a balance between ensuring that the Companies are sufficiently funded whilst minimising costs to consumers. BEIS will, however, work with the Companies over the next three years to keep the budgets under review.

19. As with previous budgets, any operating surplus will be returned to suppliers in the usual way. If the levy income is not sufficient BEIS will consider whether an in-year levy rate adjustment is appropriate, recognising the uncertainty that such an adjustment

might cause. In the event that an in-year adjustment was necessary, BEIS would be required to publicly consult on this before amending legislation and would give stakeholders as much notice as possible of the proposed change. Where appropriate, and solely at its discretion, BEIS can provide the Companies with budget and grant-in-aid to cover any levy deficit or justifiable unplanned expenditure.

20. In due course BEIS will consult on levy rates to apply from 2021/22 onwards, giving suppliers sufficient notice of any changes. At that time we will consider whether it is appropriate to continue setting levies for more than one year in advance rather than returning to an annual process. The benefits of setting rates for multiple years will need to be balanced with the ability of LCCC and ESC to accurately forecast operational costs for the relevant period and the need to minimise the risk of requiring in-year levy adjustments.

Operational costs of the Low Carbon Contracts Company

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

Summary of responses

21. Respondents recognised that, in setting operational cost budgets for LCCC, BEIS has to strike a balance between ensuring that the Company has adequate resources to maintain investor confidence in the CFD regime and ensuring that costs to customers are minimised. One respondent acknowledged that the forecast operational costs for the next three financial years appropriately strike such a balance. Another respondent noted that the budgets setting process includes external scrutiny as well as internal auditing of costs and considered this vital to ensuring that the operational costs of LCCC are properly justified.

22. One respondent emphasised that the budget setting process should be careful to avoid significant over or under collection. There was agreement that, should there be a shortfall in levy income LCCC would, in the first instance, seek to manage its costs within its available budget. A change in the levy rate in-year was seen to be a final resort, given the uncertainties this could introduce for electricity suppliers and the costs to be passed on to consumers.

23. One respondent noted that LCCC has sought to keep its 2018/19 budget (excluding a provision set aside for disputes) equivalent to that for 2017/18. As this budget contingency represents an increase in costs funded by consumers, which needs to be justified, it was assumed that the need for such provision will be kept under review.

24. 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

25. The budget has been set to ensure that LCCC has sufficient resources to perform its role as CFD counterparty effectively, whilst minimising costs to consumers. It is also set as accurately as possible to reflect expected operational costs in order to avoid under or over collection of the levy.

26. There is an established process for LCCC to manage any forecast shortfall of levy income. This requires the Company to manage its costs within its available budget, in the first instance, reprioritising expenditure where possible. An in-year levy adjustment will only be considered if there is a significant discrepancy between projected levy income and estimated costs, which is justified but cannot be managed by LCCC. As outlined above, BEIS recognises the uncertainty that an in-year levy change could cause for electricity suppliers and the proposed budget seeks to reduce the need for a levy change whilst minimising costs to consumers. Any surplus levy will be returned to suppliers in the usual way.

27. As the CFD counterparty, it is important that LCCC has sufficient funds to defend a dispute as necessary. If the contingency provision is not utilised for this purpose and the surplus levy is not required for other essential operational activity, it will be repaid to suppliers in accordance with regulations.

28. The contingency budget for potential disputes, along with the wider budget, will be kept under review over the next three years.

Forecast electricity demand

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

Summary of responses

29. There were no specific responses on this question.

Operational costs of the Electricity Settlements Company

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

Summary of response

30. Respondents recognised that, in setting operational cost budgets for ESC, BEIS has to strike a balance between ensuring that the Company has adequate resources to maintain market participant's confidence in the Capacity Market settlement process and ensuring that costs to customers are minimised. One respondent acknowledged that the forecast operational costs for the next three financial years appropriately strike such a balance. Another respondent noted that the budgets setting process includes external scrutiny as well as internal auditing of costs and considered this vital to ensuring that the operational costs of ESC are properly justified.

31. One respondent emphasised that the budget setting process should be careful to avoid significant over or under collection. There was agreement that, should there be a shortfall in levy income ESC would, in the first instance, seek to manage its costs within its available budget. A change in the levy rate in-year was seen to be a final resort, given the uncertainties this could introduce for electricity suppliers and the costs to be passed on to consumers.

32. One respondent noted that ESC's estimated operating costs for 2018/19 are significantly higher than those for 2017/18, and that the consultation document explained that this is due to the Company managing both increased capacity and increased market complexity. The same respondent also noted that the budget includes a provision to fund further software upgrades to the settlement system as a result of regulatory and rule changes, and acknowledged that these are necessary as the Capacity Market evolves. The respondent further observed that ESC's total operating costs remain relatively stable for the following two years.

33. As noted above, there was continued support for the sharing of common resources between LCCC and ESC.

Government response

34. The consultation response comments summarised in paragraphs 30 and 31 were also made in relation to LCCC, and government's response as outlined in paragraphs 25 to 26 applies equally here. ESC's budget has been set as accurately as possible to reflect the expected operational costs required for the company to perform its functions effectively whilst ensuring costs for consumers are minimised. ESC's budget will be kept under review over the three year period with any levy surplus and/or shortfall managed through the processes already outlined.

35. As the respondents noted, ESC is managing an increase in the amount of Capacity and the number of Capacity Providers. In addition, the rise in market complexity and the requirement for changes to the Capacity Market are expected to continue. ESC therefore requires further investment to manage this activity and to ensure it continues to effectively deliver all financial transactions for the Capacity Market.

Annex: List of organisations that responded to the consultation

The following organisations responded to this consultation:

EDF Energy
ScottishPower
SSE Plc

Department for Business, Energy & Industrial Strategy
www.gov.uk/beis