



Department
of Energy &
Climate Change

Low Carbon Contracts Company and Electricity Settlements Company operational costs 2015/16

Consultation on the operational cost levies

5 November 2014

URN 14D/407



The consultation can be found on DECC's website:

<https://www.gov.uk/government/consultations/low-carbon-contracts-company-and-electricity-settlements-company-operational-costs>

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General information

Purpose of this consultation:

This consultation document seeks views on the proposed 2015/16 operational cost budgets and resulting levies for the Low Carbon Contracts Company and the Electricity Settlements Company.

As the operational costs will be charged to electricity suppliers as a levy it is important to ensure that these proposals receive appropriate scrutiny through this consultation. Following the outcome of the consultation, the operational cost levy rates for 2015/16 will be reflected in secondary legislation.

Issued: 5 November 2014

Respond by: 3 December 2014

This is a short consultation period due to the limited and focussed nature of the material to be reviewed.

Enquiries to:

EMR Companies Operational Cost Consultation
Department of Energy and Climate Change
Fourth Floor, Area A
3 Whitehall Place
London
SW1A 2AW

Tel: 0300 068 6113/5409

Email: emroperationalcosts@decc.gsi.gov.uk

Consultation reference: URN 14D/407 – Low Carbon Contracts Company and Electricity Settlements Company operational costs 2015/16

Territorial extent:

This consultation applies throughout Great Britain.

How to respond:

DECC will be sending this consultation to key partners whom we invite to respond either digitally to our official mailbox emroperationalcosts@decc.gsi.gov.uk or by post to:

EMR Operational Cost Consultation
Department of Energy and Climate Change
Fourth Floor, Area A
3 Whitehall Place
London
SW1A 2AW

If you have any comments on the operational cost levies as set out in this document it would be helpful if you can also provide supporting analysis to explain your position where appropriate.

Additional copies:

You may make copies of this document without seeking permission. An electronic version can be found at <https://www.gov.uk/government/consultations/low-carbon-contracts-company-and-electricity-settlements-company-operational-costs>.

Other versions of the document in Braille, large print or audio-cassette are available on request. This includes a Welsh version. Please contact us under the above details to request alternative versions.

Confidentiality and data protection:

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information legislation (primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

If you want information that you provide to be treated as confidential please say so clearly in writing when you send your response to the consultation. It would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded by us as a confidentiality request.

We will summarise responses and confirm the outcome of the consultation in the Government response which will be published on the [GOV.UK website](#). The Government response will include a list of names or organisations that responded but not people's personal names, addresses or other contact details.

Quality assurance:

This consultation has been carried out in accordance with the [Government's Consultation Principles](#).

If you have any complaints about the consultation process (as opposed to comments about the issues which are the subject of the consultation) please address them to:

DECC Consultation Co-ordinator
3 Whitehall Place
London SW1A 2AW
Email: consultation.coordinator@decc.gsi.gov.uk

Introduction

Budget proposals for the Low Carbons Contracts Company (LCCC) and the Electricity Settlements Company (ESC)

1. Key mechanisms for implementing Government's Electricity Market Reform (EMR) include Contracts for Difference (CfDs) to incentivise investment in low carbon technologies, and a Capacity Market to ensure security of supply. Two Government-owned companies manage key parts of these mechanisms: the Low Carbon Contracts Company as counterparty to CfDs (including Investment Contracts which have been transferred to the LCCC¹) manages the contracts and is responsible for payments thereunder; and the Electricity Settlements Company which is responsible for payment flows under the Capacity Market, including making capacity payments to capacity providers, controlling collateral and managing auction bid bonds.
2. The operational costs of the LCCC and the ESC are recovered through levies on electricity suppliers, as set out in legislation^{2,3}. DECC funded the non-capital set-up costs of both companies up to 1 August 2014 and, in line with public commitments⁴, intends to fund and not subsequently recover the LCCC's expenditure on its settlement system up to 31 March 2015 when it is expected to be ready. However, the capital cost⁵ of the ESC's settlement system initially funded by DECC will be recovered through this (2015/16) and subsequent levies in line with relevant depreciation.
3. The operational cost budget for the period 1 August 2014 to 31 March 2015 for the LCCC and ESC are £6.485m and £1.374m respectively.
4. This consultation covers the proposed operational cost levies for 2015/16⁶. The functions of the two companies, their governance arrangements and the methodology for calculating the levies and apportioning them to suppliers are summarised below for information and are not subject to this consultation.

¹ Investment Contracts which have been transferred to the LCCC are treated, by virtue of the regulation Contracts for Difference (Supplier Obligation) Regulations 2014, as CfDs for various purposes. Any reference to a CfD in this document is to be treated as including any such Investment Contracts.

² Contracts for Difference (Supplier Obligation) Regulations 2014, Chapter 7, Regulation 27, Page 28:
http://www.legislation.gov.uk/ukxi/2014/2014/pdfs/ukxi_20142014_en.pdf

³ Electricity Capacity Regulations 2014, Chapter 3, Regulation 44, Page 34:
http://www.legislation.gov.uk/ukxi/2014/2043/pdfs/ukxi_20142043_en.pdf

⁴ Page 9: <https://www.gov.uk/government/consultations/consultation-on-the-emr-operational-cost-levies>

⁵ Capital expenditure is defined in HM Treasury's Managing Public Money as '*Spending on the purchase of assets (including buildings, equipment and land), above a certain threshold (set by the body concerned), which are expected to be used for a period of at least one year.*'

⁶ 1 April 2015 – 31 March 2016.

5. As 2015/16 is the first full year that the companies will be operational, we have not provided any detailed comparisons with the 2014/15 budget given the value of such comparisons would be limited. However, the move from 'start up' to 'operational' will have an impact on the costs of the companies. The LCCC and ESC will publish annual reports in the spring/summer of 2015, which will provide an update on the outturn versus the 2014/15 budget and identify any over-collection of levy income returned to suppliers, or any additional grant in aid funding provided by DECC.
6. The two operational cost levies differ in some respects, notably in terms of how the basis of payment is calculated and the frequency of payment, as described in the relevant sections below. The differences relate to the requirement for the operational cost levies to mirror their principal supplier obligations (levies), i.e. the interim levy rate to fund CfDs is based on a £/MegaWatt hour (£/MWh) rate whereas the Capacity Market obligation is based on suppliers' share of electricity demand. The operational and principal levies were aligned to streamline payments for suppliers given that they are each collected at the same time. The total operating costs (including applicable depreciation) proposed to be recovered through the levies for 2015/16 are **£12.007m** for the LCCC and **£3.891m** for the ESC.
7. We anticipate the total impact of the LCCC and ESC operational costs on household electricity bills to be around £0.18 in 2015/16 (at 2014 prices) which equates to less than a 0.05% increase in average household electricity bills. We would expect similar percentage impacts for medium-sized businesses and for energy-intensive users (except any that become exempt during 2015/16). Government intends that energy-intensive users will be exempt from contributing to CfD operational costs (and the principal levies) from 1 October 2015 subject to State Aid clearance.
8. The Energy Act 2013⁷ sets out that the Regulations for the operational cost levies are "affirmative" which means that any amendment to them has to be publicly consulted on and then approved by Parliament. Our intention is that, taking account of the outcome of this consultation, legislation to amend the Regulations to reflect the agreed 2015/16 levies will be laid in Parliament along with other EMR regulations in early 2015. The intention is that the amended Regulations will come into effect from 1 April 2015. However, if it is not possible to complete the parliamentary process for amending the Regulations before the pre-election recess, the levies that are in legislation as at 1 April 2015 will continue to apply until such time as the Regulations are amended to include the 2015/16 levies.
9. *Part 1* of this document describes the functions of the LCCC and ESC, how the two companies are governed, some of the assumptions underpinning the budget, and the timing for collecting the levies.
10. *Part 2* sets out an estimate of the LCCC's operating costs in 2015/16 and an estimate of electricity demand in Great Britain (GB)⁸ over the same period (the levy year). This allows a £/MWh rate to be calculated in line with the Supplier Obligation and to be included in legislation.

⁷ The Energy Act (2013) http://www.legislation.gov.uk/ukpga/2013/32/pdfs/ukpga_20130032_en.pdf

⁸ We expect implementation of CfDs in Northern Ireland to start from 1 April 2017.

11. *Part 2* also sets out an estimate of the ESC's operating costs in 2015/16, which will be set in Regulations as the amount collected through the supplier obligation based on market share.

Catalogue of consultation questions

Consultation Question	
1.	Do you have any comments on the LCCC costs outlined?
Consultation Question	
2.	Do you have any comments on the forecast electricity demand from which the £/MWh levy rate for LCCC is derived?
Consultation Question	
3.	Do you have any comments on the ESC costs outlined?

Part 1: Low Carbon Contracts Company and Electricity Settlements Company operational cost levies

Timing of the levies and costs covered

12. Under the Contracts for Difference (Supplier Obligation) Regulations 2014 and the Electricity Capacity Regulations 2014, Parliament has approved the recovery of the operational costs of the LCCC and ESC through a supplier levy. The Electricity Capacity Regulations only specified the method for achieving this in the first financial year of the ESC's operation (2014/15) – the forthcoming Electricity Capacity (Supplier Payment) Regulations 2014 will set out the enduring method by which this levy is collected.
13. In the last consultation on the LCCC & ESC's operational costs, we set out that DECC would fund all costs of the LCCC (then referred to as the CFD Counterparty) up to 1 August 2014 and would not seek to recover the costs up to 31 March 2015 of building the CfD settlement system. We also set out that the ESC's costs would be funded by DECC up to 1 August 2014 and that all operational costs, including the depreciation of all assets initially funded by DECC (including the ESC settlement system) would be charged through subsequent levies. That consultation set out the reasons for the different approaches to recovering settlement system costs⁹. This approach continues to be reflected in this consultation. This means that:
- Because the companies are now operational, this budget reflects that no more set-up costs will be met by DECC. This means that, for example, system updates or changes in response to policy development will be met through the operational cost levy.
 - Subject to the paragraph above, both levies include a depreciation charge on the capital expenditure initially funded by DECC with amounts received by the companies in respect of the depreciation being repayable to the Department.

Company functions

14. Both the LCCC and the ESC are companies limited by shares that are wholly owned by the Secretary of State for Energy and Climate Change. The LCCC and the ESC currently share a number of common resources to minimise overall costs, but they remain legally separate entities. For example, at present all administrative functions of the ESC are provided by the LCCC, with the cost of these functions being recovered by the LCCC through a recharge mechanism.

⁹ Page 9:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298354/CFD_Counterparty_and_Electricity_Settlements_Company_operational_costs.pdf

15. The payment and settlement functions for both companies will be provided under a contract by a wholly owned subsidiary of ELEXON Ltd (EMR Settlement Ltd), which has been designated by the Secretary of State as the EMR Settlement Services Provider. The LCCC and the ESC will retain overall responsibility and accountability for these functions.
16. Examples of the activities the LCCC will be undertaking in 2015/16 are as follows:
- Setting the quarterly supplier obligation interim rate and reserve fund payments;
 - Receiving the operational cost and supplier obligation levies from April 2015;
 - Dealing with requests for minor and necessary modifications to CfDs pre-allocation;
 - Managing Investment Contracts and signing and managing CfDs;
 - Metering verification for any private network generators that have been allocated a CfD;
 - Approval and ongoing monitoring of Fuel Monitoring, Sampling and Sustainability proposals for relevant CfD holders;
 - Making payments to generators under CfDs;
 - Implementing the EIs and Green Imports Exemptions from the Supplier Obligation through changes to the settlement system during 2015; and
 - In 2015/16, continuing to provide services at cost to the ESC.
17. Examples of the activities that the ESC will be undertaking in 2015/16 are as follows:
- Conducting post-auction metering tests on capacity providers with an agreement from the 2014 auction that either have complex sites or are not party to the Balancing and Settlement Code (BSC), including providers that use balancing services or bespoke metering configuration solutions;
 - In winter 2015/16, commencing metering tests on providers that have been successful in the 2015 transitional arrangements (TA) auction;
 - During winter 2015/16, holding and monitoring credit cover from both applicants to the TA and to the 2015 Capacity Auction;
 - Finalising the Capacity Market settlement modules being delivered by the Settlement Services Provider in time to make the first capacity payments to successful providers from the 2015 TA auction in the following financial year (September 2016); and
 - Determining, if necessary, Capacity Market settlement disputes relating to the functions of the Settlement Services Provider.

Governance

18. The Boards of the LCCC and the ESC, which comprise the same members, are responsible for each of the companies. The Boards have recruited a management team with relevant commercial experience to ensure the efficient management and delivery of each of the companies' functions. The companies do this within the objectives set out within their shareholder framework documents, which include the guiding principle that in carrying out activities the companies shall seek, in respect of the LCCC, to maintain investor confidence in the CfD regime and, in the case of ESC, maintain market participants'

confidence in the capacity market settlement, and, in both respects, minimise costs to consumers.

19. Transparency and scrutiny of the two companies' operational costs will be achieved through the annual consultation on the operational cost levies and the publication of each company's audited annual accounts. Ultimately, the operational costs of each body will also be subject to the approval of Parliament, as the operational levies are amended in Regulations annually.
20. As Government-owned companies, the LCCC and ESC will be subject to the requirements of Government's framework for managing public money¹⁰.
21. As principal Accounting Officer (AO), DECC's AO will remain accountable to Parliament for the performance of the two companies along with the CEO who has been appointed as their AO. The companies report to DECC on a regular basis to ensure the companies are run efficiently and effectively and therefore provide good value for money.
22. The relationship between the two companies and DECC is captured in separate Shareholder Framework Documents published on their websites¹¹.

Collection of the levy in 2015/16

23. The operational cost levies have been designed to be consistent with the principal supplier obligations for the CfD regime and the Capacity Market.

Low Carbon Contracts Company operational cost levy collection

24. From 1 April 2015 onwards, the LCCC's operational costs will be collected alongside the principal supplier obligation in the same daily invoice using the same settlement systems. The Settlement Service Provider will administer the collection process.
25. Operational costs will be apportioned to suppliers based on the volume of electricity supplied in the levy year. The levy rate charged will be based on total forecast electricity demand for 2015/16 as set out in Part 2 below.
26. As the levy rate is based on estimates of the LCCC's expenses and overall electricity supply, the amount collected is unlikely to match actual expenditure. As set out in the Contracts for Difference (Supplier Obligation) Regulations 2014, any surplus at year-end will be reimbursed to suppliers (likely to be offset against payments due to the LCCC the following year). Where there is a deficit Government will look to the LCCC to manage its costs from within its own budget, including re-prioritising spend where necessary. Government may also increase the levy in-year if there is a significant discrepancy between projected levy income and estimated expenditure, but DECC would have to publicly consult on this as amended regulations would be necessary to make any change to the levy rate.

¹⁰ Available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212123/Managing_Public_Money_AA_v2_-_chapters_annex_web.pdf

¹¹ See <https://lowcarboncontracts.uk> and <https://electricitysettlementscompany.uk>

Where appropriate, and solely at its discretion, DECC can provide the company with Grant-in-Aid to cover any levy deficit or unplanned expenditure.

Electricity Settlements Company operational cost levy collection

27. From April 2015 the Capacity Market operational cost levy will be collected on a monthly basis, with the Settlement Service Provider administering the collection process. Operational costs will be budgeted and the levy set for the period April to March even though the principal levy will be based on capacity market delivery years which run from October to September.
28. As set out in the forthcoming Capacity Market (Supplier Payments) Regulations 2014, suppliers will initially be levied based on their share of demand during the previous winter's 'period of high demand' (4-7pm on weekdays between November and February). This will then be revised with actual demand data from the winter of that financial year. Any surplus at year-end will be reimbursed to suppliers by issuing credit notes against the following year's levy. As with the LCCC, where there is a deficit Government will look to the ESC to manage its costs from within its own budget, including re-prioritising spend where necessary. Government may also increase the levy in-year if there is a significant discrepancy between the projected levy income and estimated expenditure, but DECC would have to publicly consult on this and obtain Parliamentary approval for any change in the amount that can be recovered through the levy. Where appropriate, and solely at its discretion, Government can provide the ESC with Grant-in-Aid to cover any levy deficit or unplanned expenditure.

Key assumptions underpinning cost estimates

Low Carbon Contracts Company assumptions

29. The cost estimates presented in this consultation document are underpinned by a number of assumptions which are subject to some uncertainty. In setting the budget, a balance needs to be struck between ensuring the LCCC has sufficient resources to perform its role effectively while minimising the risk of over-collection (notwithstanding that any surplus will be reimbursed to suppliers) and the uncertainty that could be caused for suppliers by the need to change the levy rate within year.
30. If there is a material change to estimated costs between the publication of this consultation and the laying of regulations in Parliament, DECC will publish an amendment to this consultation. In these circumstances responses will be required by the latest of either two weeks from publication of the amended consultation, or by the original closure date.
31. The number of CfD contracts that the LCCC will manage in 2015/16 is currently uncertain as it will depend on the number of successful generators coming forward in the first CfD allocation round in October 2014. Although consideration has been given to a range of possible outcomes based around the CfD Budget Notice published by DECC on 2 October¹², there is a base level of funding required to support the successful operation of the LCCC's processes and ensure regulatory compliance notwithstanding the volume of contracts. The LCCC will be resourced to manage a reasonable range of outcomes and

¹² CFD Budget Notice: <https://www.gov.uk/government/publications/cfd-budget-notice>

ensure the efficient operation of its key activities. In addition to contracts agreed following the October 2014 allocation round the LCCC is expected to be managing the Hinkley Point CfD (subject to the successful outcome of any negotiation) and 14 FID Enabling for Renewables Investment Contracts.

32. The LCCC will recharge for the share of its resources it provides to the ESC in 2015/16.
33. LCCC is VAT registered and will be able to recover VAT only on its revenue derived from recharging a proportion of its operating costs to the ESC. Therefore, the vast majority of LCCC's expenditure will incur irrecoverable VAT.

Electricity Settlements Company assumptions

34. The operational costs for the ESC set out in this consultation document are based on the assumption that the first Capacity Auction will take place in late 2014 as planned. The activities that the ESC is expected to undertake during 2015/16 are set out in paragraph 17.
35. If there is a material change to estimated costs between the publication of this consultation and the laying of Regulations in Parliament, DECC will publish an amendment to this consultation. In these circumstances responses will be required by the latest of either two weeks from publication of the amendment, or by the original closure date.
36. The ESC is not registered for VAT and as such will not be able to recover VAT on any of its expenditure.

Part 2: Estimated costs

Low Carbon Contracts Company

37. The total estimated budget for the Low Carbon Contracts Company for 2015/16, is **£12,007,000**. A breakdown of total cost by type is shown in table 1.

Table 1

Description	Estimated costs 2015/16 £'000
Premises costs	294
Payroll costs	4,493
Settlement Service Provider costs	3,707
IT & telephone costs	1,071
Professional and legal fees and contractors	2,257
Insurance	215
Other costs	825
Depreciation ¹³	499
Electricity Settlements Company cost recharge	(1,355)
Total	12,007

¹³ Depreciation charge includes depreciation from capital costs in 2014/15 and 2015/16 – see paragraph 53.

Premises costs

38. Government policy is that, where possible, existing Government estate should be used by public sector bodies rather than entering into new leases for property. For this reason, the LCCC is based at Fleetbank House, Blackfriars¹⁴, where it rents accommodation from the Department of Business, Innovation and Skills (BIS). The total cost of the rental agreement is £25k per month, which is inclusive of rent, council tax and service charge (which includes heating, water and power supply). There was a 4 month rent-free period up to July 2014 and this reduction in costs has been spread over the full lease period of 5 years which reduces the overall charge to suppliers. Dilapidation costs¹⁵ will be charged to the operational cost levy in the financial year in which they are incurred, which is expected to be 2017/18.

Staffing/payroll costs

39. Estimated staff costs for 2015/16 are just under £4.5m. This cost includes the gross salary, National Insurance, pensions, bonuses, payroll outsourcing, benefits and recruitment, a breakdown of which is included in Table 2. Whilst the LCCC is classified as a public sector organisation, its staff are not Civil Servants and so they have separate terms and conditions, pay and benefit packages.

40. As the volume of its contract management work increases, the LCCC may in future years require more staff and more bought in legal/technical support. However, it is expected that the number of employees (excluding non-executive Board members) will remain at 41 (plus 2 contractors) during 2015/16. The organisational structure has been designed to ensure that the LCCC has the optimal structure for supporting expected operational activities at the least cost. Senior salaries have been benchmarked against organisations carrying out similar activities and against other relevant Government arm's length bodies. The salaries of senior executives will be published in the companies' annual reports and accounts, and where those salaries are £150k and above they will also be published online by the Cabinet Office¹⁶ in the interests of transparency. In accordance with Government rules, any pay that is above the Prime Minister's salary will be cleared by DECC Ministers and, where such pay relates to Ministerial Board appointments, additionally by HM Treasury Ministers.

¹⁴ The location of the LCCC and ESC will be reviewed within 3 years to decide whether to locate the companies outside London and the South East within 5 years of operation.

¹⁵ Dilapidation costs are the costs that will be incurred at the end of the rental period when moving out of a leased building and needing to restore the rental space back to its original state.

¹⁶ Salaries of £150k and above will be included in data published by the Cabinet Office on high earning senior officials: <https://www.gov.uk/government/publications/senior-officials-high-earners-salaries>

Table 2

Description	Estimated costs 2015/16 £'000s
Gross salary costs ¹⁷	3,222
Employers' National Insurance	479
Employee benefits ¹⁸ , bonus ¹⁹ & pension ²⁰	670
Recruitment costs	120
Payroll outsourcing	2
Total payroll costs	4,493

Settlement Service Provider costs

41. The operational costs of the Settlement Service Provider have been estimated at £3.7m for 2015/16. These relate to the daily collection of the operational cost levy and principal Supplier Obligation and making payments to generators under CfDs. The procurement and implementation of the settlement systems that will be used are being funded by DECC in 2014/15. Capital expenditure in 2015/16 on the settlement system is described in more detail at paragraph 53.
42. Other costs reflected in table 3 include metering costs, reference price provision, and audit costs. Steria UK are competitively procured contractors of Elexon working as their IT and business process service provider to develop, maintain and operate the settlement systems for the Government's Electricity Market Reform (EMR) policies

¹⁷ Includes Board costs

¹⁸ Includes life assurance, private medical cover, personal accident cover and income protection insurance.

¹⁹ The amount budgeted is based on bonuses of up to 20% salary for 4 senior executives and 5-10% for all other staff, if all staff achieve a bonus. Bonus payments will be subject to staff meeting agreed performance criteria.

²⁰ The pension employer contribution rate is 10%.

Table 3

Description	Estimated costs 2015/16 £'000s
Elexon staff costs	2,153
Overheads	297
Steria operational costs	789
Other costs	468
Total settlement costs	3,707

IT and telephone operational costs

43. Total IT and telephone costs for 2015/16 are estimated at £1m. Operational IT and telephone costs are incurred for web hosting, support and maintenance of IT infrastructure and end user equipment, telephony running costs and mobile costs.

Professional services, legal fees and contractors

44. The total cost of professional and legal fees and contractors has been estimated at £2.3m. Professional fees include areas such as carrying out audit, assurance and compliance activities, technical and legal advice required to effectively manage the contracts, and other compliance and regulatory policies. A breakdown of these costs is outlined in Table 4.

45. The budget includes the costs of legal support and technical advice expected to be required to support the contract management activity throughout 2015/16 (an example of technical advice is consulting engineering support and generation modelling capability). Audit assurance and compliance activities will include NAO audit costs as well as internal audit and compliance activity.

46. Fuel monitoring costs relate to services (including sampling and sustainability), which are currently planned to be provided by Ofgem and the budget also includes charges associated with meter audits of private network generators.

47. The contractor costs relate to two contractor roles providing support as Finance and IT processes become established during the early stages of the LCCC's operations. There is also some resource allocated to implementing the system and process changes required as the LCCC moves towards 'business as usual'. The number of contractors required by the company has fallen significantly since its set-up and by March 2015 it is expected that 93% of staff will be permanent.

Table 4

Description	Estimated costs 2015/16 £'000s
Professional services and legal fees	826
Technical advice ²¹	312
Audit, assurance and compliance	497
Fuel monitoring, metering and biomass sustainability.	360
Contractors	263
Total professional fees and contracted labour	2,257

Insurance

48. An insurance broker has been engaged under the Crown Procurement framework and the renewal of all insurance policies, in August 2015, will be procured on a commercial basis.

Other costs

49. Other costs include stakeholder engagement and communications, travel and subsistence, training, stationery, and security etc. for which £325k has been allocated. Almost half of this amount has been allocated for facilitation of engagement with industry to ensure the LCCC meets its obligations under EMR regulations and delivers on settlement activities. The LCCC will also continue inclusive stakeholder engagement activities such as industry workshops and relationship management.

50. As the LCCC's operational cost levy is based on a £/MWh rate, its levy funding will vary with the amount of electricity actually supplied. A £500k contingency has been included in the budget to cover any reduction in volume of electricity supplied (e.g. due to warm weather). This contingency is based on a c. 4% reduction between forecast and actual supply. It is proposed that this contingency will only be used for the purposes of dealing with a deficit in levy income caused by the electricity supplied being lower than estimated. The LCCC's requirement to use this contingency will be monitored by DECC and any

²¹ E.g. engineering advice on whether projects are achieving required construction milestones.

surplus at year-end will be returned to suppliers in the same way as for any underspend in terms of the LCCC's budgeted operational costs.

51. For 2015/16 there will be additional uncertainty in the forecast electricity demand as it will include a deduction for the electricity supplied by energy intensive industries, which could access an exemption from the operational cost levy from October 2015. At this stage it is not possible to accurately estimate this deduction and as a result there may be more of a variance between the forecast and actual demand than would otherwise be the case, which the proposed contingency would also cover.

Electricity Settlements Company cost recharge

52. In order to maximise efficiencies in the operation of LCCC and ESC, it was decided that the ESC, rather than being developed independently, would contribute at cost for the use of shared facilities, back-office functions and the use of staff it requires for its corporate functions and operational activities. The allocation of the recharge agreement is explained in more detail under ESC costs.

Capital expenditure and depreciation

53. DECC will continue to provide grants in aid to the LCCC to fund capital expenditure planned for 2015/16. Any levy that is subsequently collected in respect of the cost of depreciating these assets will be repaid to DECC in the years it is collected. Capital expenditure planned for 2015/16 is estimated at £1,116k. The majority of the planned capital expenditure is related to Elexon's work on settlement systems, primarily functionality in relation to the Green Electricity Imports Exemption²², the Electricity Intensive Industries exemption²³ and the CfD for private wire networks²⁴. The levy proposed in this consultation includes £499k for depreciation, of which £107k relates to capital expenditure in 2015/16 and the remainder to non-CfD settlement system capital expenditure in 2014/15.

Low Carbon Contracts Company levy rate

54. As set out above, we are using electricity demand projections for 2015/16 as a basis to calculate the £/MWh operational cost levy rate.
55. The LCCC's operational costs (and the Supplier Obligation) will be collected on the basis of gross demand, which is a new definition that captures total demand rather than demand net of embedded generation. However, the projected gross demand figure for 2015/16 is not yet available to allow for the calculation of a levy rate on this basis for inclusion in this consultation. We are therefore using projected net demand of **304,765,716 MWh**^{25 26} for

²² <https://www.gov.uk/government/consultations/emr-changes-to-the-cfd-supplier-obligation>

²³ <https://www.gov.uk/government/consultations/emr-changes-to-the-cfd-supplier-obligation>

²⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/348208/20140812_-_PNG_Government_response_to_issues_raised_by_stakeholders_FINAL.pdf

²⁵ This forecast electricity demand figure is based on a National Grid's 'gone green' scenario for 2015/16.

²⁶ To take account of expected EII exemptions from operational cost levy payments, accessible from October 2015, a reduction has been made to the demand forecast based on estimated EII electricity usage for October 2015 - March 2016. BIS estimate that 20 TWh of electricity per annum will be eligible for exemption at a rate of 85%, so National Grid's demand projections have been reduced by 8,500,000 MWh (85% of 10 TWh) to take this into account.

2015/16 in order to calculate the levy rate. If updated forecasts for net demand, gross demand or a robust proxy for gross demand are available during or following this consultation, we will use the latest available projections to set the rate and confirm this in the Government Response to this consultation.

56. Based on estimated costs of **£12,007,000** and forecast electricity supply of **304,765,716 MWh**, the operational cost levy rate will be **£0.0394/MWh** for 2015/16.

Question 1: Do you have any comments on the LCCC costs outlined?

Question 2: Do you have any comments on the forecast electricity demand from which the £/MWh levy rate for LCCC is derived?

Electricity Settlements Company

Table 5

Description	Estimated costs 2015/16 £'000s
Settlement Services Provider costs	1,281
Low Carbon Contracts Company cost recharge ²⁷	1,626
Insurance	59
Other costs	240
Depreciation	685
Total Operating Costs	3,891

Settlement Services Provider costs

57. The costs of the Settlement Service Provider include the costs of administering and monitoring bid bonds and collateral in advance of the Capacity Market auction, collecting the operational cost levy for 2015/16, and conducting pre and post auction meter checks for Demand Side Response.

58. The costs of upgrading functionality of the settlement system will be treated as capital expenditure which will be funded through a grant in aid provided by DECC (and repaid through depreciation charges over time). This is covered in paragraphs 66-67.

59. Other costs include metering assurance and operational audit costs.

²⁷ Includes VAT

Table 6

Description	Estimated costs 2015/16 £'000s
Elexon staff costs	606
Overheads	297
Steria operational costs	198
Other costs	180
Total settlement costs	1,281

LCCC service cost recharge

60. In order to reduce costs as far as possible the ESC will share services and back-office functions with the LCCC: it does not currently intend to have any employees. Under this arrangement, the ESC pays the LCCC to provide the functions it requires. This cost is based on an estimate of the time LCCC employees will spend on ESC activities during the levy period, together with an appropriate allocation of overhead costs (including rent, service charge, ICT infrastructure support, IT support and telephony). It also includes a proportion of the salaries of the Board members who will also be dividing their time between the two companies. The LCCC will undertake these activities on behalf of ESC and the ESC Board will retain responsibility and accountability for the quality and cost of services provided by the LCCC.
61. This avoids the ESC replicating activities that the LCCC already has. However, the arrangements must ensure that the ESC has sufficient resources to fulfil its purpose and activities under the shareholder framework document and legislation for the 2015/16 period. This will include costs incurred on all activities in order that ESC can perform all of its functions in relation to the capacity market, for example managing the settlement services provider contract and any other services providers (lawyers, auditors etc).
62. For 2015/16 the cost for the period which LCCC and ESC have agreed will be incurred by LCCC and allocated to ESC is £1,355k (plus VAT) and will be payable by ESC in monthly instalments. In general this agreed cost for the period shall be fixed and not subject to amendment. If the costs incurred in undertaking ESC functions proves to be materially in excess of that estimated, LCCC shall be entitled to amend the cost rechargeable to reflect this. If the costs of undertaking ESC functions proves to be materially less than estimated resulting in actual cost savings by LCCC, the cost payable by ESC shall be reduced accordingly.

63. This cost allocation reflects the estimated cost to LCCC of the ESC functions based on the people and associated office infrastructure including:

Staff and support:

- All support functions (Finance, HR and IT) are recharged at 20% of payroll costs (basic salary plus pension and NI);
- All other employees including the Chair and Senior Independent Director are charged at 20% with the exception of the Supplier Obligation modelling team (0%) and contract management team (0%);
- A policy Manager is charged at 50% reflecting a core role focussing on the capacity market;
- The weighted percentage of FTE time spent supporting ESC is calculated as 16.78%.
- Professional and legal fees the main portion of which relates to audit and other assurance and compliance activity.

Other costs:

- Share of premises (including rent, rates and service charge) based on the weighted percentage of FTE support of 16.78% applied to these costs.
- Use of assets charge equivalent to the depreciation charged on capital spend associated with non-settlement systems (i.e. core IT infrastructure, telephony and premises)
- Shared systems such as website or financial systems at varying percentages (excluding Supplier Obligation Financial Model and CfD contract management system).
- IT & Telephony costs based on the weighted percentage of FTE support of 16.78% applied to the total cost base.
- Core systems annual maintenance and support costs which have been apportioned on the basis of usage of the system.
- Other costs including printing, stationery, training, travel & subsistence and stakeholder management costs which have been allocated on the basis of the weighted percentage of FTE (16.78%).

Insurance

64. An insurance broker has been engaged under the Crown Procurement framework and renewal of all insurance policies, in August 2015, will be procured on a commercial basis.

Other costs

65. In addition to the above there are a number of other costs which the ESC will incur. These relate primarily to consultancy for ongoing support and stakeholder management and engagement costs.

Capital expenditure and depreciation

66. DECC expects to provide grants in aid to the ESC to fund capital expenditure planned for 2015/16. Any levy that is subsequently collected in respect of the cost of depreciating these assets will be repaid to DECC in the years it is collected. The capital expenditure planned for 2015/16 relates to work on policy changes associated with private wire, termination

rules, Demand side baseline methodology and weighting factor changes which will result in settlement system functionality changes.

67. The amount of capital expenditure planned for 2015/16 is £302k. The levy proposed in this consultation includes £685k for depreciation, of which £107k relates to capital expenditure in 2015/16 and the remainder to Capacity Market settlement system capital expenditure in 2014/15.

Electricity Settlements Company levy

68. The total amount levied on suppliers will be equal to the budget included in the Capacity Market Regulations. The amount charged to suppliers will be based on each supplier's customer demand between 4 and 7pm on weekdays between November and February, reflecting the approach taken for the main Capacity Market Supplier Charge. The levy will be collected on a monthly basis and will be initially based on supplier's demand from the previous winter, which will be 'trued up' by the Settlement Service Provider when actual data is available at the end of the winter period.

Question 3: Do you have any comments on the ESC costs outlined?

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Department of Energy & Climate Change
3 Whitehall Place
London SW1A 2HD
www.gov.uk/decc
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