



Department
of Energy &
Climate Change

CFD Counterparty and Electricity Settlements Company operational costs 2014/15

Consultation on the operational cost levies

March 2014

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URN [14D/065]

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Introduction

Introduction – the budgetary proposals for the CFD Counterparty and Electricity Settlements Company

In October 2013, the Government published a consultation on its proposals for implementing Electricity Market Reform (EMR)¹. The key mechanisms to implement EMR include Contracts for Difference (CfDs) to unlock investment in low carbon technologies, and a Capacity Market (CM) to ensure security of supply. Two Government-owned companies are being set up as part of the implementation of the two schemes: a CFD Counterparty Company (the ‘CFD Counterparty’) to manage CfDs (including Investment Contracts²) with generators and manage payments between suppliers and generators, and an Electricity Settlements Company³, which will be responsible for payment flows under the Capacity Market, including making capacity payments to capacity providers, controlling collateral draw-down and managing auction bid bonds and collateral.

The EMR Implementation Consultation described our proposals for recovering the CFD Counterparty and the Electricity Settlements Company operational costs through levies on electricity suppliers. The consultation described the proposed timing of and mechanisms for setting and collecting these levies. That consultation closed on 24 December 2013 and we anticipate that the Government’s response will be published in early summer 2014.

This consultation covers only the operational cost levies for 2014/15. The budgets presented in this document are based on the design proposals presented in the October consultation. It is important to note that policy may be subject to changes due to the outcome of the October consultation following the contributions provided by respondents. Furthermore, the operational cost levies will be included in the relevant sections^{4, 5} of the Regulations which were included as part of the EMR Implementation Consultation. The Energy Act 2013 sets out that the Regulations are “affirmative” which means that they will need approval from Parliament before they can come into force and any amendment to them in the future will be consulted on and approved by Parliament.

The functions of the two bodies, the governance arrangements and the methodology for calculating the levies, and the split between suppliers are set out below for information and are not subject to this consultation. These policy areas have already been covered in the EMR Implementation Consultation and have been included for reference. The purpose of this

¹ <https://www.gov.uk/government/consultations/proposals-for-implementation-of-electricity-market-reform>

² For the purposes of this document, Investment Contracts are included within references to CfDs as they are based on the standard form of CfD despite being set up prior to the enduring CfD regime. Investment contracts include FIDeRs and new nuclear.

³ The Electricity Settlements Company has been known in previous documents as the Capacity Market Settlement Body. It was incorporated on 26th March 2014.

⁴ Chapter 7, Regulation 27, Page 28:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/249562/cfd_supplier_obligation_regulations_2014si.pdf

⁵ Chapter 5, Regulation 25, Page 13:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/249563/electricity_capacity_payment_regulations_2014_si.pdf

document is to consult on the proposed budgets and supporting assumptions which are outlined below.

To allow for the levies to be included in Regulations to be laid in summer 2014 and give notice of the proposed levies to suppliers, we are publishing the operational cost budgets prior to issuing a response to the October 2013 consultation on the implementation design and regulations.

The two operational 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 rationale for the differences is that they both mirror the larger levies (i.e. the supplier obligation and Capacity Market supplier charge) and are collected along with these, thereby streamlining the approach for suppliers. The total operating costs proposed to be recovered through the levies for 2014/15 of the two companies are **£6,485,000** for the CFD Counterparty and **£1,374,000** for the Electricity Settlements Company.

These budgets cover financial year 2014/15, however, bill impacts are calculated on calendar years. We anticipate the impact on household electricity bills to be around £0.05 in 2014 (August – December, from when the regulations are in force to the end of the calendar year). The levy is only set as part of this budget until end March 2015. If we assume the costs in the remainder of 2015 are similar to the first quarter, this would result in an annual bill impact of around £0.15 in 2015 (2012 prices, less than 0.05% increase in average household electricity bills). We would expect similar percentage impacts for medium-sized businesses and energy-intensive users (except those exempt from April 2015). Energy-intensive users will be contributing to operational costs for the first financial year (until April 2015), whereupon those eligible for exemptions will benefit from them.

Part 1 of this document describes the functions of the CFD Counterparty and Electricity Settlements Company, how the two entities will be governed and some of the assumptions underpinning the budget, for example the number of CfD contracts, the number of participants in the Capacity Market, and the timing for collecting the levies.

Part 2 sets out an estimate of CFD counterparty's operating costs in 2014/15 and an estimate of electricity demand in Great Britain (GB)⁶ during the period over which the levy will be recovered. This allows a £/MegaWatt hour (MWh) rate to be calculated in line with the current proposal for the Supplier Obligation. If the design of the Supplier Obligation were to change materially, we may set an absolute budget figure in Regulations as opposed to setting out a £/MWh rate in Regulations.

Part 2 also sets out the Electricity Settlements Company's estimated annual costs, which will be set in Regulations as an overall amount in line with the main Capacity Market supplier charge.

Part 3 sets out the anticipated cost contingencies for the Electricity Settlements Company.

Subject to the outcomes of this consultation, the Regulations will be laid in Parliament along with other EMR regulations in June 2014 and come into effect at the end of July or the start of August 2014.

The levies will apply until they are amended through the Regulations. We expect to publish the consultation on the levies for 2015/16 in October/November 2014.

⁶ As outlined in the October consultation, implementation of CfDs in Northern Ireland will follow that of Great Britain to a later timeframe.

How to respond to this consultation

The response period for this consultation is four weeks, closing on Thursday 24th April 2014, due to the limited and focussed nature of the material that is being consulted on, which builds on the policy within the EMR Implementation Consultation. As these costs are being charged to suppliers as a levy it is important to ensure that these proposals receive appropriate scrutiny through this consultation. 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
Joshua Atkins, Area 4A
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.

Part 1: CFD Counterparty and Electricity Settlements Company operational cost levies

Timing of the levies and costs covered

The CFD Counterparty is currently being setup and is expected to be operational from 1 August 2014. The processes involved in setting up the company began prior to Royal Assent of the Energy Act 2013 and Parliamentary approval for the company's costs to be recovered through a levy. The costs incurred in the period before Royal Assent have therefore been met by DECC. DECC will fund all costs of the CFD Counterparty up to 1 August 2014 (or the date of designation if later) and the set-up costs of the CFD Counterparty's settlement system to 31 March 2015.

The Electricity Settlements Company was proposed in the October consultation⁷. In contrast to the timing of the set-up of the CFD Counterparty and the funding of set-up costs by DECC, Parliament has approved the cost recovery powers for the Electricity Settlements Company prior to the set-up work for Electricity Settlements Company commencing. Had the CfD timetable not required set-up costs prior to Royal Assent of the Energy Act 2013, both bodies would be funding their set-up costs through the levy; as this was not the case, only the Electricity Settlements Company will be funding itself this way.

The Electricity Settlements Company's costs will be funded by DECC up to 1 August 2014 or when Regulations come into action. All operational costs, including depreciation on the Electricity Settlements Company settlement system costs from 1 April 2014 will be charged to the levy after 1 August 2014 (or when Regulations come into force if later). The timing of the Electricity Settlements Company's set-up was brought in line with that of the CFD Counterparty in part so as to reduce the costs associated with establishing the systems which the two companies will share. It is also crucial that both bodies are effectively set up for the enduring regimes.

From 1 August 2014 both bodies will be funded through a levy on electricity suppliers.

The cost estimates presented here only include the costs that will be recovered through the levy in its first 8 months of operation, i.e. costs incurred between 1 August 2014 and 31 March 2015. Settlement system set-up costs will be jointly borne by the Electricity Settlements Company and CFD Counterparty. This is explained in more detail within the budgets. Due to the reasons already outlined, the Electricity Settlements Company will be funding these settlement system set-up costs partly through the levy whilst the CFD Counterparty will only use DECC funding.

Company functions

As set out in the October consultation, both the CFD Counterparty and the Electricity Settlements Company will be, standalone private limited companies that are wholly owned by

⁷ Page 137:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255254/emr_consultation_implementation_proposals.pdf

DECC. Whilst DECC is the sole shareholder of the CFD Counterparty and the Electricity Settlements Company, they are to remain legally separate. We anticipate that the CFD Counterparty and the Electricity Settlements Company will share a number of features and services so as to minimise their cost to the taxpayer and industry. For example, in the first year we expect all administrative functions of the Electricity Settlements Company to be provided by the CFD Counterparty and for these costs to be recharged.

The CFD Counterparty will be responsible for the following activities:

- Setting the supplier obligation rate, reserve fund and insolvency reserve;
- Receiving the operational cost and supplier obligation levies;
- Signing and managing CfDs (including Investment Contracts once transferred);
- Payment and settlement of CfDs;
- Coordinating CfD implementation; and
- In 2014/15, providing services at cost to the Electricity Settlements Company.

The Electricity Settlements Company will be responsible for the following activities:

- Overall accountability and control of the Capacity Market settlement process;
- Administering bank accounts used for managing the Capacity Market (holding bid-bonds, making payments, etc.);
- Managing contracts with the Settlement Services Provider for Capacity Market activities;
- Determining Capacity Market settlement disputes relating to the functions of the Settlement Services Provider; and
- Monitoring and reviewing the regulations relating to settlement functions of the Capacity Market and identifying and reporting to the Secretary of State any recommended changes.

The payment and settlement functions for both bodies will be contracted from a subsidiary of ELEXON Ltd following its designation by the Secretary of State as the EMR Settlement Services Provider. The CFD Counterparty and the Electricity Settlements Company will retain overall responsibility and accountability for these functions.

Governance

The Boards of the CFD Counterparty and the Electricity Settlements Company, which we expect to comprise the same members, will be responsible for each of the companies. The Boards will recruit a management team with relevant commercial experience to ensure the effective management and delivery of each of the companies' functions.

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.

As Government-owned companies, the CFD Counterparty and Electricity Settlements Company will be subject to the applicable rules and principles in the Government's framework for managing public money⁸. We currently expect that their operations and costs will be scrutinised by the National Audit Office (NAO) and Public Accounts Committee (PAC).

⁸ Available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212123/Managing_Public_Money_A_A_v2_-_chapters_annex_web.pdf

DECC's principal Accounting Officer will remain accountable to Parliament for how the two companies perform, along with the appointed Accounting Officers of the two companies themselves. They will report to DECC against a number of operational and financial performance indicators to ensure the companies are run efficiently and effectively and provide good value for money for consumers.

The relationship between the two companies and DECC will be captured in two separate Shareholder Framework Documents which will form part of the companies' constitutional documents and shall be publicly available. These are expected to be published along with the companies' Articles of Association in July 2014. The October 2013 consultation document⁹ contains further information on the corporate governance of the CFD Counterparty and the Electricity Settlements Company.

Collection of the levy in 2014/15

The operational cost levies have been designed to maximise consistency with the main supplier obligations for the CfD regime and the Capacity Market.

CFD Counterparty operational cost levy collection

It is proposed that the CFD Counterparty operational cost levy will be charged for the period from 1 August 2014 to 31 March 2015 and collected either (a) in January, February and March 2015 or (b) collected in its entirety in March 2015. The Settlement Service Provider¹⁰ will administer the collection process. DECC will provide the CFD Counterparty with working capital to cover costs pending receipt of the levy payments.

The cost will be split amongst suppliers based on the volume of electricity supplied between 1 January and 31 March 2015. Total forecast electricity demand during these three months is set out in Part 2 below. From 1 April 2015 onwards, it is proposed that CFD Counterparty operational costs will be collected alongside the supplier obligation in the same daily invoice using the same settlement systems.

In subsequent years, the levy rate will be based on forecast electricity demand for the whole levy year. This means that, the £/MWh rate (but not the operating cost) in 2014/15 will be significantly higher than in other years (as a result of the operating costs for eight months being divided by a shorter period – three months – of estimated electricity supply).

As the levy rate is based on estimates of the CFD Counterparty's expenses and overall electricity supply, the amount that is collected may not match actual expenditure. As set out in the EMR Implementation Consultation, any surplus at year-end will be reimbursed to suppliers by issuing credit notes that will be offset against the following year's levy. Where there is a deficit Government will look to the CFD Counterparty to manage its costs from within its own budget, including re-prioritising spend where necessary. We recognise that this may not always be possible and will put arrangements in place to ensure that the CFD Counterparty remains insolvency remote if the levy is not sufficient to meet its expenditure. Where appropriate, Government may provide the counterparty with a Grant-in-Aid, and it will be able to access working capital pending receipt of the levy. Government may also increase the levy in-year if there is a significant discrepancy between the levy income and expenses, but we would consult on this and seek Parliamentary approval prior to any change.

⁹ At:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255254/emr_consultation_implementation_proposals.pdf, p. 125

¹⁰ The "Settlement Service Provider" is the new terminology for the body previously referred to as the "Settlement Agent".

Electricity Settlements Company operational cost levy collection

It is proposed that the operating cost levy will be charged and collected either (a) in January, February and March 2015 or (b) collected in its entirety in March 2015. The Settlement Service Provider will administer the collection process. DECC will provide the Electricity Settlements Company with working capital to cover costs pending receipt of the levy payments.

From April 2015 it is intended that the Capacity Market operational cost levy will be collected on a monthly basis. The main Capacity Market charge will run from October to September but the operational costs will be budgeted from April to March.

As set out in the EMR Implementation Consultation, any surplus at year-end will be reimbursed to suppliers by issuing credit notes that will be offset against the following year's levy. As with the CFD Counterparty, where there is a deficit Government will look to the Electricity Settlements Company to manage its costs from within its own budget, including re-prioritising spend where necessary. We recognise that this may not always be possible and will put arrangements in place to ensure that the Electricity Settlements Company remains insolvency remote if the levy is not sufficient to meet its expenditure. Where appropriate, Government may provide the Electricity Settlements Company with a Grant-in-Aid, and it will be able to access working capital pending receipt of the levy. Government may also increase the levy in-year if there is a significant discrepancy between the levy income and expenses, but we would consult on this and seek Parliamentary approval prior to any change.

Key assumptions underpinning cost estimates

CFD Counterparty assumptions

As the detail of EMR implementation is still evolving and this entity is a 'start-up', the cost estimates presented here are underpinned by a number of assumptions and subject to some uncertainty. In setting the budget, a balance needed to be struck between ensuring the CFD Counterparty has sufficient resources to meet estimated demand, provide a strong basis from which the company can develop and effectively perform its role in the enduring regime while minimising the risk of over-collection (notwithstanding that any surplus will be reimbursed to suppliers).

If the overall estimated costs change materially in a way that was unforeseen by this consultation document, between the publication of this consultation and the laying of Regulations in Parliament, DECC will publish an amendment to this consultation. Responses will be required by the latest of either two weeks from publication of the amendment, or by the original closure date, whichever is later. DECC would only reconsult in the highly unlikely event that the budgetary changes were of a magnitude which required it.

As mentioned above, it is anticipated that the CFD Counterparty will be operational from 1 August 2014. From August 1 2014, it is also assumed that generators will be able to approach the CFD Counterparty to request minor and necessary amendments to CfDs prior to entering the allocation process with the Delivery Body (National Grid). It is further assumed that generic CfDs allocated by the Delivery Body will be entered into and managed by the CFD Counterparty from November 2014 at the earliest. Investment Contracts are intended to be managed by the CFD Counterparty from designation onwards. The cost of managing Investment Contracts has been included in the operational cost estimates. A change to the operational date could alter the cost profile for the CFD Counterparty, with the extent of any budgetary change dependent on the start date of the operational tasks as well as the longer term requirements needed for the enduring regime.

The number of contracts that the CFD Counterparty will manage (including through modifications prior to signing) in 2014/15 is highly uncertain at this stage as it depends on the number of generators that come forward, and also whether some generators continue to use

the Renewables Obligation Scheme. During this first year of operation, the CFD Counterparty will be transferred the full management of the Hinkley Point Investment Contract and FID Enabling for Renewables Investment Contracts and will be preparing its contract management function for the enduring regime. As a result of this, any increase in standard CfD contracts in the first year would be marginal to the budget. However, it should also be noted that management of new CfD contracts in 2014/15 would be for at most one quarter of the financial year, and would be unlikely to involve any of most complicated elements of the contract management role.

The cost estimates are based on eligibility for difference payments to generators and payments from suppliers (of the CfD supplier obligation levy) commencing in April 2015.

The CFD counterparty will recharge the Electricity Settlements Company for providing the resources needed to fulfil its functions in 2014/15.

It has been assumed that, apart from the costs recharged to the Electricity Settlements Company, the CFD Counterparty will incur irrecoverable VAT on all relevant expenditure.

Electricity Settlements Company assumptions

This document is constructed on the planning assumption that the first Capacity Auction will take place in 2014/15. Beyond this, costs for the Electricity Settlements Company in 2014/15 are variable with costs for the Electricity Settlements Company in 2014/15 depending on a number of external factors. Foremost of these is the number of participants that the Electricity Settlements Company will be registering for bid bonds and collateral.

If the overall estimated costs change materially in a way that was unforeseen by this consultation document, between the publication of this consultation and the laying of Regulations in Parliament, DECC will publish an amendment to this consultation. Responses will be required by the latest of either two weeks from publication of the amendment, or by the original closure date, whichever is later. DECC would only reconsult in the highly unlikely event that the budgetary changes were of a magnitude which required it.

DECC is currently planning on laying regulations before Parliament for the Electricity Settlements Company in June with them subsequently coming into force towards the end of July or the start of August (subject to State Aid approval).

It has been assumed that the Electricity Settlements Company will incur irrecoverable VAT on all relevant expenditure, including the cost recharge from the CFD Counterparty.

Part 2: Estimated costs

CFD Counterparty

The total estimated budget for the CFD Counterparty for the start-up phase, from 1 August 2014 to March 2015, is **£6,485,000**. A breakdown of total cost by type is shown in table 1. All costs, particularly the organisational structure and IT and systems requirements, are based on an operating model which is still in the early stages of development. All costs are best estimates at this stage based upon information and benchmarks available.

Table 1

Description	8 months to 31 March 2015
	£'000
Premises costs	237
Payroll costs	2,231
Settlement Service Provider costs	258
IT & Telephone costs	362
Professional and legal fees and contractors	3,301
Other costs	342
Depreciation	20
Electricity Settlements Company cost recharge	(266)
Total	6,485

Premises costs

As set out in the EMR Implementation Consultation, Government policy is that, where possible, existing Government estate should be used rather than entering into new leases for property¹¹. For this reason, the CFD Counterparty will be based at Fleetbank House, Blackfriars, where it

¹¹ Page 127

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255254/emr_consultation_implementation_proposals.pdf

will rent accommodation from the Department of Business, Innovation and Skills (BIS). The total agreed on-going cost in the first year of the rental agreement is £25k per month. This is inclusive of rent, council tax and service charge (which includes heating, water and power supply). Premises costs also include an estimate for dilapidation costs¹².

Staffing/payroll costs

The anticipated staff costs for the period 1 August 2014 to 31 March 2015 amount to £2.2m. This cost includes the gross salary costs, recruitment costs, National Insurance, pensions, bonuses, payroll outsourcing and benefits a breakdown of which is included in Table 2. The CFD Counterparty is classified as a public sector organisation, however its staff will not be Civil Servants and as such will have separate pay, terms and conditions and benefit packages.

The company will be resourced efficiently and the recruitment of staff is to be phased over time. The number of staff employed by the company will progressively increase in-line with the functions of the company. As the contract management function increases with contract volumes, it will require more staff (and more legal/technical resources). Critical functions will be established in advance of 1 August 2014 and senior leadership roles will be filled first to allow these individuals to set up their function, prior to employees for that function starting. It is estimated that the company will have 25 employees by 31 March 2015 (plus the Non-Executive Board members). Indicative salaries have been identified through a benchmarking exercise focussed on organisations carrying out similar activities and other relevant Government arm's length bodies but also reflect that the roles will have to attract people from the private sector. Salaries for the senior positions within the company will be made available online to ensure transparency. In accordance with Government rules, any pay that is above the Prime Minister's salary will be cleared by DECC and HM Treasury Ministers.

Table 2

Description	8 months to 31 March 2015
	£'000s
Gross salary costs	1,668
Employers' National Insurance	202
Employee benefits , Bonus & Pension	322
Recruitment costs	37
Payroll outsourcing	1
Total payroll costs	2,231

Settlement Service Provider costs

Estimated Settlement Service Provider costs amount to £258k. These are incurred for calculating and invoicing the operational cost levy for the 8 months from August 2014 to March 2015 as well as preparing for the start of payments under the CfD Supplier obligation from April

¹² 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.

2015. The procurement and implementation of the settlement system are not funded through the levy; as indicated above, these costs will be funded by DECC as part of the set-up costs.

IT and telephone costs

Total IT and telephone costs are estimated to amount to £362k. Operational IT and telephone costs are incurred for the contract management system, supplier obligation forecasting systems, web hosting and other IT infrastructure and end user equipment, telephony running costs and mobile costs.

Professional services, legal fees and contractors

The total cost of professional and legal fees and contractors has been estimated at £3,301k. Professional fees include areas such as carrying out audit, assurance and compliance activities, technical and legal advice required to effectively manage the contracts, consultancy support for developing the CFD Counterparty's control framework and other compliance and regulatory policies. A breakdown of these costs is outlined in Table 3. In addition to these activities there is a small share of the cost of developing the company's operating model (most of this is incurred prior to 1 August 2014 and is therefore funded by DECC).

The contractor costs include a small amount of estimated resource cost for starting the process of refining the operating model to include Northern Ireland and the energy-intensive industries exemption (subject to state aid approval) as well as those required for the CFD Counterparty set-up team during the initial stages of operation to ensure a smooth transition. The number of contractors required by the company will change over time; we do not expect to have contractors within the company by October 2015.

The budget also includes technical and industry specific advice that is likely to be required to support the contract management activity in the first year of operation along with fuel monitoring and biomass sustainability processes¹³. This will be operational from 1 April 2015 and it is proposed to be outsourced.

The model that is being used for the provision of technical/legal advice is to not provide for all expertise to be employed within the CFD Counterparty, as it is not expected that all the different areas of advice will be required all the time. Using call-off contracts with experts for this advice means that the resource is available when it is required but the CFD Counterparty does not incur the costs should it not be required. We believe this is the most efficient way of ensuring that the CFD Counterparty has the resources available to ensure it is effectively managing CfDs.

Table 3

Description	8 months to 31 March 2015
	£'000s
Professional services and legal fees	1,490
Contractors	575

¹³ A fuel measurement and sustainability team will discuss and agree specific procedures with each CfD holder, and will then monitor and enforce compliance with set FMS procedures and sustainability criteria.

Technical advice ¹⁴	960
Audit, assurance and compliance	156
Fuel monitoring, metering and biomass sustainability.	120
Total professional fees and contracted labour	3,301

Other costs

Other costs include stakeholder engagement, travel and subsistence, training, stationery, employee referencing and security, etc. £342k has been allocated for these costs. A substantial proportion of this number has been allocated for facilitation of engagement with industry to ensure that electricity suppliers' internal systems are ready to be operational and interface with settlement systems when required, and that end-users of CfD systems are involved in systems testing and prepared to engage successfully with live systems. This estimate is based on the cost of workshops undertaken as part of the EMR Collaborative Development programme run by DECC in 2013 and industry engagement undertaken by the Green Investment Bank.

Electricity Settlements Company cost recharge

As already mentioned, the CFD Counterparty is to be established and operational before the Electricity Settlements Company. As a result it will have developed key systems, back-office functions and established a functioning office prior to the Electricity Settlements Company needing them. Consequently it is intended that the Electricity Settlements Company will pay the CFD Counterparty at cost for the use of shared facilities, back-office functions and the use of staff required by the Electricity Settlements Company for its corporate functions and activities in 2014/15, including developing the settlement systems. This cost recharge is based on an estimate of the time required from CFD Counterparty employees, together with an appropriate allocation of operating costs. It also includes a proportion of the salaries of the Board members who will also be dividing their time between the two companies.

Capital expenditure and depreciation

DECC will be providing an interest free loan to the CFD Counterparty for capital expenditure incurred after the operational date (assumed to be 1 August 2014). This loan will be repaid to DECC in the current and future years through the depreciation charged to the operational costs levy. The capital expenditure cost relates to IT expenditure (a contract management system, data warehouse, reporting and business intelligence and the supplier obligation forecasting model).

The amount of capital expenditure in the 8 months to March 2015 is estimated at £896k; the amount recovered through depreciation charged to the operational cost levy in 2014/15 is £20k.

CFD Counterparty levy rate

As set out above, we are using electricity demand data from 1 January to 31 March 2015 as a basis to calculate the £/MWh levy rate.

The forecast electricity demand from January to March 2015 is **82,929,166 MWh**. This is based on National Grid forecasts of daily GB electricity transmitted over the National Grid system

¹⁴ E.g. engineering advice on whether projects are achieving required construction milestones.

excluding station load (i.e. the power used by the generating stations). The estimate for 1 January to 31 March involved summing the individual daily forecasts of electricity transmission during that period. If National Grid updates their forecast during or following this consultation we would use the latest available forecasts.

Based on estimated costs of **£6,485,000** and forecast electricity supply of **82,929,166 MWh**, the operational cost levy rate will be **£0.08/MWh** for January to March, 2015.

Questions:

CfD1: Do you have any comments on the costs outlined?

CfD2: Do you have any comments on the forecast electricity demand from which the £/MWh is derived?

Electricity Settlements Company

Table 2

Description	8 months to 31 March 2015
	£'000
Settlement Services Provider costs	771
Counterparty cost recharge	319
Other costs	284
Total Operating Costs	1,374

Settlement Services Provider costs

The costs of the Settlement Service Provider include the costs of changes to the balancing and settlement code changes for the Capacity Market, the costs of administering bid bonds and collateral in advance of the Capacity Market auction, together with the costs for calculating and invoicing the operational cost levy for the 8 months from August 2014 to March 2015.

The costs of the settlement system are treated as capital expenditure which will be funded by an interest free loan from DECC and repaid in future years through depreciation.

Counterparty service cost recharge

In the interests of reducing the cost of EMR to industry and consumers the CFD Counterparty and Electricity Settlements Company have been developed in such a way that they share a number of services and back-office functions. This will avoid the Electricity Settlements Company replicating activities that the CFD Counterparty would already have in place e.g. back office functions. Under this arrangement, the Electricity Settlements Company will pay the CFD Counterparty to provide the functions it requires. This cost is worked out based on the cost of CFD Counterparty staff time used by the Electricity Settlements Company, and a share of the associated office and infrastructure costs. Were the CFD Counterparty and Electricity Settlements Company not to be aligned in this way, the Electricity Settlements Company would be required to replicate similar processes and functions, which would not be efficient or cost effective. The CFD Counterparty will be undertaking these activities on behalf of Electricity

Settlements Company and the Electricity Settlements Company Board will retain responsibility and accountability for the services provided by the CFD Counterparty.

Other costs

Further to these budgetary requirements are a number of additional, incidental costs, fundamental to the running of an organisation such as the Electricity Settlements Company. These relate predominantly to consultancy for set-up and on-going consultancy support as well as stakeholder management and engagement. This figure also includes the costs associated with stationery and printing and the audit fee. To further reduce the cost of the two companies, the Electricity Settlements Company is to share the same offices as the CFD Counterparty; the costs of this will be included in the CFD Counterparty cost recharge.

Capital expenditure and depreciation

As set out above, the capital expenditure on the settlement system will be funded by DECC through an interest free loan that will be repaid over future years through depreciation in the operational cost levy.

Electricity Settlements Company levy

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 the appropriate measure of market (to be decided). Payments will be based initially on estimates of market share provided by suppliers which will be 'trued up' by the Settlement Service Provider when actual data is received.

Questions:

Electricity Settlements Company 1: Do you have any comments on the costs outlined?

Electricity Settlements Company 2: Do you have any comments on the apportionment of the Electricity Settlements Company's operational costs based on market share?

Part 3: CFD Counterparty and Electricity Settlements Company year one operational cost uncertainties

As previously mentioned, the budgets for the two companies have been formed from estimates based on a series of assumptions and benchmarks. Both companies are start-ups and there is a degree of uncertainty associated with the levels of activity in 2014/15 as we are beginning implementation in parallel with finalising the policy framework. Nevertheless it is necessary to ensure that both companies are set up to fulfil their roles in the enduring regime. We do not expect that any delays in levels of activity would have any material impact on the operational cost levies.

Areas of cost uncertainty, which we have not attempted to quantify, include:

- Employee costs, which will depend on salary levels, start dates and number of employees needed.
- IT costs, which will depend on systems that have yet to be scoped and procured.
- Settlement system costs where the procurement process has started but has not yet completed.
- Associated Settlement Service Provider costs, which will depend on the settlement system provider relationship.
- Areas where policy has not yet been finalised and it has not been possible to estimate the cost impact in 2014/15, such as;
 - For the CFD Counterparty: private wire, energy intensive industry exemptions, dual scheme facilities, multiple technology sites, phasing, inclusion of Northern Ireland and international CfDs, fuel monitoring and sustainability; and
 - For the Electricity Settlements Company, the dispute resolution process and the monitoring of regulation.
- Stakeholder management resources and related costs would need to increase significantly if additional requirements were to be applied to this activity.

We have identified the specific area below which could, if our assumptions change before regulations are laid in June, result in specific changes to the budget(s).

Description	Cost
	£'000s
Reduction in cost per month to the Electricity Settlements Company should State Aid be delayed	100

Reduction in cost per month to the Electricity Settlements Company operational cost levy should State Aid clearance be delayed

This is estimated at £100k per month. These are the estimated operational costs of the Electricity Settlements Company which would no longer be levy funded if State Aid clearance is delayed or the Electricity Settlements Company operational start date is otherwise delayed.

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URN 14D/065