Department of Energy & Climate Change

Consultation on the Low Carbon Contracts Company's and the Electricity Settlements Company's operational costs 2016/17

Government Response

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Introduction

1. In 'Low Carbon Contracts Company and Electricity Settlements Company operational costs 2016/17'[1], published on 5 November 2015, the Government sought views on the proposed 2016/17 operational cost budgets and resulting levies for the Low Carbon Contracts Company ('LCCC') and the Electricity Settlements Company ('ESC').

2. This document sets out the Government Response to this consultation exercise. Section One summarises the feedback received on each of the consultation questions and sets out the Government's response to the points raised. Section Two briefly addresses issues that were raised by respondents but which fall outside the scope of the consultation.

3. In each section 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. Two key mechanisms of the Government's Electricity Market Reform (EMR) are Contracts for Difference ('CFDs') and the Capacity Market. CFDs incentivise investment in low-carbon technologies by removing generators' long-term exposure to electricity price volatility, while the Capacity Market ensures security of supply in accordance with the agreed reliability standard.

5. LCCC, as counterparty to CFDs (including the Investment Contracts which have been transferred to LCCC), manages the contracts and is responsible for payments thereunder. ESC is responsible for transactions relating to the Capacity Market.

6. The operational costs of both LCCC and ESC are funded by levies on electricity suppliers. As the amount of these levies will be revised through the amendment of secondary legislation, made under Part 2 of the Energy Act 2013, DECC is required to consult on them publicly.

7. The consultation document explained that the total operating costs (including applicable depreciation on capital expenditure), proposed to be recovered through the levies, for 2016/17 were **£14,216,000** for LCCC and **£4,474,000** for ESC.

[1] https://www.gov.uk/government/consultations/low-carbon-contracts-company-and-electricity-settlements-company-operational-costs-201617

Publication and dissemination of the consultation

8. The consultation ran from 5 November to 3 December 2015 with the consultation document published on the Government website. A news bulletin, including a link to the consultation document, was sent to approximately 550 stakeholders, including electricity generators, suppliers and consumer groups.

9. In total, two responses were received to the consultation; the organisations that responded are listed in the Annex.

Outcome of the consultation

10. Following analysis of the responses to this consultation, no amendments to LCCC's and ESC's budgets are required.

11. Since publication of the consultation document, the costs that the companies expect to incur in 2016/17 in relation to depreciation charges and settlement operational activity have been re-assessed. This has resulted in refined forecasts of operational costs for 2016/17 of £14,407,000 for LCCC and £4,283,000 for ESC. The total operational costs budget across both companies remains unchanged.

12. The forecast of gross electricity demand for 2016/17 to be used to calculate LCCC's operational cost levy is confirmed as 282.85 TWh[2]. The resulting levy rate that will be included in regulations is £0.0509/MWh.

13. The total amount per financial year charged to electricity suppliers to fund ESC will be specified in Regulations as £4,283,000.

Next steps

14. The Energy Act 2013[3] provides that Regulations setting the operational cost levies are subject to the 'affirmative' Parliamentary procedure. This means that any amending 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 along with amendments to other EMR regulations. The intention is that the Regulations will come into effect on, or before, 1 April 2016.

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[2] This forecast electricity demand figure is based on a National Grid's Indicated Out-Turn forecast for 2016/17.
[3] The Energy Act (2013) http://www.legislation.gov.uk/ukpga/2013/32/pdfs/ukpga_20130032_en.pdf

Section 1: Questions and Responses

Operational costs of the Low Carbon Contracts Company

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

Summary of responses

15. One respondent queried whether the budget would be adjusted in the event that the Hinkley Point C nuclear CFD contract was not signed before the start of the 2016/17 financial year.

16. The same respondent sought clarification on the budget contingency for managing any CFDs for Carbon Capture and Storage (CCS), following HM Government's confirmation that the £1bn ring-fenced capital budget for the CCS Competition is no longer available.

Government response

17. LCCC's Board has agreed that the company will operate in accordance with its Guiding Principle, as set out in its Framework Document[4]. The Guiding Principle requires LCCC, in carrying out its functions, to seek to maintain investor confidence in the CFD regime and to minimise costs to consumers.

18. To comply with the Guiding Principle the company needs to find a balance between ensuring that it is adequately resourced through its operational budget to carry out its functions effectively, whilst not over-estimating its costs. Since the company has not yet achieved 'business as usual' this is not a simple balance to achieve.

19. If the company were to under-estimate its operating costs this could result in the operational cost levy rate initially being set too low and then needing to be increased in-year, causing uncertainty over costs for electricity suppliers.

20. The 2016/17 operational cost budget assumes that the Hinkley Point C CFD will be signed and transferred to LCCC on, or before, 1 April 2016. If the contract is not transferred to LCCC by that date, it would not be required to make an adjustment to its

[4] The Framework Documents are published on the companies' websites – see www.lowcarboncontracts.uk and www.electricitysettlementscompany.uk.

budget. Instead, in the event there is an underspend in the total operational costs recorded at year-end, that amount would be reimbursed to suppliers.

21. On 25 November 2015, HM Government confirmed that the £1bn ring-fenced capital budget for CCS competition would no longer be available and that the CCS competition could not proceed on its current basis. Accordingly, as no CCS CFDs will be awarded in the near term, there is no requirement for LCCC to have additional budget, as proposed in paragraph 26 of the consultation document.

Forecast electricity demand

Consultation question		**1 response**
2	Do you have any comments on the forecast electricity demand from which the £/MWh levy rate for LCCC is derived?	

Summary of responses

22. One respondent noted that the forecast of gross electricity demand used to set LCCC's £/MWh operational cost levy may be subject to significant estimating error for two reasons:

    a. Gross electricity demand (in which embedded generation has not been netted off) has not historically been measured to provide a robust track record as the basis for this estimate; and

    b. The forecast includes an adjustment for the estimated consumption of electricity intensive industries (EIIs) who will be entitled to partial exemption from the levy; however, actual data on EII exemption volumes does not yet exist.

Government response

23. Gross (rather than net) electricity demand is used to set LCCC's operational cost levy, for consistency with the principal supplier obligations for the CFD regime. As there is currently very limited historical data for gross demand, LCCC is currently making adjustments to National Grid's Indicated Out-Turn (INDO) forecast to derive gross demand data and Government is satisfied that this adjustment is fit for purpose. In future, as historical data on gross demand becomes available, LCCC's forecasting should be further refined. The adjustment to demand made for EII exemptions is based on Government's[1] best estimate of EII electricity usage eligible for exemption.

[1] The Department of Business Innovation and Skills has calculated estimated electricity usage by EIIs eligible for exemption at a rate of 85%.

Operational costs of the Electricity Settlements Company

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

Summary of Responses

24. There were no specific responses on this question.

Section 2: Issues raised which fall outside the scope of this consultation

Summary of responses

25. One respondent noted that it would be helpful in to show a comparison of proposed budget figures with previous years. The other suggested that high level indicators of LCCC’s and ESC’s future operational activity, compared to historical activity, would help external stakeholders understand how costs may change.

Government response

26. As both LCCC and ESC transition towards ‘business as usual’, we will consider, in the interests of transparency and accountability, including comparative budget data in future consultations on the companies’ proposed operational costs. Information on LCCC’s and ESC’s actual annual operational costs can be found in their Annual Report and Accounts.

Annex: List of organisations that responded to the consultation

The following organisations responded to this consultation:

EDF Energy

Scottish Power

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