Department
of Energy &
Climate Change

CFD Supplier Obligation: Consultation on improving efficiency & transparency

Consultation

15D/410 September 2015

Department of Energy and Climate Change
3 Whitehall Place
London
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Telephone: 0300 068 4000

The consultation and Impact Assessment can be found on DECC's website:

http://www.gov.uk/government/consultations/contracts-for-difference-supplier-obligation-improving-efficiency-transparency

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General information

Purpose of this consultation:

The Department of Energy and Climate Change is seeking views on proposals to amend the CFD Supplier Obligation. We are consulting on a series of technical amendments aimed at reducing CFD costs to consumers through incremental changes to the efficiency and transparency of the SO design. This consultation is particularly relevant to: licensed electricity suppliers in Great Britain; generators; consumer groups; electricity intensive industries and businesses; CFD delivery bodies and other stakeholders with an interest in the energy sector. DECC invites interested parties to submit comments and evidence.

Issued: 14 September 2015

Respond by: 23 October 2015

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Consultation reference: URN15D/410 – CFD Supplier Obligation: Consultation on improving efficiency & transparency

Territorial extent:

Whilst this consultation applies to the UK, it should be noted that that the supplier obligation regulations currently only affect holders of electricity supply licences in Great Britain.

How to respond:

Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome. Electronic responses should be sent to the email address above.

Additional copies:

You may make copies of this document without seeking permission. An electronic version can be found at http://www.gov.uk/government/consultations/contracts-for-difference-supplier-obligation-improving-efficiency-transparency

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 all responses and place this summary on the GOV.UK website. This summary 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
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Email: consultation.coordinator@decc.gsi.gov.uk

Contents

Executive Summary 7

Summary of Proposals 7

Next Steps 8

Chapter 1: Improving the efficiency of the SO 9

Changes to the Interim Levy Rate and Interim Rate Payments 9

Changes to the timing of reconciliation payments and calculation of the Total Reserve Amount 12

Chapter 2: Delivering transparency 19

Projections of CFD costs 19

Updating the CFD register with CFD start dates 20

Chapter 3: Minor and technical amendments to the SO 24

Set-off provisions 24

Generation and non-generation payments 26

Interactions between the CFD exemptions 27

Mutualisation 28

Letter of credit expiry and bank ratings 30

Issuing notices to all licenced suppliers 31

Chapter 4: EII exemption – Eligible sectors 33

Catalogue of consultation questions 35

Glossary 39

Annex – Draft amended Schedule 40

Executive Summary

i This consultation sets out proposals for a number of technical changes to the CFD supplier obligation to improve its efficiency and transparency, thereby reducing costs to consumers.

ii The Contract for Difference (CFD) scheme was introduced in 2014 as a new mechanism for incentivising renewable and low carbon electricity generation at a lower cost to consumers than the existing Renewables Obligation. A CFD is a contract signed between a low carbon electricity generator and the Low Carbon Contracts Company (LCCC) as the CFD Counterparty, and includes provisions for LCCC to make payments to generators. The CFD Supplier Obligation (SO) is the mechanism by which the LCCC collects money from electricity suppliers in order to make payments to CFD generators.

iii The CFD SO consists of a series of prepayments from suppliers, and a reconciliation process. The prepayments comprise of:

a. interim rate payments, paid daily by suppliers at an Interim Levy Rate (ILR) set by LCCC; and

b. reserve payments paid once a quarter that provide LCCC with a Total Reserve Amount (TRA) set at a level to ensure payments can be made to generators in 19 out of 20 scenarios.

iv Once a quarter ends, LCCC assess each supplier's pre-payments and their share of CFD costs (resulting from payments owed to generators for generation in the quarter). These amounts are reconciled, with suppliers receiving any over-payments back from LCCC in due course.

v The regulations that establish the SO came into force in August 2014, although the current obligation level is zero as no CFD generators have yet commissioned or received payments from LCCC. In light of feedback received since implementation, we have identified a number of technical changes that could be made to reduce risks to suppliers and therefore **lower the costs of CFDs that are passed on to consumers**. This consultation sets out these proposed changes, spanning three themes:

a. Proposals to improve the efficiency of the SO design

b. Proposals to improve transparency of the CFD costs

c. Minor and technical amendments that clarify provisions in the regulations

vi We welcome views on the proposed changes, particularly focussing on whether such changes would allow suppliers to reduce the costs of the SO passed on to consumers.

Summary of Proposals

vii We are consulting on several proposed changes to the SO that all aim to reduce the cost to consumers of CFDs. The proposals span three broad themes:

a. Proposals to improve the efficiency of the SO design. These include:

i. Modifying the way the ILR is calculated in order to align it with suppliers' expected liabilities for a quarter (i.e. estimated generation and non-generation payments due). We also propose allowing LCCC to reduce (but not increase) the

ILR without notice, and the removal of within-period data reconciliation of interim rate payments.

ii. Making reconciliation payments more quickly once a quarter ends. Currently these payments are made 90 days after the relevant notice is issued, which may result in LCCC holding more reserves than necessary for a significant period of time. We propose reducing this payment period to 5 or 10 working days following the issue of the relevant notice. We also propose adjusting the period over which the TRA is calculated to reduce cash-flow risk to LCCC, give LCCC power to reduce the TRA, and allowing them slightly longer to issue invoices to suppliers for their individual reserve amounts.

b. Changes that would deliver greater transparency over CFD costs, including:

i. Requiring LCCC to provide CFD cost projections for three quarters beyond the one for which they set the ILR and TRA.

ii. Requiring LCCC to publish generators' expected CFD start date within the public CFD register.

c. Minor and technical amendments that clarify provisions in the regulations:

i. Clarification on the setting-off and netting of SO payments.

ii. Changing how compensation payments that are considered 'generation payments' are dealt with during reconciliation.

iii. Ensuring that suppliers do not benefit excessively by simulateous use of the electricity intensive industry and green excluded electricity exemptions.

iv. Making a number of amendments to the way the regulations address mutualisation.

v. Allowing LCCC to convert letters of credit to cash collateral where not replaced before expiry, or where they become invalid.

vi. Restricting the sending of notices to suppliers that have the capacity to supply.

viii Finally, we are also consulting on changes to the list of sectors that are eligible for the electricity intensive industries (EII) exemption.

Next Steps

ix We welcome views on the proposals set out in this consultation until it closes on 23 October 2015. An Impact Assessment is published alongside. All changes will be subject to their satisfactory integration within regulations, and a more detailed assessment of the feasibility and cost of any IT system changes required to implement them.

x Draft regulations setting out these amendments will be published in due course. Changes as a result of these proposals affect The Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 ("ESO Regulations"), The Contracts for Difference (Standard Terms) Regulations 2014 ("Standard Terms Regulations"), and the Electricity Supplier Obligations (Amendment & Excluded Electricity) Regulations 2015.

xi Following this consultation we intend to publish the Government Response and lay regulations in Parliament in early 2016 to enable regulations to be in force by 1 April 2016. Note that particular measures may be commenced at a later date to enable stakeholders and delivery partners to make required system changes.

Chapter 1: Improving the efficiency of the SO

1.1. This chapter sets out proposals to deliver our objective to improve the efficiency of the supplier obligation (SO) in order to meet the aim of minimising costs to consumers.

1.2. To meet this objective we propose:

A. Changes to the determination of the interim levy rate (ILR) paid by suppliers on each unit of electricity they supply. These changes would make the ILR more reflective of the total costs that suppliers will expect to owe following a quarter, and typically reduce the total reserve amount (TRA). We also propose allowing LCCC to reduce (but not increase) the ILR without notice in order to minimise overpayments, and removing within-period data reconciliation to reduce administrative burden.

B. Changes to the timing of reconciliation payments, which would see suppliers refunded any overpayments within 13 working days of the end of a quarter, alongside changes to the period over which the TRA is calculated to cover the cash-flow risk for LCCC from the payment of one TRA until the one that follows. To avoid unnecessary payments being made by suppliers, we also propose allowing LCCC to reduce (but not increase) the TRA without notice before the reconciliation notice is issued that immediately proceeds the payment due date.

1.3. Together, we estimate that these proposals will increase the average annual ILR over the period to Q1 2018 by 5%, and reduce the average annual TRA over the same period by 56%. We believe that this will lead to a net saving to suppliers of **£39m** (in net present value, 2015 prices) in reduced financing costs over the period 2016-2020, leading to a reduction in consumer bills of £0.40 – 0.60 over that period.[1]

1.4. Below we set out these proposals in more detail.

Changes to the Interim Levy Rate and Interim Rate Payments

1.5. The ILR is a pound per megawatt-hour (£/MWh) rate set by LCCC three months in advance of a given quarter. Suppliers make daily interim rate payments to LCCC on every unit of electricity that they supply during the quarter.

1.6. The ILR is an estimate of the income from suppliers required to enable LCCC to make CFD payments to generators during a quarter. LCCC must set the ILR at least a quarter in advance of the quarter to which it will apply, though they are able to change the rate with a minimum of 30 days' notice in exceptional circumstances[2].

1.7. The regulations set out how LCCC must calculate the ILR: LCCC estimate the net expected CFD payments to be made to generators in the quarter and divide this by expected electricity supply in the quarter.

[1] Further details set out in the draft Impact Assessment published alongside this consultation.

[2] For example, the ILR was set at 3.5p/MWh on 18 December 2014 for the quarter that commenced 1 April 2015. However, LCCC subsequently reduced it to zero once it became clear from the results of the CFD allocation round that no generators would commission within the first quarter.

Proposal 1: ILR calculated on expected accrued payments to generators

1.8. Feedback from stakeholders and LCCC has highlighted that the numerator in the ILR calculation – net payments expected to be made to generators within the quarter – is suboptimal because**,** on average, **it will underestimate suppliers' liabilities for the quarter.** Once a quarter ends, each supplier's total pre-payments (i.e. interim levy and reserve payments) are reconciled against their share of CFD costs *accrued* during the quarter. Accrued payments are those due in respect of CFD generation during the quarter, rather than the actual payments made to CFD generators during the quarter (which is what the ILR calculation is based on) – a difference arising from the fact that generators are paid 28 days after the day of generation.

1.9. As a result, the ILR is set on a different set of cost assumptions to supplier's ultimate liabilities: the former being based on expected generation across a period 28 days earlier than the latter. If CFD generation typically increases over time, on average the ILR will underestimate each supplier's liabilities. This may lead to confusion, particularly when it comes to suppliers' communications with their customers. In order to address these issues, we propose a change to the way the ILR is calculated: the numerator of the ILR calculation would change from an estimate of *payments to be made* to generators during the quarter to an estimate of expected net *CFD liabilities* within the quarter. CFD liabilities would comprise of both:

- Estimated net CFD generation payments in respect of generation in the quarter[3], plus
- Estimated net CFD non-generation payments[4] to be made in the quarter.

1.10. This would bring the ILR calculation in line with the calculation of each supplier's ultimate liabilities during reconciliation; the ILR would be an estimate of those liabilities, increasing transparency.

1.11. Since CFD payments are expected to increase over time (as more CFD generators commission their plant), this change is expected to lead to an increase in the average ILR compared with the current calculation (because it would in effect cover generation over a period 28 days later than at present). As a result, to retain the same overall level of confidence in being able to make payments to CFD generators in 19 out of 20 scenarios, there would be a corresponding reduction in the average TRA.

1.12. Our analysis[5] suggests that on average, the proposed changed would lead to an average increase in the ILR over the period to Q1 2018 of 5%, and an average reduction in the TRA over the same period of 22%. This is expected to reduce costs to

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[3] These are referred to in the ESO regulations as 'generation counterparty payments' and 'generation party payments' (Regulation 4(1)), which are defined as payments calculated directly by reference to an amount of electricity generated on a day (i.e. CFD top-up or difference payments). Suppliers are liable for a share of these payments according to their market share on the day of generation.

[4] CFD non-generation payments are CFD payments that are not calculated by reference to an amount of electricity generated on a day. Suppliers are liable for these payments based on their average electricity supply over the quarter that the payment liability falls in.

[5] Analysis is set out in the Impact Assessment published alongside this consultation: http://www.gov.uk/government/consultations/contracts-for-difference-supplier-obligation-improving-efficiency-transparency

consumers, as it is assumed that it costs suppliers more to lodge a lump sum reserve payment at the start of the quarter than smaller, regular payments throughout.

1.13. We expect that these changes would only require minor changes to LCCC's SOFM model, with minimal implementation costs for suppliers, but would welcome views.

Proposal 2: Allowing the ILR to be reduced without notice

1.14. Whilst LCCC must set the ILR at least a quarter in advance of the quarter to which it will apply, the ESO regulations allow LCCC to change the rate with a minimum of 30 days' notice where they are of the opinion that there is a high degree of likelihood that they will (a) be unable to make all CFD payments during a quarter, or (b) collect significantly more from suppliers than they need in order to make those CFD payments.

1.15. In some circumstances events may occur that make it immediately clear that LCCC will over-collect from suppliers – for example the disclosure of a CFD Auction Round results, or a change in the expected CFD start date of a generator. In such events we consider it in suppliers', consumers' and LCCC's interests for LCCC to be able to *reduce* the ILR without any notice.

1.16. Therefore we propose to waive the 30 days' notice requirement where LCCC decides to reduce the ILR, enabling the reduced ILR to take effect from the working day after the publication of the notice setting out the lower rate. Electricity supplied from this date will be charged at the new ILR (i.e. invoices from this point onwards would see electricity supply charged at the lower ILR). LCCC would retain the ability to give more notice if appropriate.

1.17. For clarity, this would not affect LCCC's ability to *increase* the ILR, which it could only do by providing a minimum of 30 days' notice.

Proposal 3: Removal of within-period data reconciliation of interim rate payments

1.18. The Balancing and Settlement Code Company (BSCCo) carry out a number of reconciliation runs in respect of electricity supplied on a given day as the data quality improves over time. For the SO, the key reconciliation runs are the interim information volume allocation run ("II run"), the initial volume allocation run ("SF run") and the reconciliation volume allocation runs ("reconciliation runs"). The II and SF runs take place approximately 5 and 16 working days after settlement respectively.

1.19. Suppliers are initially invoiced for interim rate payments using the volumes calculated within the II run. However, as set out in ESO Regulation 9, where additional runs take place before the end of a quarter, invoices for interim rate payments relating to that quarter are adjusted according to the latest data.

1.20. Some stakeholders have questioned whether it is necessary to reconcile interim rate payments within a quarter, since the reconciliation against actual generation payments takes place shortly after the end of the quarter. We are therefore seeking views on whether we should remove the requirement for LCCC to undertake data reconciliation of interim rate payments within the quarter.

1.21. If this were implemented, suppliers' interim rate payments would be based on information from the II run only. Changes in metered supply volumes would be reflected in the quarterly reconciliation process after the end of the quarter, which 'trues up' suppliers prepayments against their liability for payments to CFD generators.

1.22. This has the advantage of simplicity for LCCC and suppliers, with all interim rate payments based on the II run only, avoiding the need for data reconciliation for payments that may not reflect the underlying liability, and the need for suppliers to check these daily reconciliations.

1.23. However, this would move away from the current process that suppliers and LCCC have built their systems around, and could also mean that it takes longer for suppliers' charges to reflect their actual liabilities. In addition, there would be system costs for LCCC to implement the change. We would therefore welcome views from suppliers on the importance of this change.

Consultation Questions	
1.	Do you agree that the ILR calculation should be amended so that it is based on suppliers' expected 'accrued liabilities' for the quarter?
2.	Do you agree that LCCC should be able to *reduce* the ILR immediately if it expects to collect significantly more from suppliers than required to make CFD payments?
3.	Do you consider that it would be appropriate to remove the requirement for LCCC to undertake within-period data reconciliation of interim rate payments? What would be the impact of such a change? Please provide evidence to support your answer.

Changes to the timing of reconciliation payments and calculation of the Total Reserve Amount

1.24. Under the current SO design LCCC must, at least a quarter before the quarter in which it is paid, calculate a TRA that, when combined with expected interim rate payments, would provide them with sufficient revenue during the quarter to meet all CFD payments to generators in 19 out of 20 scenarios. Suppliers must make individual reserve payments for their share of the TRA around the 7th working day of a quarter[6].

1.25. After a quarter ends, LCCC calculate the total pre-payments made by suppliers through interim rate and reserve payments, and compare this to each supplier's share of CFD costs arising from generation that took place during the quarter plus any 'non generation' payments made to CFD generators during the quarter. A reconciliation notice detailing any monies to be returned to suppliers (or paid to LCCC)[7] is issued

[6] Specifically, suppliers must make these payments by the 90th day after the reconciliation notice is issued in the previous quarter, or on the 7th working day of a quarter if no reconciliation notice was issued for the previous quarter.

[7] In the vast majority of scenarios suppliers will be owed money by LCCC since the combination of interim rate and reserve payments should exceed the total liabilities. It is theoretically possible for suppliers to owe an additional amount to LCCC if both (a) LCCC make use of a large proportion of the TRA, and (b) a supplier's market share increases significantly between the period upon which their reserve payment is calculated and the quarter of supply.

around the 7th working day after a quarter ends. However, those reconciliation payments are not due for a further 90 days after the notice is issued, at the same time as suppliers' reserve payments are due for the quarter that follows. In total therefore there are 6 months between a supplier making their reserve payment and receiving any unspent part of this payment back from LCCC.

1.26. Following stakeholder feedback we have identified three areas where the current reconciliation and reserve arrangements could be improved to reduce costs to consumers and better reflect policy intent:

A. The additional 90 day period between reconciliation notices being issued and payments made. Since suppliers are also making reserve payments for the intervening quarter, on average LCCC will hold more reserves than is needed for them to be satisfied that they can meet payments in 19 out of 20 scenarios.

B. The TRA is sized to provide LCCC with sufficient revenue to make payments to generators within the quarter in which it is paid. Since suppliers are not due to make their reserve payments until c.7th working day of a quarter, the cashflow risks over the first seven working days of each quarter are not factored in when LCCC determines the TRA.

C. LCCC are not able to reduce the level of the TRA after it has been set. This creates a risk that suppliers may be required to make unnecessary payments if it becomes clear that the TRA has been set too high.

1.27. Below we make a series of proposals to address these issues, in order to reduce costs to consumers and risks faced by LCCC.

Proposal 4: Making reconciliation payments more quickly

1.28. As described above, currently reconciliation payments are made to (or collected from) suppliers 90 days after the reconciliation notices are issued, and at the same time as the reserve payments are due for the following quarter (the payments are effectively netted off against each other). This design was chosen because it provides suppliers with around 3 months certainty over future payments, making it easier for them to manage their cash-flow.

1.29. However, this design means that on average, LCCC will hold two quarters' reserve payments at the same time, since the unspent reserve payments from one quarter are not returned until three months after the end of the quarter that they covered. This could lead to higher costs to consumers than necessary.

1.30. We are therefore seeking views on whether LCCC should make reconciliation payments earlier, shortly after reconciliation notices are issued following the end of a quarter. We consider that this can be achieved whilst at the same time retaining the alignment of reconciliation and reserve payments, ensuring that only a single, net payment is required.

1.31. We propose to **bring forward the reconciliation payment from 90 days to 5 working days after the issue of the reconciliation notice**. This would be implemented as follows:

- LCCC issue a reconciliation notice to each supplier as soon as reasonably practicable after the end of a quarter, stating the reconciliation amount due.
- The reconciliation payment would be due 5 working days after the reconciliation notice is issued. Based on the LCCC issuing the reconciliation notice on the 8th

working day, the payment would usually be due on the 13th working day of the quarter (which is the first day that payments from suppliers would be due at the ILR for that quarter).

- In order to align reconciliation and reserve payments, **we also propose to amend the due date of the reserve payments to 5 working days after the issuing of the reconciliation notice** in the quarter for which the payment is due. Reserve payments will therefore be collected on the same day as the first payments are due at the revised ILR.

1.32. We consider that this earlier reconciliation will have material benefits for suppliers because it would reduce the reserves held by the LCCC by an average of 47% over the period to Q1 2018.

1.33. However we consider that, whilst such proposals are likely to benefit suppliers, there may be some reservations with the proposals. Notably:

- Whilst suppliers will know their reserve payment that is due around the 13th working day of the quarter at least three months in advance, they will not know the net payment (i.e. after subtracting the amount owed to them from LCCC) until the reconciliation notice is issued 5 working days before this net payment is due. Suppliers will benefit from receiving any reconciliation payment more quickly, but will lose the certainty of the total payment that is inherent within the existing SO design, which may make it more difficult to manage cash flow. We would welcome views on the merits of the trade-off here.
- There may be occasions in which a supplier may owe a reconciliation payment to LCCC (i.e. is required to make an additional payment rather than receive monies back). This would occur where both (a) accrued CFD payments to generators during the quarter covers a very large proportion of the pre-payments made by suppliers, meaning that the total net amount for LCCC to return to suppliers is low, and (b) an individual supplier's market share increases significantly between the period upon which their reserve payment is calculated and the quarter of supply[8]. If this situation did arise, the proposal outlined above reduces the notice that suppliers have of additional payments from 90 days under the current regulations to 5 working days.

1.34. We consider that the likelihood of suppliers needing to make reconciliation payments to LCCC is sufficiently low that our preferred approach would be to implement the proposal as set out above. However, in order to mitigate the possible impact of requiring suppliers to make additional payments promptly, however remote, we would welcome thoughts on two adaptations to the central proposal that would provide suppliers with more foresight of any payments due from them to LCCC:

1.35. Proposal 4A: To provide more notice for suppliers, we could provide additional time between the issuing of the reconciliation notice and the point at which reconciliation and reserve payments are due. Specifically, payments could be due 10 working days after the reconciliation notice is issued (i.e. around the 17th working day of the quarter). This option provides suppliers with 5 additional working days' notice before making

[8] To illustrate the likelihood of such a scenario, a supplier that increased their market share by 33% from the period across which that supplier's share of the TRA was calculated would face an additional payment if more than 75% of the TRA was utilised.

payment to LCCC, but would also mean that any payments due from LCCC to suppliers would be received later.

1.36. Proposal 4B: We could differentiate between reconciliation payments owed from LCCC to suppliers ("excess payments") and payments owed from suppliers to LCCC ("shortfall payments"), with suppliers given longer to make any shortfall payments. Under this proposal, LCCC would return any net excess payments to suppliers 5 working days after the reconciliation notice is issued, with each excess payment pro-rated to reflect any shortfall payments. Suppliers would have an additional 3 months to make their shortfall payments, at which point the remaining excess payments would be made to those suppliers that received part-payment in the previous quarter[9]. This proposal introduces significant additional complexity and may require significant resources to implement, and is **therefore not our preferred option**[10].

1.37. To provide further insight to suppliers and help them manage the risk that they face additional payments, LCCC could provide within-quarter updates to individual suppliers on the balance of their liabilities (i.e. the difference between their interim rate and reserve payments made and their liability for CFD payments to date). We do not plan to regulate on this option, but welcome feedback as to whether suppliers wish for LCCC to follow this approach.

Proposal 5: Adjusting the period over which the TRA is calculated

1.38. In theory, there is a small risk to LCCC created by the current design: the TRA is calculated for a given quarter to provide LCCC with sufficient revenue to be able to pay generators in 19 out of 20 scenarios within that quarter. However LCCC do not receive the quarter's reserve payments until the 7th working day of the quarter (under the current regulations), leaving a period of payments to CFD generators that is not taken account of in the calculation of the TRA. This risk would increase if the changes in Proposal 4 were implemented since (a) the date on which the TRA would be paid would move back to the 13th working day of the quarter[11], and (b) LCCC would not have access to reserve payments from the preceding quarter to provide a cushion.

1.39. Therefore to remove this residual risk to LCCC we propose that instead of covering cash-flow risk within the quarter in which it's paid, the TRA is calculated to cover cash-flow risk between the day on which the reserve payments for that quarter are due and the date on which the reserve payments are due in the quarter that follows. In practice, this would shift the period over which LCCC assess the cashflow risk by 12 working days.

1.40. Reconciliation would be undertaken on the same basis as at present by comparing the pre-payments made by suppliers in a quarter (interim rate payments and reserve

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[9] For example, suppliers A and B are due to receive £1m in excess payments each, and supplier C owes a £500k shortfall payment. Suppliers A and B would receive £750k each in excess payments at the start of Q2, and the balance at the start of Q3. Supplier C's shortfall payment would be due at the start of Q3.

[10] Given the complexity of this option, the draft regulations include this drafting to ensure that the proposal can be fully scrutinised within this consultation.

[11] Note that under proposal 4A, the date on which the reserve payment would be due would be the 17th working day of the quarter. Our proposal that the TRA should be calculated to cover cash-flow risk between the day on which it is paid and the date on which the following reserve payments are due remains the same.

payments) with their liabilities for CFD payments in respect of generation in the quarter, and non-generation CFD payments made in the quarter.

1.41. We estimate that this change will increase the average annual TRA over the period to Q1 2018 by 4% (although when combined with the other proposed changes, the average TRA would be reduced by 56%).

Proposal 6: Allowing LCCC to reduce the TRA

1.42. The regulations currently give power to LCCC to increase the TRA with a minimum of 30 days' notice. However, there is no provision allowing the TRA to be reduced if it is set too high. This could result in LCCC holding more money than needed[12] and suppliers having to wait until the next reconciliation for any excess payments to be returned.

1.43. We propose giving LCCC the power to reduce the TRA with no notice where it considers that it would collect significantly more from suppliers than needed in order to meet all CFD payments to generators in 19 out of 20 scenarios. In order to avoid complications over reducing the TRA it has been paid, LCCC would only be able to reduce the TRA up until the point at which the reconciliation notice is issued in the quarter in which suppliers' reserve payments are due.

1.44. We propose that where the TRA is reduced, each supplier's reserve payment will be reduced pro-rata (i.e. based on their share of the original TRA, not factoring in any changes in market share that may have occurred since that point).

1.45. Note that the pro-rata reduction of TRA is a different approach than is taken if an additional TRA is requested, where a supplier's share of the additional amount owed is based on market share over the most recent 30 day period at the time the increased amount is determined. We do not consider that this approach is appropriate where the TRA is reduced, since changes in market share since the original TRA was determined could result in some contrary outcomes. For example:

- If a supplier markedly increased their market share from a low base, they could have been invoiced only a small reserve payment initially but see a large credit amount in the amended invoice if the adjustment was based on their most recent market share. In theory, this could see a supplier's reserve payment be negative;
- Where a supplier's market share has reduced, they would receive a smaller reduction than the amount they were initially invoiced in their reserve payment, even though their actual liabilities for CFD payments will be lower. In extremis, a supplier that had exited the market at the time the reduced TRA was determined would receive no reduction in its reserve payment, even though it could not be liable for any CFD payments in the quarter that the reserve payment applies to.

1.46. As a result, we consider that a pro-rata reduction is more appropriate and would welcome views from respondents.

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[12] For example, the TRA was set at £1,061,400 on 18 December 2014 for the quarter that commenced 1 April 2015. LCCC subsequently reduced the ILR to zero once it became clear from the results of the CFD allocation round that no generators would commission within the first quarter. However, they were unable to reduce the TRA, and this amount was ultimately paid by suppliers and will be returned on 7 October 2015.

1.47. There may be occasions where suppliers have made early reserve payments to LCCC before the TRA has been revised downward. To avoid discouraging suppliers from making early payments to LCCC, if a supplier makes a reserve payment before the date on which it is due and that payment is revised, we propose to allow LCCC to repay the difference to suppliers. It is intended that LCCC will return any amounts to suppliers as soon as is reasonably practicable.

Proposal 7: Allowing LCCC to calculate and provide notice of suppliers' individual reserve amounts by the 13th working day of the quarter before the payment is due

1.48. At present, LCCC must issue a notice to each electricity supplier setting out their share of the TRA before the commencement of the quarter before the one in which the payment is due – the same deadline as it has for setting the TRA.

1.49. Whilst it is important for LCCC to publish the TRA by this deadline, we consider that they should have longer to notify individual suppliers of their share of this payment; since the TRA must be calculated before individual suppliers are informed, the current arrangements effectively require the LCCC to calculate the TRA in advance of the deadline.

1.50. Therefore we propose that LCCC must issue the notice to individual suppliers by the 13th working day of the quarter before the one in which the payment is due. Since under proposal 4 we propose to move the reserve payment due date such that it is typically due on the 13th working day of a quarter, this would still provide suppliers with three months' notice of their reserve payment.

Consultation Questions	
4.	(a) Do you agree with our proposal to make reconciliation payments sooner after they have been calculated? (b) Do you agree that the date on which the TRA is paid should continue to align with the date on which reconciliation payments are made? (c) Do you consider that we should implement proposal 4A or 4B to provide additional protection to suppliers in the event that they owe a shortfall payment to LCCC? If so, which proposal is your preferred approach and why? (d) Do you agree that the LCCC should provide suppliers with regular updates on their liabilities over the course of a quarter?
5.	Do you agree that the TRA should be sized to give cash-flow protection to LCCC between the day it is paid and the day the next TRA is collected?
6.	(a) Do you agree that LCCC should be able to reduce the size of the TRA up until the reconciliation notice before the payment due date is issued? (b) Should arrangements be put in place to repay suppliers who have made reserve payments before this date? (c) Do you agree that, where LCCC reduce the TRA, each supplier's reserve payment should be reduced pro-rata (i.e. based on their share of the original TRA)?

7.	Should LCCC have until the 13th working day of the quarter before the reserve payments are due to issue notices to individual suppliers of their individual reserve amounts?

Chapter 2: Delivering transparency

2.1 This chapter sets out proposals that we consider will improve suppliers' abilities to manage their CFD SO payments, and reduce the costs passed through to customers as a result.

2.2 These changes include requiring LCCC to issue additional projections of CFD costs and requiring LCCC to enter generators' most recent expected CFD start dates into the public CFD register.

Projections of CFD costs

2.3 LCCC is required to set the ILR and TRA one quarter in advance of the quarter to which they apply. However, there is no requirement on LCCC to provide projections of CFD costs that suppliers may face beyond this. Suppliers and large consumers (who seek to understand future policy costs) therefore have no visibility over estimated future CFD liabilities. This leads to uncertainty for suppliers, which could lead to excessive risks being priced into tariffs, increasing consumer bills.

Proposal 8: Requiring LCCC to project CFD costs for a further three quarters

2.4 To provide suppliers with more foresight over potential future liabilities, we propose regulating to require LCCC to publish CFD cost projections for the three quarters beyond the one for which they are currently required to set the ILR and TRA on a quarterly basis. This would mean that suppliers always have access to projections of CFD costs for at least the year ahead so that they can take a view on likely payments over the medium-term. LCCC have already begun to provide forecasts for three quarters ahead[13], but we believe that there is value in placing this on a statutory footing.

2.5 We do not propose being prescriptive over precisely what LCCC must publish, since we believe it is important that they have the flexibility to choose the scenarios and outputs that are of most value to their stakeholders, published in the appropriate format. Examples of projections that the LCCC could choose to publish include projecting both the ILR and TRA for the given quarters, or projecting payments from the LCCC to CFD generators under different scenarios. Note that in all cases we anticipate that the projections would only reflect the costs of CFDs that LCCC are managing; we do not propose to require LCCC to estimate the costs of CFDs that have not been awarded.

2.6 An important factor that will affect future CFD costs is what assumptions are made about the amount of qualifying CFD generation, which is in turn affected by assumptions such as expected CFD start dates, installed capacity, commissioning profiles, load factors, Renewable Qualifying Multipliers, CHP Qualifying Multipliers, etc. Under the terms of their CFDs, generators are required to provide LCCC with some of this information on a regular basis, but it is defined as 'generator confidential information' and there are strict limitations on its use and disclosure by LCCC. In particular, this information may not be disclosed or made use of by LCCC (without the consent of the

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[13] The first forecasts, covering the period 1 January to 30 September 2016, were published on the Transparency Tool, available on LCCC's website: https://sofm.lowcarboncontracts.uk/

generator) other than for certain ‘permitted purposes’, which are limited primarily to obligations and responsibilities under CFDs, or statutory requirements on LCCC.

2.7 We welcome feedback on two options for what information LCCC should be able to use to inform its projections of CFD costs for the 3 quarters ahead of the relevant levy quarters for which the ILR and TRA has been or is being set:

A. Our preferred option is to amend the regulations to allow LCCC to use all information available to them in their CFD cost projections, including generator confidential information and any additional other available sources information. This would ensure that LCCC issue projections based on the most reliable information.

However, there is a possibility generators may be concerned that allowing the LCCC to use information provided by them in this way could result in the disclosure of commercially sensitive information. We welcome views, especially from generators, on this proposal.

B. Alternatively, we could require that LCCC only base projections on publicly available information or information that CFD generators have agreed can be used. Under this approach, if permission is not granted by generators, LCCC will not be permitted to use generator confidential information in its projections. Though this option mitigates any risk of inadvertently disclosing commercially sensitive information, it is likely to reduce the accuracy of the projections and their effectiveness at reducing risk to suppliers and large consumers.

Consultation Questions	
8.	(a) Do you agree with our proposal to require LCCC to publish CFD cost projections? (b) Do you agree that these projections should cover three quarters beyond the quarter for which the ILR and TRA are set? (c) Do you agree that LCCC should be allowed flexibility over the precise nature of what must be published about future CFD costs? (d) Do you agree with our preferred proposal (Option A), that LCCC should be able to use all the information available to them, including generator confidential information, to project CFD costs? Please explain your reasoning.

Updating the CFD register with CFD start dates

2.8 LCCC is currently required to publish certain project information within a public CFD register. The CFD register is accessible via LCCC’s website[14] and lists key information for all investment contracts and CFDs to which LCCC is a party, including the generation technology, target commissioning date (TCD) and strike price. The CFD register currently contains project information provided to LCCC during the application

[14] Available here: https://lowcarboncontracts.uk/

for a CFD, and any subsequent updates to this information (such as a reduction of project capacity).

2.9 One important purpose of the CFD register is to allow for transparency of key CFD project parameters that will materially affect suppliers' payments. However, some important information that would be required for suppliers to make their own forecasts of CFD costs is not currently included in the CFD register.

Proposal 9: Requirement on LCCC to place CFD start dates into the CFD register

2.10 One of the most important factors in determining CFD costs is the date on which CFD generation payments start being paid to a generator (the 'CFD start date').

2.11 The CFD register currently includes the start of the target commissioning window (TCW) and the TCD that were submitted as part of the CFD application process. However, the TCD may not be an accurate estimate of the generator's actual planned commissioning date[15]. CFD projects may nominate a CFD start date at any point within their TCW without impacting on the term of their CFD. For all technologies except landfill gas and solar PV[16] the TCW is one year in length, which provides a wide window of uncertainty for suppliers as to when generator payments could commence. As a result, suppliers are largely unsighted over when they are likely to begin being liable for payments to a generator within the TCW. Suppliers may price this risk into their tariffs, increasing costs for consumers.

2.12 Generators are required to provide monthly updates to LCCC under the terms of the CFD, which must include an estimate of the expected CFD start date and commissioning profile. These updates are likely to be more representative of the actual commissioning date than the TCD submitted during the application process. Embedded generators must also provide LCCC with a minimum of 3 months' notice of the intended CFD start date.

2.13 To ensure that suppliers have access to the most up to date estimate of project start dates, we propose that the CFD (Standard Terms) Regulations 2014 be amended so that LCCC are required to include on the CFD register the most recent estimate of the CFD start date as provided by the generator on the date of publication, and to update this information on a quarterly basis.

2.14 We are mindful that generators may consider this information to be commercially sensitive, so would welcome views on two options for publication of CFD start dates:

A. Our preferred option whereby expected CFD start dates must be published and updated by LCCC for all generators. This would provide maximum transparency over future CFD costs.

B. As above, but allowing the LCCC to exclude information on CFD start dates from the CFD register for a particular generator where they consider that it would be commercially damaging to the generator to publish it (having taken representations from the generator). This would enable a generator to make a

[15] There is no requirement for the TCD to be an accurate estimate of CFD start date at the point of application. Since the TCD affects the delivery year within which a project will compete with others for a CFD, it is possible that the TCD reflects a project's bidding strategy to a greater extent than it does their expected start date.

[16] The TCWs under the October 2014 allocation round for landfill gas is 0.5 years and for solar PV is 0.25 years.

case for information about its expected CFD start date to be withheld from the CFD register in certain circumstances. However, the withholding of information could increase the cost to consumers if, for example, that information related to a large generator being delayed in commissioning.

2.15 In addition, we are interested in views as to whether the requirement to publish CFD start dates should only apply within a minimum period of time before the start of a generator's TCW, in order that such information is only published when of most importance to suppliers in setting their electricity tariffs and to mitigate issues around the publication of commercially sensitive information. For example, we could require the publication of only expected CFD start dates for projects that have TCWs within the next 18 months.

2.16 Irrespective of whether we adopt option A or B above, we also propose an additional amendment to the CFD register provisions in the Standard Terms Regulations relating to disclosure of information. At present, Standard Terms Regulations 12(6) and (7) enable LCCC to exclude any information from the CFD register if, in its opinion, it would be entitled to withhold it in response a request for its disclosure under the Freedom of Information Act 2000[17] or the Environmental Information Regulations 2004[18]. Before deciding which information will be excluded, LCCC must give a generator an opportunity to make representations.

2.17 We consider that, as currently drafted, it is only information under Regulation 12(2)(d) (LCCC's reasons for accepting modification of the CFD standard terms and conditions) that could include commercially sensitive information and requires these protections. As a matter of principle, we believe that the other information listed in Regulation 12(2) (such as changes to a generator's strike price or capacity) should always be published, and the LCCC should not have the ability to exclude such information. We therefore propose restricting the application of Regulations 12(6) and (7) to provision 12(2)(d), and, in the event option B is taken forward, CFD start dates.

Consultation Questions	
9.	(a) Do you agree with our proposal to require expected CFD start dates to be published in the CFD register and for this information to be updated on a quarterly basis? (b) Please indicate which option you prefer regarding the exclusion of CFD start dates from the CFD register, and provide reasons for your view. (Option A: no exclusions; option B: ability for LCCC to exclude information following representations from a generator). (c) Would it be helpful for expected CFD start dates to only be published within a minimum period before the start of a generator's TCW? (d) Do you agree with our proposal to restrict LCCC's ability to exclude other information from the CFD register, so that this only applies to LCCC's reasons for

[17] Available here: http://www.legislation.gov.uk/ukpga/2000/36/contents

[18] Available here: http://www.legislation.gov.uk/uksi/2004/3391/contents/made

	accepting a modification of the CFD standard terms and conditions? (e) Is there any other information held by LCCC that you believe should be required to be published on the CFD register? Please provide evidence to support why this would be beneficial.

Chapter 3: Minor and technical amendments to the SO

3.1 As a result of feedback from stakeholders we propose to make a number of minor and technical amendments to the SO. These amendments seek to clarify sections of the regulations and ensure they reflect the policy intent.

Set-off provisions

3.2 Regulation 30 sets out provisions for LCCC to set-off (withhold) a payment it is due to make to a supplier against payments the supplier is due to make to it. Set-off can currently only be used where:

i) both amounts (to be paid and owed) have been determined (that is, they have been calculated by LCCC);

ii) the payments have not yet been made, and

iii) the amount LCCC is due to pay the supplier is less than or equal to the sum of payments the supplier is due to make to LCCC.

3.3 The intention behind these provisions is to ensure that LCCC is able to withhold a payment due to a supplier when it believes there is a risk that the supplier will not make a payment that it is due to make LCCC, and reduce the credit risk that LCCC faces.

3.4 However, as currently drafted the regulations encompass two situations:

i) where payments are due to be made by a supplier on the same day as payments from LCCC to the supplier (this could be described as 'netting' of payments);

ii) where payments are due from the supplier at a future date, after the date the payment is due to the supplier.

3.5 We consider that there would be value in distinguishing between these situations, and providing some further clarity about the situations in which LCCC can set-off a payment owed to a supplier against the future payments the supplier owes LCCC.

Proposal 10: Clarification on set-off provisions

3.6 The regulations currently allow LCCC to set-off a payment it is due to make to a supplier against 'determined' payments that the supplier is due to make to it in the future. There is no limit on how far into the future the determined payments may be due, or in what circumstances LCCC can retain payments: for example, LCCC could set-off a reconciliation payment due to be paid to a supplier in the next few days against a reserve payment from the supplier that is not due to be paid until 90 days later.

3.7 We believe this exposes suppliers to an undue risk of having payments withheld in circumstances that are not justified (albeit that LCCC has no plans to make use of the powers in this way).

3.8 We are therefore proposing to amend the regulations to limit both the situations in which LCCC can withhold payments as follows:

i) LCCC may only withhold a payment due to a supplier where it considers there is a high degree of likelihood that the supplier will fail to make payments that are due; and

ii) LCCC may only set-off the withheld payment against payments that the supplier is due to make to LCCC within five working days of the date the withheld payment is due to be made to the supplier. This period is proposed because it covers all 'determined' payments apart from reserve and reconciliation payments. (Note that we would propose extending this to 10 working days in the event that Proposal 4A is taken forward for the change to the timing for reconciliation and reserve payments.)

3.9 We also propose removing the limitation that set-off can only be used when the amount LCCC is due to pay the supplier is less than or equal to the sum of determined payments the supplier is due to make to LCCC. Instead, we propose that LCCC should be able to withhold up to the total amount of determined payments due to be paid within 5 (or 10, if Proposal 4A is taken forward) working days.

3.10 For example, if LCCC is due to pay a reconciliation amount of £1,000 today and LCCC considers it is highly likely the supplier will fail to make £5,000 of interim rate payments that have already been invoiced and are due to be paid over the coming 5 days, LCCC could choose to withhold the £1,000 payment to the supplier and use this to reduce the level of determined payments owed to £4,000.

Proposal 11: Clarification on netting provisions

3.11 We also propose to clarify in the regulations that LCCC can automatically net-off payments against each other when payments are owed in two directions on the same day (that is, LCCC is due to make a payment to a supplier and receive a payment from a supplier on the same day).

3.12 We propose that the netting of payments should be automatic, as opposed to set-off which is discretionary. We also propose that when netting payments, there should be no need for LCCC to send a notice to the supplier "by the relevant date" stating the sum that was retained as set out in ESO Regulation 30(4), since no sum has been "retained" and payments have simply been netted off against each other.

3.13 We anticipate that these amendments will ensure that the set-off provisions work as intended, and protect suppliers from the risk of set-off being used inappropriately.

Consultation Questions	
10.	Do you agree with the proposed clarification of set-off provisions, and the restriction of the circumstances in which it can be used?
11.	Do you agree that LCCC should automatically be able to net payments when a payment is owed from LCCC to a supplier and from the supplier to LCCC on the same day?

Generation and non-generation payments

3.14 There are two types of payments that can be made to CFD generators: top-up or 'difference' payments, reflecting the eligible metered volume multiplied by the difference between the strike price and market reference price (i.e. payments in respect of generation that occurred on a specified day), and other payments, for example compensation[19]. The SO regulations treat these payments in different ways. Suppliers are liable for top-up payments (which are defined as 'generation payments' in the regulations) according to their market share on the day of generation (i.e. the date the payment relates to). Other payments ('non-generation payments' in the regulations) are not linked to a particular day, and therefore suppliers are liable based on their average electricity supply over the quarter that the payment liability falls in.

3.15 However, in certain circumstances, qualifying changes in law could lead to a generator's strike price being adjusted retrospectively. This would lead to changes in their historic difference payments for all the affected days, which would be classified as generation payments under the SO regulations.

3.16 Under these circumstances, LCCC would need to recover the compensation payment from suppliers under the SO. Each supplier's liability to cover the compensation amount must be calculated using both the generation and supply on the day on which the electricity was generated. If the compensation is due based on generation in preceding quarters, suppliers' liabilities from those quarters will need to be recalculated during reconciliation. We foresee two issues with the current process:

i) The reconciliation process is limited to 10 quarters; if the compensation is not agreed before 10 quarters after the date on which the change in law occurred, LCCC will not be able to recover the costs via reconciliation.

ii) Compensation payments would be largely unforeseeable and therefore suppliers are unable to hedge this risk in advance.

Proposal 12: Amend the ESO Regulations to treat retrospective compensation payments as non-generation payments for the purposes of reconciliation

3.17 To address these issues, we propose to amend the ESO Regulations so that where the amount paid to a generator changes after the first reconciliation determination for a quarter (e.g. due to strike price adjustments or changes in metered generation volumes), suppliers' liabilities for these payments should be determined by reference to their market share in the quarter in which the adjusted payments were made to the generator, rather than their market share on the day on which the relevant generation took place.

3.18 This means that after the first reconciliation determination, a supplier's CFD daily contributions[20] for a quarter would only change due to changes in supply volumes (i.e. supplier market share).

3.19 After the first reconciliation determination any other changes in CFD payments (e.g. due to retrospective strike price adjustments or changes in generation volumes) would be factored into the CFD quarterly contribution for the quarter in which the payments were

[19] These payments are referred to as 'difference amounts' and 'reconciliation amounts' in the CFD.

[20] See Regulation 4 of the ESO regulations.

made. We anticipate that using the most recent market share to calculate liabilities for these types of payments, which are inherently unforeseeable, will reduce the risk to suppliers in having to meet historic costs that are no longer commensurate with the size of their supply business.

3.20 Note that whilst we are considering making this change, it could require significant changes to LCCC's settlement systems which may be costly to implement. Therefore we welcome views from suppliers on how important they consider this proposal to be.

3.21 In addition, we propose to require LCCC to inform suppliers as soon as reasonably practicable when they consider there is a reasonable likelihood of a CFD quarterly contribution being due in a quarter, and to indicate the potential size of that payment (which could be a range rather than just a single number). This will increase transparency for suppliers and enable them to take account of these sums when setting their tariffs, and should therefore reduce the risk premia suppliers will need to charge their customers.

Consultation Questions	
12.	(a) Do you agree that the regulations should be amended so that after the first determination the CFD daily contribution can only change due to changes in supply volumes? (b) Do you agree that LCCC should be required to inform suppliers when they consider there is a reasonable likelihood of a CFD quarterly contribution being due in a quarter? (c) Given that the proposed change may require costly changes to LCCC systems, how important do you consider this proposal to be? Please provide evidence to support your response.

Interactions between the CFD exemptions

3.22 The Electricity Supplier Obligations (Amendment & Excluded Electricity) Regulations 2015 introduced two exemptions for suppliers from a proportion of their CFD costs. The first of these exempts suppliers from SO and operational cost levy payments on up to 85% of electricity supplied to eligible electricity intensive industries (EIIs). The second exemption is available to suppliers who import renewable electricity from EU Member States (green excluded electricity or GEE), and supply it to customers in Great Britain. This exemption is limited to electricity imported from generators that commissioned on or after 1 April 2015, with a cap on the total volume of GEE that can be claimed as exempt within a quarter. Exempted electricity will not count towards electricity suppliers' market share for the purpose of calculating CFD liabilities.

3.23 As presently drafted, it is theoretically possible for an individual supplier to demonstrate a net *negative* market share over a quarter if they claim both exemptions for the majority of their supply, i.e. a supply can claim a GEE and EII on the same unit of electricity. Since the exemptions are only intended to exempt from CFD cost, suppliers should not receive the benefit of both exemptions on the same unit.

Proposal 13: Prevent double counting of GEE and EII exemptions

3.24 We propose to amend the regulations to prevent a supplier receiving a supplementary benefit when both exemptions apply to their electricity supply at the same time.

Consultation Question	
13.	Do you agree that the regulations should be amended to prevent a supplier claiming a double discount as a result of the dual application of the exemptions?

Mutualisation

The ESO Regulations require non-defaulting suppliers to pay a share of relevant SO payments when a supplier defaults on their SO payments. We have received feedback that further clarity could be built into the regulations to ensure efficient administration of mutualisation processes. We propose to make a number of changes to the regulations to ensure that these efficiencies are achieved.

Proposal 14: Mutualisation of payments

3.25 ESO Regulation 17(1) sets out that all suppliers apart from the defaulting supplier (whose payment is being mutualised) should make mutualisation payments. This means that if there was another defaulting supplier whose payments were being mutualised, they would also be expected to make mutualisation payments in respect of the first supplier. In reality they may be unlikely to do so.

3.26 We propose to amend ESO Regulation 17(1) to exclude other suppliers who have defaulted on a payment **and** whose collateral is exhausted or is likely to be exhausted within 5 working days from being required to mutualisation payments (similar to the provision in ESO Regulation 17(3) which determines whether LCCC can issue a mutualisation notice).

Proposal 15: Mutualisation reference periods

3.27 Currently, two different reference periods are used to calculate a supplier's market share for the purpose of mutualisation payments relating to different sorts of defaults. Where mutualisation relates to a default on an interim rate payment, Regulation 17(8) specifies that the reference period is the day to which the default relates.

3.28 The reference period for mutualisation relating to defaults on all other payments is the most recent period of 30 consecutive days in respect of which the BSCCo has carried out an initial volume allocation run (SF).

3.29 We have received feedback that having different reference periods for different payment types may be confusing and complex to validate as well as not providing a clear advantage to suppliers. In addition, we note that the BSC uses a monthly mutualisation reference period for trading, default and dispute charges.

3.30 We therefore propose amending the regulations so that a rolling 30 day reference period is used for mutualisation of defaults on all payments.

Proposal 16: Mutualisation Notices

3.31 The regulations make provisions for LCCC to send a combination of mandatory and discretionary notices to suppliers informing them of their mutualisation liabilities. We propose amendments to two of these mutualisation notices.

3.32 ESO Regulation 17(2)(a-f) sets out provisions for LCCC to issue a notice informing individual suppliers of the amount of mutualisation payments they are required to make. With the proposed move to a rolling monthly reference period for mutualisation of all payment defaults, we believe it is no longer necessary to require LCCC to provide information to non-defaulting suppliers on the provision of the regulations under which the defaulting supplier should have paid, and the day to which the payment relates (ESO Regulation 17(2)(c) and (d)). We therefore propose to amend the regulations to remove 17(2)(c-d). This will remove unnecessary information from notices and simplify IT system requirements.

3.33 We also propose to exclude ESO Regulation 17(4), which requires LCCC to issue a notice to the defaulting supplier specifying details of the mutualisation. This may make it appear to the defaulting supplier that their debts have been paid and increase operational costs.

3.34 ESO Regulation 25 sets out discretionary provisions for LCCC to issue notices to suppliers informing them where they have failed to make a payment. There is a requirement to include within such notices information about the amount of interest that has accrued as at the date of the notice. However, since interest accrues daily on unpaid amounts, we think this is potentially misleading as it is just a snapshot, and does not reflect the total interest that will be payable.

3.35 We therefore propose to remove Regulation 25(e) so the notices no longer include the amounts of interest accrued as at the date of the notice.

Proposal 17: Repayment of mutualised payments and interest on credit cover

3.36 ESO Regulation 18 requires LCCC to repay recovered mutualisation payments to non-defaulting suppliers by the 5th working day after the day on which the amount was recovered.

3.37 Similarly, ESO Regulation 22(3) requires LCCC to pay any interest earned on collateral provided as cash to the supplier within 5 working days of receiving that interest.

3.38 We have received feedback that this will be operationally difficult to deliver, since it allows no time for LCCC to calculate the mutualisation payments and/or interest to be paid back to suppliers before putting these amounts onto invoices (since the standard payment terms on all invoices is 5 working days).

3.39 We therefore propose amending ESO Regulations 18(3) and 22(3) to require LCCC to make payments within 15 working days of recovering the mutualised payment or receiving interest on cash collateral.

3.40 This will still provide suppliers with a definite day by which they will receive the payment while giving LCCC more time to process calculations and make payments to suppliers.

Consultation Questions	
14.	Do you agree with the proposal to exclude from the requirement to make mutualisation payments those suppliers who have defaulted on a payment and whose collateral is exhausted or is likely to be exhausted within 5 working days?
15.	Do you agree that a rolling 30 day reference period should be used to calculate suppliers' liabilities for all mutualisation payments?
16.	Do you agree that LCCC should be given 15 rather than 5 working days to pay recovered mutualisation payments and interest earned on cash collateral?
17.	(a) Do you agree that ESO regulation 17(2)(c-d) should be removed to simplify the information sent in suppliers' mutualisation notices? (b) Do you agree that the amount of interest accrued to date should be excluded from the non-payment notice sent by LCCC to suppliers?

Letter of credit expiry and bank ratings

3.41 ESO Regulation 19 sets out the requirement for suppliers to provide collateral. Collateral is needed to ensure LCCC have sufficient funds to cover a supplier's determined interim rate payments in the event of default. LCCC can call on collateral if a supplier defaults on a payment, including interim levy rate, reserve, reconciliation, and mutualisation payments.

3.42 Collateral can be provided as an appropriate letter of credit (LoC) (i.e. issued by a person who holds a required rating and is provided on appropriate terms) or cash, or a combination of the two.

Proposal 18: Allowing LCCC to convert a LoC to cash collateral

3.43 If a LoC is not replaced before it expires, or the issuer's credit rating falls beneath the requirements set out in regulations, the supplier would be in breach of the credit cover provisions in the regulations. However, the regulations do not currently make provisions for LCCC to act if a LoC is due to expire shortly, or if it becomes invalid due to a bank's rating being downgraded, other than notifying Ofgem that the supplier is in breach of their licence requirements.

3.44 We intend to ensure that the LCCC has the ability to act to minimise their risk by converting a LoC to cash collateral in certain circumstances.

3.45 We propose that:

i) when the LoC lodged by a supplier is within 20 working days of expiry LCCC will inform the supplier of the potential breach, in order to provide the supplier with time for the situation to be rectified (either by providing written confirmation from the issuing bank that the LoC will be extended for a minimum of 6 months from the expiry date, or providing replacement collateral);

ii) If the supplier does not replace the LoC or provide cash collateral by 10 working days prior to expiry, LCCC can convert the LoC to cash and hold this as credit cover.

iii) LCCC can also convert a LoC to cash collateral from 10 working days after the point at which the issuer of the LoC ceases to hold the required credit rating.

3.46 This will reduce the risk to LCCC that a supplier will be without credit cover, of other suppliers having to pay any defaulting amounts, and also bring the ESO Regulations in alignment with collateral requirements in CFD contracts and Capacity Market regulations.

Consultation Question	
18.	Do you agree that LCCC should be able to call on LoCs which are due to expire, or are issued from a bank that no longer meets the required credit rating, and hold the cash as credit cover?

Issuing notices to all licenced suppliers

3.47 Currently the ESO Regulations require LCCC to send certain notices to all licenced suppliers, for example when informing all suppliers of that quarter's ILR. No distinction is made in the regulations between those suppliers who are capable of making a supply (i.e. they have registered BM units) and those who are not capable (inactive). There are currently over 150 licensed suppliers, around 60 of which are inactive and therefore would not be making SO payments.

3.48 This requirement is operationally onerous to LCCC who are required to process and send notices to each of these suppliers even though payments will not be received from them, and where they may not hold the appropriate contact details.

Proposal 19: Restricting notices to only suppliers that have the capability to supply

3.49 To resolve this issue, we propose to amend the SO regulations so that notices only need to be sent to suppliers who are supplying electricity or who have the capability to supply during the period covered by the notice. If a notice refers to past quarters, it would be sent to all suppliers that had liabilities during that period.

3.50 We think that this change will be sufficient to ensure that all relevant suppliers are informed of their potential liabilities, whilst reducing the administrative burden on LCCC.

Consultation Question	
19.	Do you agree that LCCC should only be required to send notices to suppliers who have the capacity to supply?

Proposal 20: Implementation dates and transitional measures

3.51 A number of interlinked and technical proposals are set out Chapters 1 to 3 that may require significant changes to both the LCCC's and electricity suppliers' IT systems. If the changes are made after CFD payments have started, there may also be a need for specific arrangements to deal with the transition, which we will consider in due course.

3.52 Should we decide to proceed with amendments we would seek to lay legislation that would come into force by the 1st April 2016. However, given that some of the proposals will require system changes, we are aware that we may need to allow a longer period before some of the proposals are implemented.

3.53 Therefore we would welcome views from stakeholders on whether any of the specific changes that we propose would need an implementation date beyond 1st April in order to accommodate system changes.

Consultation Question	
20.	Which (if any) of the proposals outlined in Chapters 1-3 would require an implementation date beyond 1st April, and why? What would represent a reasonable date for implementation?

Chapter 4: EII exemption – Eligible sectors

4.1 A consultation on providing relief for Electricity Intensive Industries from the indirect costs of renewables policy[21] was held between 31 July and 24 October 2014, and included proposed eligibility criteria for an exemption from the costs of CFDs.

4.2 Following the consultation, we laid the Electricity Supplier Obligations (Amendment & Excluded Electricity) Regulations 2015, which set out a Schedule of specified activities (i.e. sectors) that may be eligible for an EII exemption certificate. The Government Response published alongside those Regulations clarified that the initial list of sectors would be reassessed following additional consideration of the comments and data received through consultation, and further engagement with stakeholders. Following this process we are now proposing to amend the Schedule of specified activities.

Proposal 21: Amending the list of specified activities eligible for an exemption from the costs of CFDs

4.3 Eligibility for the exemption extends to electricity intensive businesses within the sectors[22] that have a trade intensity of at least 4% and an electricity-intensity of at least 7%. Following further analysis and engagement, we propose to update the Schedule to add and remove the specified activities listed in Table 1:

[21] https://www.gov.uk/government/consultations/electricity-intensive-industries-relief-from-the-indirect-costs-of-renewables

[22] Sectors are defined by the four-digit Standard Industrial Classification (SIC) code, 2007

Table 1 – Specified activities that we propose to add (left) and remove (right) from those within the Schedule that are eligible for the exemption from the costs of CFDs

Specified activities added	*Code*	**Specified activities removed**	*Code*
Cold drawing of wire	24.34	Manufacture of knitted and crocheted hosiery	14.31
Cold rolling of narrow strip	24.32	Manufacture of light metal packaging	25.92
Manufacture and processing of other glass, including technical glassware	23.19	Manufacture of other electronic and electric wires and cables	27.32
Manufacture of ceramic tiles and flags	23.31	Manufacture of other knitted and crocheted apparel	14.39
Manufacture of other rubber products	22.19	Manufacture of other products of wood; manufacture of articles of cork, straw and plaiting materials	16.29
Manufacture of refractory products	23.20	Manufacture of other technical and industrial textiles	13.96
Manufacture of tubes, pipes, hollow profiles and related fittings of steel	24.20	Manufacture of other textiles not elsewhere classified	13.99
		Manufacture of other wearing apparel and accessories	14.19
		Manufacture of plaster products for construction purposes	23.62
		Manufacture of prepared feeds for farm animals	10.91
		Manufacture of rubber tyres and tubes; retreading and rebuilding of rubber tyres	22.11
		Quarrying of ornamental and building stone, limestone, gypsum, chalk and slate	8.11
		Striking of coins	32.11
		Tanning and dressing of leather; dressing and dyeing of fur	15.11

Consultation Question

21.	Do you agree with the amendments to the Schedule of specified activities?

Catalogue of consultation questions

Chapter 2: Consultation Questions	
1.	Do you agree that the ILR calculation should be amended so that it is based on suppliers' expected 'accrued liabilities' for the quarter?
2.	Do you agree that LCCC should be able to *reduce* the ILR immediately if it expects to collect significantly more from suppliers than required to make CFD payments?
3.	Do you consider that it would be appropriate to remove the requirement for LCCC to undertake within-period data reconciliation of interim rate payments? What would be the impact of such a change? Please provide evidence to support your answer.
4.	(a) Do you agree with our proposal to make reconciliation payments sooner after they have been calculated? (b) Do you agree that the date on which the TRA is paid should continue to align with the date on which reconciliation payments are made? (c) Do you consider that we should implement proposal 4A or 4B to provide additional protection to suppliers in the event that they owe a shortfall payment to LCCC? If so, which proposal is your preferred approach and why? (d) Do you agree that the LCCC should provide suppliers with regular updates on their liabilities over the course of a quarter?
5.	Do you agree that the TRA should be sized to give cash-flow protection to LCCC between the day it is paid and the day the next TRA is collected?
6.	(a) Do you agree that LCCC should be able to reduce the size of the TRA up until the reconciliation notice before the payment due date is issued? (b) Should arrangements be put in place to repay suppliers who have made reserve payments before this date? (c) Do you agree that, where LCCC reduce the TRA, each supplier's reserve payment should be reduced pro-rata (i.e. based on their share of the original TRA)?
7.	Should LCCC have until the 13th working day of the quarter before the reserve payments are due to issue notices to individual suppliers of their individual reserve amounts?

Chapter 2: Consultation Questions	
8.	(a) Do you agree with our proposal to require LCCC to publish CFD cost projections? (b) Do you agree that these projections should cover three quarters beyond the quarter for which the ILR and TRA are set? (c) Do you agree that LCCC should be allowed flexibility over the precise nature of what must be published about future CFD costs? (d) Do you agree with our preferred proposal (Option A), that LCCC should be able to use all the information available to them, including generator confidential information, to project CFD costs? Please explain your reasoning.
9.	(a) Do you agree with our proposal to require expected CFD start dates to be published in the CFD register and for this information to be updated on a quarterly basis? (b) Please indicate which option you prefer regarding the exclusion of CFD start dates from the CFD register, and provide reasons for your view. (Option A: no exclusions; option B: ability for LCCC to exclude information following representations from a generator). (c) Would it be helpful for expected CFD start dates to only be published within a minimum period before the start of a generator's TCW? (d) Do you agree with our proposal to restrict LCCC's ability to exclude other information from the CFD register, so that this only applies to LCCC's reasons for accepting a modification of the CFD standard terms and conditions? (e) Is there any other information held by LCCC that you believe should be required to be published on the CFD register? Please provide evidence to support why this would be beneficial.

Chapter 3: Consultation Questions	
10.	Do you agree with the proposed clarification of set-off provisions, and the restriction of the circumstances in which it can be used?
11.	Do you agree that LCCC should automatically be able to net payments when a payment is owed from LCCC to a supplier and from the supplier to LCCC on the same day?
12.	(a) Do you agree that the regulations should be amended so that after the first determination the CFD daily contribution can only change due to changes in supply volumes? (b) Do you agree that LCCC should be required to inform suppliers when they consider there is a reasonable likelihood of a CFD quarterly contribution being due in a quarter? (c) Given that the proposed change may require costly changes to LCCC systems, how important do you consider this proposal to be? Please provide evidence to support your response.
13.	Do you agree that the regulations should be amended to prevent a supplier claiming a double discount as a result of the dual application of the exemptions?
14.	Do you agree with the proposal to exclude from the requirement to make mutualisation payments those suppliers who have defaulted on a payment and whose collateral is exhausted or is likely to be exhausted within 5 working days?
15.	Do you agree that a rolling 30 day reference period should be used to calculate suppliers' liabilities for all mutualisation payments?
16.	Do you agree that LCCC should be given 15 rather than 5 working days to pay recovered mutualisation payments and interest earned on cash collateral?
17.	(a) Do you agree that ESO regulation 17(2)(c-d) should be removed to simplify the information sent in suppliers' mutualisation notices? (b) Do you agree that the amount of interest accrued to date should be excluded from the non-payment notice sent by LCCC to suppliers?
18.	Do you agree that LCCC should be able to call on LoCs which are due to expire, or are issued from a bank that no longer meets the required credit rating, and hold the cash as credit cover?
19.	Do you agree that LCCC should only be required to send notices to suppliers who have the capacity to supply?

20.	Which (if any) of the proposals outlined in Chapters 1-3 would require an implementation date beyond 1st April, and why? What would represent a reasonable date for implementation?

Chapter 4: Consultation Question	
21.	Do you agree with the amendments to the Schedule of specified activities?

Glossary

BIS	Department for Business, Innovation and Skills
BMU	Balancing Mechanism Unit
BSC	Balancing and Settlement Code
BSCCo	Balancing and Settlement Code Company (Elexon)
CFD	Contract for Difference
EMRS	EMR Settlement Limited
ESO Regulations	The Contracts for Difference (Electricity Supplier Obligations) Regulations 2014
II run	Interim information volume allocation run
ILR	Interim Levy Rate
LCCC	Low Carbon Contracts Company Ltd, the CFD Counterparty
LoC	Letter of credit
MWh	Megawatt hour
SF run	Initial volume allocation run
SO	Supplier Obligation
TCD	Target Commissioning Date
TCW	Target Commissioning Window
TRA	Total Reserve Amount

Annex – Draft amended Schedule

DRAFT SCHEDULE

Regulation 2

Specified activities

Description of activity	*NACE Rev 2 Class*
Mining of hard coal	05.10
Operation of gravel and sand pits; mining of clays and kaolin	08.12
Other mining and quarrying not elsewhere classified	08.99
Manufacture of malt	11.06
Preparation and spinning of textile fibres	13.10
Weaving of textiles	13.20
Manufacture of non-wovens and articles made from non-wovens, except apparel	13.95
Manufacture of veneer sheets and wood-based panels	16.21
Manufacture of paper and paperboard	17.12
Manufacture of household and sanitary goods and of toilet requisites	17.22
Manufacture of refined petroleum products	19.20
Manufacture of industrial gases	20.11
Manufacture of other inorganic basic chemicals	20.13
Manufacture of other organic basic chemicals	20.14
Manufacture of fertilisers and nitrogen compounds	20.15
Manufacture of plastics in primary forms	20.16
Manufacture of synthetic rubber in primary forms	20.17
Manufacture of man-made fibres	20.60
Manufacture of other rubber products	22.19
Manufacture of plastic plates, sheets, tubes and profiles	22.21
Manufacture of plastic packing goods	22.22
Manufacture of flat glass	23.11
Manufacture of hollow glass	23.13
Manufacture of glass fibres	23.14
Manufacture and processing of other glass, including technical glassware	23.19
Manufacture of refractory products	23.20
Manufacture of ceramic tiles and flags	23.31
Manufacture of bricks, tiles and construction products, in baked clay	23.32
Manufacture of ceramic sanitary fixtures	23.42
Manufacture of other technical ceramic products	23.44
Manufacture of cement	23.51
Manufacture of lime and plaster	23.52
Manufacture of other non-metallic mineral products not elsewhere classified	23.99
Manufacture of basic iron and steel and of ferro-alloys	24.10
Manufacture of tubes, pipes, hollow profiles and related fittings of steel	24.20
Cold rolling of narrow strip	24.32
Cold drawing of wire	24.34
Aluminium production	24.42
Lead, zinc and tin production	24.43
Copper production	24.44
Other non-ferrous metal production	24.45
Casting of iron	24.51
Casting of light metals	24.53
Manufacture of electronic components	26.11
Manufacture of batteries and accumulators	27.20

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