



Department  
of Energy &  
Climate Change

# Government Response

CFD Supplier Obligation:  
Consultation on improving efficiency and  
transparency

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# Executive summary

## Purpose of this document

This document sets out the government's response to the '*CFD Supplier Obligation: Consultation on improving efficiency and transparency*' document published on 14 September 2015<sup>1</sup>, which proposed a series of technical amendments to the CFD Supplier Obligation (SO) with the aim of reducing CFD costs to consumers through incremental changes to the efficiency and transparency of the SO design. The consultation also proposed changes to the list of sectors eligible for the electricity intensive industries (EII) exemption.

## Consultation responses

In total, 26 responses were received to the consultation, with most respondents agreeing with the majority of the proposals. They included responses from a range of stakeholders, including large and small suppliers, generators, developers, trade associations and EIs. Most respondents provided comments on all parts of the consultation, although some focussed on specific areas of interest.

The majority of respondents agreed with the range of proposals consulted upon. Respondents were wholly positive on proposals to amend the calculation of the interim levy rate (ILR), the principle of bringing forward reconciliation payments, and allowing LCCC to reduce the ILR and total reserve amount without notice.

Proposals to increase transparency were generally well received by suppliers, but generators raised concerns about the potential disclosure of commercially sensitive information.

## Post consultation decisions

Following analysis of the responses received and further assessment of implementation options with delivery partners, we intend to implement the majority of the proposals consulted upon. However, because some of the proposals will require changes to the settlement system to be made, we are implementing the proposals in two phases.

We have laid regulations in Parliament which will, subject to parliamentary approval, bring the following measures into effect from 1 April 2016:

- A change to the way that the ILR is calculated, so that it better reflects suppliers' actual liabilities (*proposal 1*);
- Powers for LCCC to reduce the ILR without notice (*proposal 2*);
- A requirement on LCCC to publish projections of CFD costs for at least 15 months ahead (*proposal 8*);

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<sup>1</sup> <https://www.gov.uk/government/consultations/contracts-for-difference-supplier-obligation-improving-efficiency-transparency>

- A requirement on LCCC to include generator start dates in the public CFD Register (*proposal 9*);
- A number of minor and technical amendments (see Annex A for details; *proposals 7, 10, 11, 15, 16, 17, 19*).

In addition to the above, the government intends to lay regulations in Parliament in due course in order to implement the following measures in the first half of 2017:

- Making reconciliation payments more quickly after the end of the quarter (*proposal 4*);
- Amending the period over which the total reserve amount (TRA) is calculated (*proposal 5*);
- Allowing LCCC to reduce the TRA without notice (*proposal 6*);
- A number of minor and technical amendments (see Annex A for details; *proposals 13, 14 and 18*).

The government has decided not to implement the proposal to remove the interim data reconciliation process which takes place within a quarter (*proposal 3*), as the feedback received made clear that this was unlikely to result in any significant benefit, and may increase costs for some suppliers.

The government intends to consider further the proposal to change the treatment of generation and non-generation payments (*proposal 12*) before making a decision on whether to implement this change.

## Economic impacts

In the impact assessment published alongside the consultation document<sup>2</sup>, DECC quantified the economic benefits that were likely to result from the implementation of the proposals. The potential net cost saving over 5 years (2016-2020) to electricity suppliers of implementing the proposals was estimated to be £39m (NPV, 2015 prices), which would lead to a reduction in consumer bills of £0.40-£0.60 over the total period under analysis (2015 prices), assuming that these savings were passed through to consumers in their entirety. These savings result from a net reduction in financing costs associated with reduced reserve payments to LCCC, and a reduction in the amount of time LCCC retains excess reserve or interim rate payments before making repayments back to suppliers<sup>3</sup>.

An updated impact assessment has been published alongside this government response, which includes a preliminary estimate of the cost impacts of changes to the settlement system and quantifies the potential net cost saving of the proposals as £38m (NPV, 2015 prices).

## Next steps

The Electricity Supplier Payments (Amendments) Regulations 2016, setting out the amendments that the government plans to come into effect in 2016/17, have been laid before

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<sup>2</sup>

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/460444/Final\\_Supplier\\_Obligation\\_Consultation\\_Impact\\_Assessment.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/460444/Final_Supplier_Obligation_Consultation_Impact_Assessment.pdf)

<sup>3</sup> Note the regulations being laid in January 2016 will not implement the earlier reconciliation payments; however it remains the government's intention to do so in due course such that the change is implemented in the first half of 2017. Deferring its introduction will have only a minimal impact on the figure quoted above, as the government's intention is for the measure to be in place by the time CFD payments become material.

Parliament alongside the publication of this response. Subject to parliamentary approval, the amendments to the SO set out in these regulations will come into force on 1 April 2016.

As stated, where the implementation of proposals affects the CFD settlement system, we intend for them to be implemented in the first half of 2017, to enable stakeholders and delivery partners the time to make the necessary system changes. The government will lay regulations covering these proposals in due course.

Changes as a result of these proposals affect the Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 (“ESO Regulations”) and The Contracts for Difference (Standard Terms) Regulations 2014 (“Standard Terms Regulations”). The regulations also amend the ESO Regulations to set the operational cost levy from 1 April 2016 and make changes to the Electricity Capacity (Supplier Payment etc.) Regulations 2014 to set the settlement costs levy from 1 April 2016, which are covered in a separate government response to the consultation on operational cost levies<sup>4</sup>.

The government has not yet received state aid approval for the full EII aid scheme. Following this, the government will need to make a number of further amendments to The Electricity Supplier Obligations (Amendment & Excluded Electricity) Regulations 2015 at a later date. A separate response on this issue will be published by the Department for Business, Innovation and Skills (BIS) in due course. For an update on the revised list of eligible sectors since the publication of this consultation in September 2015, see the updated government response published by BIS on 19 January 2016<sup>5</sup>.

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<sup>4</sup> <https://www.gov.uk/government/consultations/low-carbon-contracts-company-and-electricity-settlements-company-operational-costs-201617>

<sup>5</sup> The updated government response to ‘*Electricity Intensive Industries – relief from the indirect costs of renewables*’ is available here: <https://www.gov.uk/government/publications/electricity-intensive-industries-indirect-costs-of-renewables-further-government-response>

# 1. Introduction

## Background

- 1.1. The Contract for Difference (CFD) scheme was introduced in 2014 as a new mechanism for incentivising renewable and low carbon electricity generation. A CFD is a contract signed between a low carbon electricity generator and the CFD Counterparty (the Low Carbon Contracts Company, LCCC) 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 those payments to CFD generators.
- 1.2. The SO consists of a series of prepayments from suppliers and a reconciliation process following each quarter. The prepayments comprise of:
  - Interim rate payments, paid daily by suppliers at an Interim Levy Rate (ILR) set by LCCC on a quarterly basis, three months in advance of the quarter in which it's paid; and
  - Reserve payments, paid at the start of each quarter, to provide LCCC with sufficient funds to ensure payments can be made to generators in 19 out of 20 scenariosBoth the ILR and the total of the reserve payments (the Total Reserve Amount, TRA) are set by LCCC on a quarterly basis, three months in advance of the quarter in which the payments are made.
- 1.3. Once a quarter ends, LCCC assesses each supplier's prepayments and their liability for actual CFD costs in the quarter. These amounts are reconciled and the difference paid to the owed party. Reconciliation for a quarter is repeated in each subsequent quarter as supply and generation volume data is updated, until it is finalised in the 10<sup>th</sup> reconciliation determination.

## Purpose of the consultation

- 1.4. The SO regulations came into force on 31 July 2014. In light of feedback received since implementation, DECC 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 onto consumers, as well as technical changes that will ease administration.
- 1.5. The consultation set out a number of proposals that were aimed at improving the efficiency and transparency of the SO, thereby reducing costs to consumers. The consultation also included proposed changes to the list of sectors are eligible for the electricity intensive industries (EII) exemption.
- 1.6. This document sets out the government response to the changes proposed in the consultation, which spanned three themes:
  - i. Improving efficiency of the SO design;

- ii. Increasing transparency of CFD costs;
- iii. Minor and technical amendments.



# Responses and Decisions

## 2. Improving the efficiency of the SO

- 2.1. In the consultation we set out proposals to improve the efficiency of the SO in order to meet the objective of minimising costs to consumers. These proposals included:
- Changes to the calculation of the interim levy rate (ILR);
  - Allowing LCCC to reduce (but not increase) the ILR without notice;
  - Removing within-period data reconciliation;
  - Making reconciliation payments more quickly after the end of a quarter;
  - Changes to the period over which the total reserve amount (TRA) is calculated;
  - Allowing LCCC to reduce (but not increase) the TRA without notice;
  - Allowing LCCC more time to provide notice of individual suppliers' reserve amounts.
- 2.2. In the draft impact assessment, DECC identified that, taken together, these proposals would lead to a net saving to suppliers of £39m (NPV, 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.
- 2.3. Each of these proposals is set out below in more detail, with a summary of the responses received, and the government's decision.

### Proposal 1 – ILR Calculation

#### Original proposal

- 2.4. Feedback from stakeholders and LCCC had highlighted that the numerator in the current ILR calculation (net payments expected to be made to generators *within the quarter*) will typically underestimate suppliers' actual liabilities for the quarter (assuming that CFD generation and payments increase over time). Suppliers' liabilities are based on net payments made to generators *in respect of generation within the quarter*. As generators are paid 28 days after the day of generation, the period used to calculate the ILR commences 28 days earlier than the period used to calculate actual liabilities during reconciliation.
- 2.5. In order to address this issue, we proposed to change the numerator of the ILR calculation from an estimate of payments to be made to generators during the quarter to an estimate of payments to be made to generators in respect of generation during the quarter (plus any non-generation payments to be made during the quarter). 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 and reducing the risk of reconciliation payments being due from suppliers to LCCC.

## Summary of responses

2.6. All 15 respondents who answered this question agreed with the proposal to amend the calculation. The majority of the respondents were suppliers, but also included an EII and generators.

2.7. Reasons provided for agreement included:

- The change would result in a more accurate view of their actual liabilities, which is expected to reduce the impact of reconciliation and suppliers' costs;
- The resulting reduction in the TRA would reduce costs to suppliers by improving supplier cash flow;
- Increased transparency for consumers would allow them better able to understand the CFD costs passed onto them from suppliers.

One supplier did note that whilst in the early stages of the scheme implementing the change would not have a significant effect, as CFD generation increases it would be preferable for the ILR to be an accurate reflection of suppliers' liabilities.

2.8. One respondent agreed with the proposal but, noting that this would result in an increase in the ILR, argued that the change should be implemented alongside the proposal that would allow LCCC to reduce the ILR without notice (*proposal 2*).

## Post consultation decisions

2.9. Following the positive feedback received on this proposal, **the government intends that the ILR will be calculated using an estimate of expected net CFD liabilities within the quarter**, with effect from 1 April 2016. As LCCC must determine the ILR at least a quarter in advance of the quarter in which the rate applies, the first quarter for which the new ILR calculation method will be applied will be October – December 2016.

## Proposal 2 – Allowing the ILR to be reduced without notice

### Original proposal

2.10. We proposed to waive the 30 days' notice requirement under the current regulations 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 would 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. This would not affect LCCC's ability to *increase* the ILR, which it could only do by providing a minimum of 30 days' notice.

### Summary of responses

2.11. All 16 respondents who answered this question agreed with the proposal, stating that it was a sensible amendment to the regulations, particularly at the start of the CFD scheme when there may be uncertainty over CFD start dates.

2.12. Four suppliers suggested that, when the ILR is reduced within the quarter, a short notice period would be preferred to allow time for suppliers' billing and settlement systems to be updated (3-5 working days was proposed).

2.13. Two suppliers requested further clarity on the circumstances in which LCCC should amend the ILR (i.e. defining how much over-collection would trigger a reduction in the ILR) and how LCCC would monitor this, in order for parties to calculate if LCCC is over-accruing and what the likely reduction to the ILR would be.

- 2.14. One respondent (a generator) noted that they would also like to see the 30 day notice period for an upward adjustment to the ILR removed, in order to reduce the risk to LCCC of under-collection.

### **Post consultation decisions**

- 2.15. Following the positive feedback received on this proposal, **the government intends that LCCC should be allowed to reduce the ILR without notice**, with effect from 1 April 2016.
- 2.16. Suppliers will have 12 working days' notice of payments at the reduced ILR (because suppliers are invoiced around 7 working days after the day of supply, with the payment being made 5 working days later), and LCCC can (at their discretion) provide longer notice if they deem it to be appropriate. Therefore we have not included a minimum notice period in the regulations.
- 2.17. LCCC intend to provide within-quarter updates to suppliers on actual invoiced CFD payments compared with the forecast CFD generator payments that were expected at the time of making the ILR/TRA determination, which is intended to provide transparency for suppliers on whether LCCC is likely to over- or under-collect in a quarter.
- 2.18. We do not intend to remove the 30 day notice period for LCCC to *increase* the ILR, as we view that this period is necessary for suppliers to understand their liabilities, manage their cash-flow, and not incorporate additional risk premia into their tariffs. Generators are currently paid 28 days after the day of generation. Given the TRA is sized to enable LCCC to fund CFD payments to generators in 95% of scenarios, we consider this as sufficient time for LCCC to monitor their funds and adjust the ILR and TRA if necessary without putting undue risk on payments to CFD generators.

## **Proposal 3 – Removal of within-period data reconciliation of interim rate payments**

### **Original proposal**

- 2.19. Some stakeholders had questioned whether the reconciliation of interim rate payments within a quarter under the current regulations was necessary given the reconciliation against actual generation payments shortly after the end of the quarter. DECC therefore sought views on whether the requirement for LCCC to undertake data reconciliation of interim rate payments within the quarter should be removed in order to simplify the SO.

### **Summary of responses**

- 2.20. Of the 16 respondents who answered this question, 10 agreed with the proposal, four did not hold strong views, and two disagreed.
- 2.21. Of the respondents who agreed, three stated positively that the proposal would reduce administrative burden, including by reducing backing data and within-period adjustments for generally insignificant sums. The other respondents agreed that the current requirement was unnecessary and that the proposal offered simplification whilst not significantly affecting suppliers' systems, but also stated that the change would not affect the overall cost to suppliers or would have no impact. One respondent agreed but did not consider the change important enough to justify large implementation costs.
- 2.22. Four other respondents commented that the change would have no great impact as suppliers have already built systems for the current mechanism, and so if the change would require significant costs then they would not support it, but otherwise they held no strong views on the proposal.

2.23. Two smaller suppliers strongly disagreed with the proposal. One argued that within-period data reconciliation should be allowed in case of significant error in the II run. Another argued that the proposal would lead to significant additional system development costs, as the current systems are already designed to reflect changes in volume allocation.

### **Post consultation decisions**

2.24. Given the qualitative responses to this proposal that the change would result in limited savings to suppliers and could require them to incur additional costs in amending systems, together with potential impacts of changing the CFD settlement system, DECC does not consider that the costs of this change are justified. **The government has therefore decided not to implement this proposal.**

## **Proposal 4 – Making reconciliation payments more quickly**

### **Original proposal**

- 2.25. Currently reconciliation notices are issued around 7 working days after the end of a quarter, with reconciliation payments made to (or collected from) suppliers 90 days' later. DECC sought views on whether LCCC should make reconciliation payments more quickly following the end of a quarter, by bringing forward the reconciliation payment from 90 days to 5 working days after the issue of the reconciliation notice. Reconciliation notices would be issued on the 8<sup>th</sup> working day of a quarter, with payment of the reconciliation sum on the 13<sup>th</sup> working day (such that the reconciliation payment is netted off against the reserve payment due to be made for that quarter).
- 2.26. DECC noted a possible risk with the proposal, that, on rare occasions, suppliers might be required to make reconciliation payments to LCCC at short notice in addition to their reserve payments, and we welcomed thoughts on two adaptations to the central proposal:
- Proposal 4A: providing additional time (10 working days) between the issuing of the reconciliation notice and the payment due date.
  - Proposal 4B: differentiating the timing of payment 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.

### **Summary of responses**

- 2.27. All respondents agreed that reconciliation payments should be made more quickly following the issue of the reconciliation notice, but there were mixed views on respondents' preferred approach, with preferences split between the three options.
- 2.28. Six suppliers supported DECC's preferred option (4) of reconciliation payments in either direction 5 working days after the issuing of the reconciliation notice, although two also noted the merits of the additional 5 working days' notice under option 4A.
- 2.29. In addition, three respondents (two independent suppliers and a generator) preferred option 4A, particularly whilst a direct debit facility is not available. Other respondents did not consider the additional 5 working days to be necessary and preferred prompter settlement to longer notice.
- 2.30. Three independent suppliers and an EII strongly supported the asymmetrical payment option (4B), though seven other respondents explicitly stated that they were against this

approach due to its additional complexity and system changes that suppliers would be required to make. One respondent argued that this option did not allow the full benefits of earlier reconciliation to be realised, because when shortfall payments were due by one or more suppliers to LCCC other suppliers would not receive their full reconciliation payment on the 13<sup>th</sup> working day, and therefore these suppliers would still provide a certain level of duplicate reserve to LCCC until the remainder was paid 90 days after the reconciliation notice (due to the pro-rating of payments).

- 2.31. One respondent commented on the risk to suppliers being required to make a reconciliation payment to LCCC, claiming that the combined ILR and TRA for the first quarter of 2016 amounts to less than the expected accrued liability for the quarter<sup>6</sup>. The respondent also commented that any reconciliation payment made to LCCC should be accounted for in the calculation of the TRA for the following quarter.

### Post consultation decisions

- 2.32. **The government intends to implement the proposal to bring forward reconciliation payments to 5 working days after the reconciliation notice is issued.** This option has the benefit of simplicity, returning money to suppliers as soon as possible, and of being lowest cost to implement.
- 2.33. However, this measure requires significant change to LCCC's settlement system, which is still under development. As such, **we have decided not to implement this change until the first half of 2017.** The government will bring forward regulations in due course.
- 2.34. In order to mitigate concerns around having to make payments to LCCC at short notice, LCCC are intending to develop their 'transparency tool' to provide additional daily updates on actual payments to CFD generators compared to the forecast CFD payments that were expected at the time of making the ILR/TRA determination. This will provide suppliers with greater foresight over the magnitude and direction of potential reconciliation payments. With regard to the concern that some respondents raised regarding 5 working days being too short given that a direct debit facility was not in place at the time of consultation, we note that this facility is now in place.
- 2.35. DECC considers that the possibility of the combined ILR and TRA being below the expected accrued liabilities for a quarter is a result of the current ILR being calculated by reference to CFD payments made in a quarter rather than accrued liabilities. This issue will therefore be addressed by the implementation of *proposal 1*, which will ensure that the ILR and TRA will always equal or exceed the expected accrued liabilities for a quarter and therefore reduce the risk of reconciliation payments being due from suppliers to LCCC.

## Proposal 5 – Adjusting the period over which the TRA is calculated

### Original proposal

- 2.36. We proposed adjusting the period over which the TRA is calculated to match the period of cash-flow risk for LCCC, i.e. from the point in time that one set of reserve payments are due, to the time the next set are due. This is because in theory there is a small risk to LCCC created by the current design<sup>7</sup>: the TRA is calculated for a given quarter to provide

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<sup>6</sup> LCCC publishes the ILR and TRA on its transparency tool, which is accessible via LCCC's website: <https://lowcarboncontracts.uk/>

<sup>7</sup> This risk would also increase with the implementation of *proposal 4*, see paragraph 1.38 of the [CFD Supplier Obligation: Consultation on improving efficiency & transparency](#)

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 7<sup>th</sup> 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. In practice, this change would shift the period over which LCCC assess the cash-flow risk by 12 working days.

### Summary of responses

- 2.37. 11 of the 14 respondents who answered this question supported the proposal, noting that it seemed sensible to address the risk identified, and that the combination of proposals put forward in the consultation document were expected to reduce the TRA overall.
- 2.38. Three respondents disagreed because the proposal would likely result in a higher TRA (on average by 4% over the period to Q1 2018). The respondents did not consider that this was justified and claimed that LCCC have sufficient other tools to manage the risk of under-collection.

### Post consultation decisions

- 2.39. Given that the consultation feedback was largely positive, and this proposal provides LCCC with the appropriate level of cash-flow protection, **the government intends to implement this change** so that the TRA is calculated to provide cash-flow protection to LCCC between the day it is paid and the day the next TRA is collected.
- 2.40. DECC notes that whilst the TRA is expected to slightly increase under this proposal, it will decrease overall as a result of the implementation of *proposal 1*. The risk of an increase in the TRA will only really materialise once LCCC begins to make earlier reconciliation payments, something which we do not intend to implement until the first half of 2017 (see paragraph 2.33). Therefore we believe that there is no need to implement a proposal which will increase the TRA until this point, and will therefore delay implementation until *proposal 4* has been implemented. The TRA is calculated a quarter in advance, and therefore the government intends for **this change to be implemented in time for it to affect the calculation of the TRA for either the April – June or July – September quarters in 2017**. The government intends to lay regulations covering this proposal in due course.

## Proposal 6 – Allowing LCCC to reduce the TRA

### Original proposal

- 2.41. 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. We proposed giving LCCC the power to reduce the TRA (up to the point that the invoice that nets the reserve payment against a reconciliation payment is issued) 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. We also proposed 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).

### Summary of responses

- 2.42. All 15 respondents who answered these questions supported this proposal because it would have a significant positive impact, particularly for smaller suppliers, in the event that the TRA was set too high for an upcoming quarter. Some respondents commented

that they would wish to see more transparency over what level of over-collection would trigger LCCC to reduce the TRA.

- 2.43. All respondents agreed with the pro-rating approach proposed for calculation of the reduced reserve amount; one small supplier noted that, whilst they would not benefit from the approach, they agreed with the policy intent. One respondent argued that the same approach should be used for when the TRA is increased; however, DECC set out the argument for the differing approaches in the consultation document (which was agreed with by another respondent).
- 2.44. All respondents agreed with the provision to repay suppliers who pay the original reserve amount early, although one noted that it would be unlikely for suppliers to pay amounts significantly in advance of the due date.

#### **Post consultation decisions**

- 2.45. Given the positive feedback and clear benefits for suppliers in reducing the TRA if it has been set higher than necessary, **the government intends to implement this change.** However, because the LCCC would not be able to reduce the TRA once the reconciliation notice which nets the reserve payment against a reconciliation amount has been issued (which under the current regulations is 90 days before the reserve payment is due), this change would have no significant effect until *proposal 4* is implemented (because under the current regulations LCCC sets the TRA before the quarter preceding the quarter in which it would apply, but under this proposal LCCC would then only have ~7 working days to reduce the TRA before the reconciliation notice is issued). **The government intends to implement this amendment alongside the other proposals affecting the TRA in the first half of 2017.**

### **Proposal 7 – Allowing LCCC to calculate and provide notice of suppliers' individual reserve amounts by the 13<sup>th</sup> working day of the quarter before the one in which the payment is due**

#### **Original proposal**

- 2.46. 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. DECC proposed that LCCC must issue the notice to individual suppliers by the 13<sup>th</sup> working day of the quarter before the one in which the payment is due.

#### **Summary of responses**

- 2.47. The majority of respondents (11 of 14) agreed with this proposal. Of the two respondents who disagreed with the proposal, one questioned whether the benefits of the change would be significant, whilst the other, although sympathetic to the issue faced by LCCC, suggested that 13 working days was too long a delay, as the sooner suppliers have sight of their liabilities the better they can plan their cash-flow.

#### **Post consultation decisions**

- 2.48. **The government intends to implement this proposal with a minor amendment, so that the notice will be due before the 8<sup>th</sup> working day of the quarter before the payment is due.** Subject to Parliamentary approval, the change will come into effect from 1 April 2016.
- 2.49. Before the 8<sup>th</sup> working day of the quarter before the payment is due, LCCC will be required to send a notice to suppliers setting out their reserve payment for the following quarter. Reserve payments will continue to be due 90 days after the reconciliation notice

is issued until *proposal 4* is implemented in 2017, following which the reserve payment will be due 5 working days after the subsequent reconciliation notice. This change will allow LCCC the time they need to issue the notices and not requiring them to calculate the TRA early, whilst still giving suppliers 90 days' notice of their reserve payments.



## 3. Delivering Transparency

- 3.1. In the consultation, DECC set out several proposals that it considered would improve suppliers' abilities to manage their CFD SO payments, reducing the costs passed through to customers as a result.
- 3.2. These changes included 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.
- 3.3. Below these proposals are set out in more detail, alongside a summary of the responses received and the government's response.

### Proposal 8 – Obligation upon LCCC to project forecasts of CFD costs for at least three quarters beyond existing requirements

#### Original proposal

- 3.4. DECC proposed to require LCCC to project CFD costs for a further three quarters in order to provide suppliers with more foresight over potential future liabilities. This means that suppliers would always have access to projections of CFD costs for at least the year ahead.
- 3.5. The government's preferred approach was to amend the regulations to allow LCCC to use all information available to them in their CFD costs projections, including generator confidential information. DECC also set out an alternative option whereby the government would require that LCCC base projections only on publicly available information or information that CFD generators agree can be used.

#### Summary of responses

- 3.6. All respondents agreed with the principle of projecting CFD costs as well as with the proposal that these projections should cover three quarters beyond the quarter for which the ILR and TRA are set.
- 3.7. General comments on the first two questions included:
  - A question over whether the government needed to regulate, given that LCCC have already started to provide forecasts;
  - How far forward the projections would go. Some respondents argued that the projections should go further to align with suppliers' needs to forecast three years ahead, whilst another respondent questioned how reliable the projections could be given the season or day-ahead nature of the prices used to calculate CFD payments to generators. Others agreed with the proposal of having at least one year of visibility;
  - Two respondents claimed that the proposal would level the playing field between larger and smaller suppliers, as larger suppliers are at an advantage through being able to manage uncertainty over their CFD liabilities more effectively, and, in some cases, having a link via their development arm to a CFD project;

- Two respondents believed that given CFD generators are benefiting from a subsidy paid for by consumers, it is fair that suppliers are able to forecast their costs more accurately and reduce the risk premium incorporated in their prices to end consumers.
- 3.8. On the issue of whether or not LCCC should have flexibility over the precise nature of what must be published about future CFD costs, the majority of respondents agreed that LCCC *should* have flexibility, with one respondent disagreeing. The one respondent that disagreed suggested that the information to be published should be constrained to a projection of ILR and TRA for an additional three quarters only. Of those that neither clearly agreed nor disagreed, respondents broadly considered that although there could be some flexibility over what LCCC publishes, there should be a minimum amount of information that LCCC is required to publish.
- 3.9. Responses were mixed on the question of whether LCCC should be able to use all of the information it has available, including generator confidential information, in its projections of CFD costs. The majority of suppliers (including those with generation arms) considered that LCCC should be able to use all the information it has available, although three suppliers did disagree with this option, raising concerns regarding the confidentiality of information, and whether this could negatively influence the accuracy of information supplied to LCCC by generators. Most generators preferred the second option, arguing that LCCC should not be able to use confidential information in a way that results in the direct disclosure of information or where confidential information could be identified by analysis of the projections. One developer claimed that they would be more comfortable with a clear list of information that is required to be used, as LCCC would not need to use all the information available to them for these projections.

### Post consultation decisions

- 3.10. Having considered the range of views expressed by stakeholders, **the government intends to require LCCC to project CFD costs for a further three quarters**. Subject to Parliamentary approval, this change will come into effect on 1 April 2016.
- 3.11. The government considers that the increased transparency over CFD costs will bring significant benefits to consumers. DECC notes that LCCC are already projecting CFD costs, but considers that putting this requirement on a statutory footing will be beneficial as it will ensure that LCCC are required to continue to project CFD costs.
- 3.12. Noting the feedback from respondents, the government will require LCCC to, as a minimum, publish projections of the ILR, TRA and estimated total CFD payments for the three quarters that commence two quarters after the current quarter. Since this places a statutory requirement on LCCC, under the terms of CFDs LCCC will be permitted to use relevant generator confidential information for the purpose of determining the forecasts. However, because LCCC will only be required to publish aggregated information, DECC considers that this will not result in the disclosure of commercially sensitive information.

## Proposal 9 – Updating the CFD register with CFD start dates

### Original proposal

- 3.13. The CFD register currently includes the start of the target commissioning window (TCW) and the target commissioning date (TCD) that was submitted as part of the CFD application process, but no information is provided about when payments to a generator are likely to begin within the TCW. The government therefore proposed to require LCCC to place the most recent estimate of the CFD start date provided by the generator into the CFD register, and to update this on a quarterly basis.

- 3.14. The government's preferred approach was for expected CFD start dates to be published and updated for all generators. However, we consulted on an alternative (option B) whereby LCCC would be allowed to exclude information on CFD start dates from the CFD register for particular generators where they consider that it would be commercially damaging to the generator to publish it.
- 3.15. The government also proposed an additional amendment to the CFD register provisions relating to disclosure of information. The government proposed to only allow LCCC to exclude information from the CFD register that relates to both the generator's CFD start date (if the alternative proposal were to be taken forward), and LCCC's reasons for accepting an application to modify the standard terms.

### Summary of responses

- 3.16. Of the 20 respondents who answered this question, 16 (13 suppliers, a trade association, an EII and a generator) agreed with the proposal to publish CFD start dates in the CFD register, arguing that CFD start dates were important in order for suppliers to be able to accurately forecast CFD costs. One supplier suggested that the CFD register could be updated monthly with this information, as this is the frequency that CFD generators provide updates to LCCC under the CFD contract. Another respondent noted that it was important to make it clear that CFD start dates published on the CFD register would be indicative only.
- 3.17. The majority of suppliers who responded to this question supported there being no option to exclude CFD start dates from the register, although two suppliers explicitly stated that they preferred option B (with the caveat that there must be strong commercial reasons for the CFD start date to be withheld). Two other suppliers noted that whilst they preferred no exclusions, they recognised that on rare occasions it may be beneficial to allow LCCC to be able to exclude CFD start dates following a representation from the generator.
- 3.18. The four respondents who disagreed, all generators or developers, argued that the CFD start date constitutes confidential information that is an integral part of a project's commercial position, and that such information is provided to LCCC in confidence and should not be released publically. One generator claimed that the requirement for LCCC to publish projections of CFD costs under *proposal 8* is sufficient to improve transparency of CFD payments.
- 3.19. All generators and developers who responded preferred option B in order to protect commercially sensitive information. One respondent noted that option B was also problematic, as the exclusion of information from the CFD register might serve to highlight an issue with the project or cause speculation.
- 3.20. Of the 13 respondents who answered the question on the restriction on excluding information from the CFD register, 12 agreed with the proposal. One developer agreed with the proposal but also suggested that LCCC should also be able to exclude from the CFD register information on any modification of standard terms. One generator disagreed, arguing that LCCC should be entitled to exclude from publication any information which it would not be entitled to disclose in response to a request for its disclosure under the Freedom of Information Act 2000 ("FOI Act") or Environmental Information Regulations 2004 ("EI Regulations").

### Post consultation decisions

- 3.21. The government considers that the benefits in transparency of requiring LCCC to publish CFD start dates are significant and therefore **intends to implement the requirement for**

**LCCC to publish CFD start dates from 1 April 2016.** LCCC will be required to update this information on a quarterly basis.

- 3.22. Given the concerns expressed by all generators regarding the disclosure of potentially commercially sensitive information, we have decided to allow LCCC to exclude information which in its option it would be entitled not to disclose in response to a request for its disclosure under the FOI Act or EI Regulations (following suitable representations to LCCC from a concerned generator to have such information withheld). We expect this discretion to be used rarely.
- 3.23. **The government also intends to implement the proposal to restrict the ability of LCCC to exclude information from the CFD register** under provision 12(6-7) to LCCC's reasons for accepting an application to modify the standard terms and generators' latest CFD start dates. Subject to Parliamentary approval, this change will come into effect from 1 April 2016.

## 4. Minor and technical amendments

- 4.1. In the consultation the government set out a range of minor and technical amendments to the SO which sought to clarify sections of the regulations and ensure they reflect the government's policy intent.
- 4.2. These proposals are set out in more detail below, alongside a summary of the responses received and the government's response.

### Proposal 10 – Clarification on set-off provisions

#### Original proposal

- 4.3. The government proposed amending the regulations so that 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 other payments that have been determined; and 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.
- 4.4. The proposal also included 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.

#### Summary of responses

- 4.5. All respondents supported this proposal. One respondent emphasised the need for clarity to avoid suppliers making gross payments when a net payment was due, or vice versa. Another noted that the proposal appeared reasonable for the sake of minimising credit risk.

#### Post consultation decisions

- 4.6. **The government intends to implement this proposal with effect from 1 April 2016.**

### Proposal 11 – Clarification on netting provisions

#### Original proposal

- 4.7. The government proposed to clarify the regulations to make clear 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).
- 4.8. The government proposed that the netting of payments should be automatic, as opposed to set-off which is discretionary, and 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.

#### Summary of responses

- 4.9. The majority of respondents (13 of 15) supported this proposal, with some noting it was a sensible measure which is normal business practice and reduces administrative overheads. Two suppliers disagreed with the proposal, highlighting concerns about the

risk of error and the potential need for manual intervention. Many respondents requested clarification about how the processes would work in order to avoid errors occurring.

### **Post consultation decisions**

- 4.10. The government considers that these amendments will increase efficiency for many suppliers, as well as reduce the risk to LCCC of receiving automatically netted payments in error. The government considers that the implementation of direct debit by EMRS will address the concerns raised by the respondents above regarding the need for manual intervention. **The government intends therefore to implement this change with effect from 1 April 2016.**

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

### **Original proposal**

- 4.11. The government proposed 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.
- 4.12. The proposal also included a measure 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).

### **Summary of responses**

- 4.13. This proposal received a mixed response from stakeholders (including suppliers, generators and an EII), with eight in agreement, five in disagreement and two with no strong views. Of those who agreed, three stated that they did not consider the benefits would justify significant implementation costs.
- 4.14. Reasons for agreement with the proposal included acknowledgement of the unforeseeable risk that suppliers face of having to make significant payments based on their previous market share, and the administration required by suppliers to recover money from previous customers who had pass through arrangements in place. These respondents considered the proposal to be beneficial as treating compensation payments as non-generation payments would help to limit retrospective changes to CFD rates.
- 4.15. One supplier argued that the proposal would make it more difficult for suppliers to pass through costs to their customers, and preferred the link between generation and customers' consumption on any given day to be maintained. Two independent suppliers did not support the proposal because they considered it would disadvantage small growing suppliers as instead of paying the amount owed when the event took place, suppliers would now be made to pay according to market share at the time of discovery.

### **Post consultation decisions**

- 4.16. The government considers that the complex issues raised by respondents in response to this proposal means further consideration is needed as to how best to take this measure forward. The government believes that the risk to LCCC of compensation payments not

being recoverable through the reconciliation process is one that needs to be addressed. However, this issue will not materialise within the next year, so we intend to carry out further work with suppliers to identify an appropriate solution. The implementation of this measure would also have a significant impact on settlement systems. As a result, **the government does not intend to implement this change in 2016/17.**

## Proposal 13 – Preventing double counting of GEE and EII exemptions

### Original proposal

4.17. At present, it is theoretically possible for an individual supplier to demonstrate a net negative market share over a quarter if they claim both green excluded electricity (GEE) and EII exemptions for the majority of their supply (i.e. a supplier can claim GEE and EII on the same unit of electricity). The government proposed to implement measures that would prevent a supplier claiming a double discount as a result of a GEE exemption and an EII exemption.

### Summary of responses

4.18. The majority of respondents (14 of 16) supported this proposal. Only one respondent disagreed with the proposal because they considered it to be unnecessary, understanding the issue as not one of ‘double discount’ but an issue of a net payment due to a supplier. This respondent stated that they would agree with capping the total exemption quarterly, to allow for a negative market share on individual days but not overall.

### Post consultation decisions

4.19. Whilst the government wishes to implement this proposal, given the impact on settlement systems and low likelihood of the issue occurring, the government does not consider it to be a priority for 2016/17. **The government intends therefore to implement this amendment alongside *proposal 4* in the first half of 2017**, and will lay the associated amended regulations in due course. It is the government’s intention to cap the exemptions on a quarterly basis, so that the total exemption a supplier may demonstrate over a quarter cannot exceed that supplier’s total supply over the quarter (i.e. no supplier can have a negative market share over a quarter).

## Proposal 14 – Mutualisation of payments

### Original proposal

4.20. The government proposed to exclude other suppliers who have defaulted on a payment and whose collateral is exhausted or is likely to be exhausted within five working days from being required to make mutualisation payments.

### Summary of responses

4.21. Seven of the 15 of respondents who answered this question agreed to the proposal, considering it to be sensible. Three respondents disagreed, noting that the proposal raised the possibility that a supplier who temporarily defaults or is close to defaulting is excused their share of mutualisation payments. Five respondents did not express a strong opinion either way, stating that the proposal seemed sensible but requesting clarity on the circumstances in which LCCC would determine whether a supplier’s collateral was “likely” to be exhausted.

## Post consultation decisions

- 4.22. The government considers this proposal to be a sensible protection for LCCC. However, because it would require changes to settlement systems and is not a high priority, **the government intends to implement this amendment in the first half of 2017**, with the regulations being laid in due course.

## Proposal 15 – Mutualisation reference periods

### Original proposal

- 4.23. The government proposed to amend the regulations so that a rolling 30 day reference period is used for mutualisation of defaults on all payments.

### Summary of responses

- 4.24. The majority of respondents (13 of 15) supported this proposal, simplifying the existing regulations. One (growing) supplier disagreed because they claimed they would likely be charged a greater share of mutualisation payments.

### Post consultation decisions

- 4.25. The government considers that having different reference periods for different payment types may be confusing and complex to validate, as well as not providing suppliers any clear advantage. Although we acknowledge the concern raised by the supplier above, we do not consider this to be a sufficient enough reason to not implement the proposal. As a result **the government intends for this change to come into effect on 1 April 2016**.

## Proposal 16 – Repayment of mutualised payments and interest on credit cover

### Original proposal

- 4.26. The government proposed to increase the period of time that LCCC has to repay mutualised payments and interest on credit cover from 5 working days to 15 working days.

### Main messages from responses

- 4.27. The majority of respondents (9 of 15) supported this proposal, with those disagreeing pushing back on the length of time required by LCCC to pay recovered mutualisation payments and interest earned on cash collateral, stating that 15 working days was overly generous.

### Summary of decisions

- 4.28. **The government intends to implement this proposal with effect from 1 April 2016.** The amendment will require LCCC to pay recovered mutualisation payments and interest on cash collateral within 15 working days, although they are permitted to make the payments earlier and we would expect them to do so where possible.

## Proposal 17 – Mutualisation notices

### Original proposal

- 4.29. The government proposed amending two of the mutualisation notices that LCCC is required to send to suppliers. The first proposed change was to remove information on the notices sent 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. The second proposed change was to remove the requirement for LCCC to issue a notice to the defaulting supplier specifying the details of the mutualisation.

### **Main messages from responses**

4.30. The majority of respondents agreed that ESO regulation 17(2)(c-d) should be removed to simplify the information sent in suppliers' mutualisation notices, apart from one respondent who neither agreed nor disagreed, but was wary of the potential systems impact of such a change, noting the number of changes that suppliers have been required to make in the early months of the scheme. The majority of respondents also agreed that the amount of interest accrued to date should be excluded from the non-payment notice sent by LCCC to suppliers.

### **Post consultation decisions**

4.31. The government considers that this proposal will remove unnecessary information from mutualisation notices and simplify the IT system requirements of relevant parties. Given the largely positive feedback received on this proposal, **the government intends for the amendments to come into effect on 1 April 2016.**

## **Proposal 18 – Allowing LCCC to convert a LoC to cash collateral**

### **Original proposal**

4.32. The government proposed that LCCC should be able to convert a letter of credit (LoC) to cash collateral if the bank that issued the LoC is downgraded or if the LoC expires.

### **Summary of responses**

4.33. The majority of respondents (12 of 15) agreed that the proposed change was sensible. Two respondents disagreed, claiming that no change is required as a LoC which is about to expire remains valid up until the point of expiry, and as long as a supplier continued to make payments there would not be breach of obligations until the point of expiry. One respondent argued that LCCC should be able to call on the LoC for the amount required only.

4.34. Some respondents argued that if an issuing bank is downgraded the obligation should be on the LCCC to inform relevant parties in writing in the first instance. A supplier should then have a fair and reasonable amount of time to allow for a replacement of the LoC from a different bank, which meets the minimum credit rating.

### **Post consultation decisions**

4.35. The government considers that this change will reduce the risk to LCCC that a supplier will be without credit cover and of other suppliers having to pay any defaulting amounts. However, at this stage DECC and LCCC intend to keep under review whether an amendment to the regulations to implement this change is necessary.

## **Proposal 19 – Restricting notices to only suppliers that have the capability to supply**

### **Original proposal**

4.36. The government proposed to reduce the administrative burden on LCCC to send notices to all suppliers, even to those that cannot supply.

## Summary of responses

4.37. The majority of suppliers supported the proposal. Only one respondent disagreed with the proposal, believing that LCCC should be required to include all suppliers until it knows that a supplier will not supply in the next six months. This respondent acknowledged the administrative burden this places on LCCC, but highlighted the risk of excluding suppliers who may be planning to commence supply within the next two quarters, who would benefit from receiving a notice for planning their cash-flow.

## Post consultation decisions

- 4.38. **The government intends to implement this change with effect from 1 April 2016.** The regulations set out different requirements for issuing notices depending on the type of notice. In particular, LCCC will be required to issue:
- Notices of the ILR to every supplier who has a registered BM unit on the day before the ILR notice is published, and every supplier that subsequently registers a BM Unit;
  - Notices setting out reserve payments to every supplier who supplied electricity during the reference period which was used to calculate the reserve payment;
  - Notices setting out reconciliation payments to every supplier who supplied electricity during the reconciliation period, is due to make or receive a reconciliation payment, or is due to make a reserve payment;
  - Mutualisation notices to every supplier who supplied electricity during the reference period which was used to calculate the mutualisation amount.
- 4.39. We believe that these arrangements will ensure that notices will be sent to those suppliers to whom they are relevant, whilst significantly reducing the administrative burden on LCCC and EMRS.

# Annex A – List of Respondents

- British Ceramic Confederation
- British Gas
- Brookfield Renewable Energy Group
- British Rubber and Polyurethane Products Association
- BTMA Ltd
- Celsa Group Purchasing
- Cemex
- DONG Energy
- Drax
- Ecotricity
- EDF Energy
- EDP Renewables
- Energy UK
- E.ON
- First Utility
- Gazprom Energy
- Good Energy
- Haven Power
- Mineral Products Association
- Opus Energy
- Ovo Energy
- RWE npower
- Sembcorp Utilities (UK) Limited
- Shell
- SmartestEnergy Ltd
- SSE

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