Department for
Business, Energy
& Industrial Strategy

Low Carbon Contracts Company's and Electricity Settlements Company's Operational Costs 2021/22

Government Response to consultation

January 2021

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Contents

List of acronyms

Acronym	
BEIS	Department for Business, Energy and Industrial Strategy
CfD	Contract for Difference
EMR	Electricity Market Reform
ESC	Electricity Settlements Company
LCCC	Low Carbon Contracts Company
MWh	Megawatt-hour
TWh	Terawatt-hour

Introduction

1. In the ‘Low Carbon Contracts Company and Electricity Settlements Company operational costs 2021/22: consultation on the operational cost levies’[1], published on 16 November 2020, the government sought views on the proposed 2021/22 operational cost budgets and resulting levies for the Low Carbon Contracts Company (LCCC) and the Electricity Settlements Company (ESC).

2. This document sets out the Government Response to that consultation, summarising the feedback received on each of the consultation questions and setting out the government’s response to the points raised.

3. The summary of responses focuses on the key issues and themes raised. Although it neither lists nor comments on every point made by consultees, all of them have been analysed by government.

Background

4. LCCC and ESC are responsible for delivering key elements of the Contracts for Difference (CfDs) scheme and the Capacity Market respectively.

5. LCCC, as counterparty to CfDs (including the Investment Contracts which have been transferred to it[2]), enters into and manages the contracts with low carbon generators, awarding top-up payments for qualifying generation. ESC is responsible for all financial transactions relating to the Capacity Market, including making capacity payments to capacity providers and managing supplier credit cover and capacity provider’s auction credit cover.

6. The operational costs of both LCCC and ESC are recovered through levies on electricity suppliers as set out in legislation (“the Regulations”[3] [4]). The Energy Act 2013 requires that we consult before making any regulations to amend the levies.

Publication and dissemination of the consultation

7. The consultation ran from 16 November to 14 December 2020 with the consultation document published on the government website. In addition, the department also

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/935495/lccc-esc-operational-costs-consultation-2021-22.pdf

[2] Investment Contracts which have been transferred to the LCCC are treated, by virtue of regulation 2(4) of the Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 as CfDs for various purposes. Any reference to CfDs in this document is to be treated as including any such Investment Contracts.

[3] Regulation 23 of the Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 (as amended).

[4] Regulation 9 of the Electricity Capacity (Supplier Payment etc.) Regulations 2014 (as amended).

published the consultation on Citizen Space, an online platform used by a number of public bodies to disseminate consultations.

8. The LCCC and ESC published details of the consultation and how to respond on their website. In addition, they sent a news bulletin, including a link to the consultation document, to approximately 375 contacts, including electricity generators, suppliers and other stakeholders. They also posted details of the consultation on their page on the professional network LinkedIn, which has approximately 1,800 followers across a wide range of stakeholders.

9. EMR Settlement Limited also published a news item informing their stakeholders of the consultation launch and added the consultation to their online calendar to enable stakeholders to easily export consultation dates to their personal calendars.[5]

10. In total, 1 response was received to the consultation; the organisation that responded is listed in the Annex. The respondent welcomed the opportunity to review and respond to the proposed operational costs budgets for LCCC and ESC.

Outcome of the consultation

11. Following analysis of the responses to this consultation, no amendments to the budgets proposed for LCCC and ESC are required.

12. However, the consultation was published before the outcome of the 2020 Spending Review was known. [6] The Review announced a pause in public sector pay rises for all workforces excluding the NHS, with an exception for employees earning less than £24,000 in basic salary on a full-time equivalent basis. HM Treasury expects all other Departments and Arm-Length Bodies not covered by remit letters and or/civil service pay remit guidance to apply this policy.

13. Notwithstanding that LCCC is not subject to the civil service pay remit, the LCCC Renumeration Committee has brought forward its discussions on pay awards for 2021/22 (normally conducted in February or March each year). Taking into account the wider economic landscape, the Renumeration Committee has decided to agree to a pay pause for its staff for 2021/22. Consequently, an allowance contained within LCCC's budget for pay rises that was included in the consultation has now been removed.

14. The estimated operating costs for LCCC, the forecast of gross electricity demand to be used to calculate its operational cost levies and the levy rates that will be included in regulations are confirmed in table 1.

[5] EMR Settlement Ltd (EMRS) is a wholly owned subsidiary of Elexon Ltd and was set up in March 2014 to be the settlement agent for the CfD scheme and the Capacity Market.
[6] https://www.gov.uk/government/publications/spending-review-2020-documents

Table 1:

Year	Estimated costs (£m)	Forecast electricity demand (terawatt hours (TWh))[7]	Levy rate (£/megawatt hour)
2021/22	20.736	271.84	0.0760

15. At the time of the consultation, LCCC forecast a total gross demand 273.63 TWh for 2021/22. Updated forecasts, as set out in Table 1, have been used for the final levy rate calculations and result in a marginally lower levy rate.

16. The total operational costs budget (the "settlement costs levy") to be charged to electricity suppliers to fund ESC will be specified in regulations as £7.472m for 2021/22.

Next Steps

17. The Energy Act 2013 provides that regulations setting the operational cost levies are subject to the 'affirmative' Parliamentary procedure. This means that any amendments to the Regulations have to be debated and approved by Parliament before they are made. Legislation to amend the Regulations to reflect the outcome of this consultation has now been laid before Parliament. The intention is that, subject to the will of Parliament, the provisions for the 2021/22 levies will come into effect on the day after the day on which the amending regulations are made in respect of the settlement cost levy and on 1 April 2021 in respect of the operational cost levy.

[7] This forecast of gross electricity demand is based on a dedicated forecast model developed by LCCC. The model uses statistical techniques taking into account trends in electricity demand and embedded generation, which is connected to the distribution network rather than the transmission grid. It also considers the long-term variability of weather.

Questions

Operational costs of the Low Carbon Contracts Company

Consultation question	1 response
1	Do you have any comments on LCCC's estimated operational costs set out in this consultation document?

Summary of responses

18. The respondent recognised that LCCC plays a vital role in delivering and managing CfDs and that it is important the company is adequately resourced to perform its role effectively. The fact that LCCC is consumer funded was noted, as was the need to ensure costs passed on to consumers are controlled effectively and that opportunities for operational cost savings should be identified wherever possible. The sharing of common resources between LCCC and ESC was cited as an example of where such savings have already been identified and the respondent highlighted their support for this approach.

19. Whilst noting that they are not in a position to provide detailed assessment of the estimated costs for LCCC in 2021/22, the respondent noted the estimated costs of the company are 19% higher than in 2020/21, which they maintain is a significant increase when compared to annual increases of c.3% over the past two years. The respondent proposed, where practicable, it would be preferable to phase-in costs increases of this magnitude so as to limit future volatility in the levy.

20. The fact that a substantial part of the projected increase in operational costs for LCCC was due to growth in contingency to cover legal disputes and the possibility that electricity demand may be lower than forecast was also highlighted by the respondent. It was assumed by the respondent that the need for such contingencies will be kept under careful review.

21. The respondent supported the Government's current proposal to set the operational cost levy for the LCCC for 2021/22 only, taking into account the increased uncertainty in forecasting electricity demand during the ongoing Covid-19 pandemic. However, the respondent also noted their support for setting the levy over a longer timeframe in the future, where it is appropriate to do so, as this provides stakeholders with greater foresight of operational costs over a longer period. In addition, it was recognised that setting the levies over a longer period will reduce the administrative burden on the LCCC. In this regard, the respondent noted the Government's intention of consulting in 2021 on a budget and associated levy costs over a longer period (i.e. financial years

2022/23, 2023/24 and 2024/25), provided there is sufficient confidence that electricity demand can be robustly forecast at this stage. They agreed this approach is sensible.

Government response

22. 2021/22 operational costs for LCCC set out in the consultation were set at a level that will ensure the company has sufficient resources to perform its role as CfD counterparty effectively, whilst minimising costs to consumers.

23. The Government, and LCCC, are very mindful of the fact that the company's operational costs are funded via a levy on consumers electricity bills. We recognise that an increase in operational costs of 19% from 2020/21 to 2021/22 is significant. However, it is important to bear in mind that a significant proportion of this increase is accounted for by contingencies within the budgets, which will be repaid to suppliers in the event they are not required (see further details below in paras 25-27). When you remove these contingencies, the underlying budget increase for LCCC's day-to-day operations is approximately 9%.

24. Increases in LCCC's day-to-day operational cost reflect increased activities in delivering and managing CfDs, most notably the upcoming fourth CfD allocation round, which is an essential component of the Government's plans to deliver its legally binding net zero commitment. In some cases, costs have also increased due to issues beyond LCCCs control. For example, insurance premiums have increased due to the Covid-19 pandemic and other factors impacting the insurance market.

25. The Covid-19 pandemic has resulted in disruption to the energy market in 2020, with electricity demand reducing, and this is likely to continue into 2021 as the Government takes further actions to resolve the pandemic, not all of which can be predicted at this time. Consequently, the existing contingency provision for lower than forecast electricity demand within LCCC's budget has been increased to take into account this increased uncertainty.

26. The risk of legal disputes being brought against LCCC has also increased as more CfDs are signed and more projects with an existing CfD move into construction. The contingency provision for legal disputes within LCCC's budget has been increased to meet this risk and has been informed by the costs of recent disputes, which suggest the contingency needs to be larger than that contained in previous budgets. It should be noted that having an adequate contingency in place to meet legal disputes may act as a deterrent to disputes being raised.

27. The contingency provisions, along with the wider budget, will be kept under review over the next year. If the contingency provisions are not used for these specific purposes and the surplus levy is not required for other essential operational activity, they will be repaid to suppliers in accordance with regulations.

28. The Government has considered the respondent's proposal to phase in the cost increases set out in the consultation so as to limit future volatility in the levy. We are

keen to reduce such volatility where possible. However, as this budget only relates to one year, we do not believe it would be possible to phase in costs increases in the time available. On balance, we do not expect volatility in the levy to have a material impact on any supplier.

29. The Government reconfirms its intention to consult on the LCCC's operational costs again in 2021 for the financial years 2022/23, 2023/24 and 2024/25 should it be appropriate to do so at this time.

Forecast electricity demand

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

Summary of responses

30. The respondent recognised the difficulties in forecasting electricity demand for 2021/22, given the uncertainties resulting from the Covid-19 pandemic. However, they stated that LCCC's methodology for estimating this demand appears to be robust and have no specific comments.

Government response

31. The Government notes these comments but does not believe they require any specific response.

Operational costs of the Electricity Settlements Company

Consultation question	1 response
3	Do you have any comments on ESC's estimated operational costs set out in this consultation document?

Summary of responses

32. The respondent noted that the estimated costs of the ESC for 2021/22 are marginally lower than the budgeted costs for 2020/21, reflecting in part the experience and capacity being built in the ESC in managing the increased number of agreement holders within the Capacity Market.

33. As noted above, the respondent noted their support for the continuation of common resources being shared between LCCC and ESC where this delivers operational cost savings.

Government response

34. ESC's operational costs set out in the consultation document have been set as accurately as possible to reflect the expected costs required for the company to perform its functions effectively whilst ensuring costs for consumers are minimised. ESC's operational costs will be kept under review over the next year in case any further operational cost savings can be identified, with any levy surplus being returned to suppliers at the end of the financial year.

Annex: List of organisations that responded to the consultation

The following organisation responded to the consultation:

ScottishPower

This publication is available from: www.gov.uk/government/consultations/low-carbon-contracts-company-and-electricity-settlements-company-operational-costs-2021-to-2022

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