Department for
Business, Energy
& Industrial Strategy

Low Carbon Contracts Company’s and Electricity Settlements Company’s Operational Costs 2022/23, 2023/24 and 2024/25

Government Response to consultation

February 2022

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List of acronyms

Acronym	
BECCS	Bioenergy with Capture Use and Storage
BEIS	Department for Business, Energy and Industrial Strategy
CCUS	Carbon Capture Use and Storage
CfD	Contract for Difference
ESC	Electricity Settlements Company
LCCC	Low Carbon Contracts Company
MWh	Megawatt-hour
OBR	Office of Budget Responsibility
ONS	Office for National Statistics
TWh	Terawatt-hour

Introduction

1. In the 'Low Carbon Contracts Company and Electricity Settlements Company operational costs 2022/23, 2023/24 and 2024/25: consultation on the operational cost levies'[1], published on 5 November 2021, the government sought views on the proposed 2022/23, 2023/24 and 2024/25 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. The LCCC and the ESC are responsible for delivering key elements of the Contracts for Difference (CfDs) scheme and the Capacity Market respectively.

5. The 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. The 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 the LCCC and the 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 5 November to 3 December 2021 with the consultation document published on the government's website. In addition, the department also

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1031311/lccc-esc-operational-costs-consultation-2022-2025.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. Details of the consultation were also published in the CfD stakeholder bulletin which included a link to the consultation and was sent to approximately 680 contacts.

9. The LCCC 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 2,600 followers across a wide range of stakeholders.

10. 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]

11. 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 the LCCC and the ESC.

Outcome of the consultation

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

13. The estimated operating costs for the 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.

Table 1:

Year	Estimated costs (£m)	Forecast electricity demand (terawatt hours (TWh))[6]	Levy rate (£/megawatt hour)
2022/23	24.210	275.38	0.0879
2023/24	26.978	271.46	0.0994
2024/25	29.051	266.87	0.1089

[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] This forecast of gross electricity demand is based on a dedicated forecast model developed by the 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.

14. At the time of the consultation, the LCCC forecast a total gross demand of 279.73 TWh for 2022/23, 277.80 TWh for 2023/24 and 275.12 TWh for 2024/25. Updated forecasts, as set out in Table 1, have been used for the final levy rate calculations and result in a marginally higher levy rate.

15. The total operational costs budget (the "settlement costs levy") to be charged to electricity suppliers to fund the ESC will be specified in regulations as £6.954m for 2022/23, representing a £0.518m decrease on the £7.472m budget for 2021/22. The total budget for 2023/24 is £7.382m, representing an increase of £0.428m on the budget for 2022/23, and £7.734m for 2024/25, representing an increase of £0.352m on 2023/24.

Next Steps

16. 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 2022/23, 2023/24 and 2024/25 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 2022 in respect of the operational cost levy.

Questions

Operational costs of the Low Carbon Contracts Company

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

Summary of responses

17. The respondent recognised that the 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 the LCCC is consumer funded was acknowledged, 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 the LCCC and the ESC was cited as an example

of where such savings have already been identified and the respondent highlighted their support for this approach.

18. The respondent also stated their support for the government's approach of setting the operational cost levy over a longer time period (i.e. over three financial years as opposed to one). They agree with the government's rationale for this approach in that setting the levies for a longer time period offers stakeholders greater foresight of projected operational costs over a longer timeframe. In addition, they also recognised that setting the levies over a longer period will reduce the administrative burden on the LCCC and the ESC.

19. Whilst noting that they are not in a position to provide detailed assessment of the estimated costs for the LCCC in 2022/23 to 2024/25, the respondent highlighted the estimated costs of the company are increasing by 17% between 2021/22 and 2022/23, by 11% between 2022/23 and 2023/24, and by 8% between 2023/24 and 2024/25. Overall, this represents an increase of 40% between 2021/22 and 2024/25.

20. The fact that a substantial part of the projected increase in operational costs for the LCCC is associated with increasing headcount was accepted by the respondent, whilst noting that this represents a significant increase in the associated levy. The respondent recommended the LCCC consider how best to ensure efficiencies are maximised as the LCCC continues to develop its services and processes over the budget period.

21. The respondent noted that a number of cost items are associated with the LCCC providing support to BEIS in developing policy and processes associated with Dispatchable Power Agreements for Power Carbon Capture Use and Storage (CCUS) projects, Biomass with CCUS (BECCs) and Northern Ireland CfDs. The early stage of development and uncertainty associated with some of these evolving areas was recognised and the respondent strongly recommended the need for these budget lines to be kept under careful review, and for funds to be returned to suppliers at the earliest opportunity (as appropriate).

22. The 5% assumption used in the proposed budgets for inflation was referenced by the respondent, who stated this was relatively high in their opinion.

Government response

23. The 2022/23, 2023/24 and 2024/25 operational costs for the 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.

24. The government, and the LCCC, are very mindful of the fact that the company's operational costs are funded via a levy on consumers' electricity bills. The respondent noted the percentage increases in the LCCC's budgets between financial years.[7] These

[7] The LCCC operational costs budget increased by 85% between 2014/15 and 2015/16, reflecting set up costs, by 18% between 2015/16 and 2016/17, by 4% between 2016/17 and 2017/18, by 12% between 2017/18 and

increases are significant but not unprecedented in percentage terms. As set out in the consultation, these increases are in line with those seen in previous years and lower than the 19% increase seen between the 2020/21 budget and the 2021/22 budget.

25. As the respondent noted, the increase in budget is largely a result of increases in payroll costs. These increases are necessary to ensure the LCCC can recruit and retain staff with the required skill set to manage the expected growth in CfDs under management and to enable them to develop and manage support schemes for new low carbon technologies in the form of Power CCUS and BECCS. These activities form an important part of the government's plans to meet its legally binding net zero target and the requirements of the Net Zero Strategy.

26. Where it is possible to keep operational costs flat or reduce them without compromising scheme delivery, the LCCC has taken steps to do so to ensure efficiencies are maximised. Funds allocated in the budget for the development of new policy and processes associated with Dispatchable Power Agreements for Power CCUS projects, BECCs and Northern Ireland CfDs that are not spent will be returned to suppliers in accordance with the regulations if not required for unforeseen eventualities.

27. The respondent also noted the inflation assumption used in the budgets, which they believe is high at 5%. In the consultation, we committed to revisit this assumption at the time of writing this response in order to take into account the latest inflation forecasts published by the Office of Budget Responsibility (OBR) before finalising the proposed budgets and associated levy rates that will be put before Parliament. At the time of writing, the latest OBR forecasts were published on 27 October 2021 and suggest that inflation will peak at 4.4% in the second quarter of 2022 and afterwards gradually reduce, reaching 2% at the end of the budget period in the first quarter of 2025.[8] According to the Office for National Statistics, inflation had reached 5.1% by November 2021.[9]

28. It should be noted that the OBRs forecast was published before the Omicron COVID-19 variant was first identified. Therefore, the forecasts cannot consider the impacts of the new variant on inflation. A more recent survey conducted in January 2022 found that more than 50% of economists expect inflation to peak above 6% next year, while 15% predict it will reach more than 6.5%.[10]

29. Taking into account these factors, the inherent difficulties involved in accurately forecasting inflation and the additional uncertain variable introduced by the COVID-19

2018/19, by 3% between 2018/19 and 2019/20, by 3% between 2019/20 and 2020/21, and by 19% between 2020/21 and 2021/22. The proposed budget set out in this consultation would see the budget increase by 17% between 2021/22 and 2022/23, by 11% between 2022/23 and 2023/24, and by 8% between 2023/24 and 2024/25.

[8] Economic and fiscal outlook – October 2021 (27 October 2021) OBR: https://obr.uk/efo/economic-and-fiscal-outlook-october-2021/

[9] Consumer price inflation, UK: November 2021 (15 December 2021), ONS: https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/november2021

[10] The Times Economic Survey: Inflation will rise but little to fear for UK's jobs market (4 January 2022), The Times: https://www.thetimes.co.uk/article/inflation-will-rise-but-little-to-fear-for-uks-jobs-market-sms7f7m7q

pandemic, we believe it is prudent to retain an assumption of 5% within the proposed budgets. If inflation is below 5% in practice, it is expected that this will result in funds being returned to suppliers at the end of the relevant financial year in accordance with the regulations, where these are not needed to cover other essential operational activity.

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 the LCCC are derived?

Summary of responses

30. The respondent recognised the difficulties in forecasting electricity demand out to 2024/25, given the uncertainties resulting from the COVID-19 pandemic. However, they stated that the 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 the 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 2022/23 are lower than the budgeted costs for 2021/22, before increasing only slightly to 2024/25. They have no additional comments on the detail set out in the Consultation document.

Government response

33. The government notes these comments but does not believe they require any specific response.

Annex: List of organisations that responded to the consultation

The following organisation responded to the consultation:

Scottish Power

This publication is available from: www.gov.uk/government/consultations/low-carbon-contracts-company-and-electricity-settlements-company-operational-costs-20222023-to-20242025

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