



Department for
Business, Energy
& Industrial Strategy

LOW CARBON CONTRACTS COMPANY AND ELECTRICITY SETTLEMENTS COMPANY OPERATIONAL COSTS 2018/19- 2020/21

Consultation on the operational cost levies



November 2017

LOW CARBON CONTRACTS COMPANY AND ELECTRICITY SETTLEMENTS COMPANY OPERATIONAL COSTS

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The consultation can be found on the BEIS section of GOV.UK:

<https://www.gov.uk/government/consultations/low-carbon-contracts-company-and-electricity-settlements-company-operational-costs-2018-2019-to-2020-2021>

Low Carbon Contracts Company and Electricity Settlements Company Operational Costs 2018/19-2020/21

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Any enquiries regarding this publication should be sent to us at LCCC-ESCOperationalcosts@beis.gov.uk.

Contents

General information	3
Purpose of this consultation	3
How to respond	3
Confidentiality and data protection	4
Quality assurance	4
Introduction	5
Consultation questions	7
Consultation Questions	7
What happens next?	7
Part 1: Low Carbon Contracts Company and Electricity Settlements Company operational costs – background information	9
Overview	9
Governance	11
The Operational Cost Levies	11
Key assumptions underpinning cost estimates	13
Part 2: Amendment to the Regulations	14
Proposal for setting more than one levy rate	14
Consultation Question	14
Part 3: The Companies' estimated costs for 2018/19, 2019/20 and 2020/21	15
Low Carbon Contracts Company	15
Consultation Questions	21
Electricity Settlements Company	22
Consultation Questions	25

General information

Purpose of this consultation

This consultation document seeks views on the proposed 2018/19, 2019/20 and 2020/21¹ operational cost budgets, resulting levies for the Low Carbon Contracts Company (LCCC) and the Electricity Settlements Company (ESC), and changes to legislation.

Issued: 10 November 2017

Respond by: 8 December 2017

Enquiries to:

LCCC/ESC Shareholder Team – Clean Electricity Directorate
Department for Business, Energy & Industrial Strategy,
3rd Floor Spur,
1 Victoria Street,
London, SW1H 0ET
Email: LCCC-ESCooperationalcosts@beis.gov.uk

Territorial extent:

This consultation applies throughout Great Britain.

How to respond

You are invited to respond to this consultation either by email to our official mailbox LCCC-ESCooperationalcosts@beis.gov.uk or by post to:

Fiona Reynolds
LCCC/ESC Shareholder Team – Clean Electricity Directorate
Department for Business, Energy & Industrial Strategy,
3rd Floor Spur,
1 Victoria Street,
London, SW1H 0ET

Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome. If you have any comments on the operational cost budgets and levies as set out in this document it would be helpful if you could

¹ The financial year runs from 1 April – 31 March.

provide supporting analysis to explain your position, where appropriate.

Additional copies:

You may make copies of this document without seeking permission. An electronic version can be found at <https://www.gov.uk/government/consultations/low-carbon-contracts-company-and-electricity-settlements-company-operational-costs-2018-2019-to-2020-2021>.

Other versions of the document in Braille, large print or audio-cassette are available on request.

Confidentiality and data protection

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information legislation (primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

If you want information that you provide to be treated as confidential please say so clearly, in writing, when you send your response to the consultation. It would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded by us as a confidentiality request.

We will summarise all responses and confirm the outcome of the consultation in the Government response, which will be published on the [GOV.UK website](#). The Government response will include a list of organisations that responded but not people's personal names, addresses or other contact details.

Quality assurance

This consultation has been carried out in accordance with the [Government's Consultation Principles](#).

If you have any complaints about the consultation process (as opposed to comments about the issues which are the subject of the consultation) please address them to:

Email: beis.bru@beis.gov.uk

Introduction

Budget proposals for the Low Carbon Contracts Company and Electricity Settlements Company

- 1.1. The operational costs of the Low Carbon Contracts Company (LCCC) and the Electricity Settlements Company (ESC) are recovered through levies on electricity suppliers as set out in legislation ('the regulations'^{2,3}). The Energy Act 2013⁴ requires that we consult before making any regulations to amend the levies. In legislation, the levy relating to ESC is called the 'settlement costs levy', and the levy relating to LCCC is called the 'operational costs levy'. This consultation refers to 'operational costs' to cover both levies for simplicity.
- 1.2. This consultation document seeks views on the proposed operational costs for ESC and LCCC and resulting levies, and changes to regulations which will enable levies to be set more than one financial year in advance.
- 1.3. Previously we have consulted on and amended the levies on an annual basis for the following financial year. However, in order to offer stakeholders and parliament greater visibility of the estimated operational costs moving forward, to reduce the administrative burden on LCCC and ESC, and to save Parliamentary time, we are consulting on changes to the regulations that would enable levies to be set for the next three financial years: 2018/19, 2019/20 and 2020/21.
- 1.4. We are consulting on the operational costs for 2018/19, 2019/20 and 2020/21 which are based on estimated costs (including applicable depreciation) of £16.519m in 2018/19, £17.020m in 2019/20 and £17.485m in 2020/21 for LCCC, and £7.629m in 2018/19, £7.554m in 2019/20 and £7.502m in 2020/21 for ESC.
- 1.5. We estimate that the total impact of LCCC and ESC operational costs on household electricity bills over the period (2018/19 to 2020/21) will be around £0.30 per year (at 2016 prices)⁵, which equates to around 0.1% of an average household electricity bill.
- 1.6. The consultation document is split into the following sections:
 - Part 1 sets out LCCC's and ESC's functions and describes their governance structures, the assumptions underlying the operational costs, and the timing for collecting the levies.

² Regulation 23 of the Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 (as amended).

³ Regulation 9 of the Electricity Capacity (Supplier Payment etc.) Regulations 2014 (as amended).

⁴ The Energy Act 2013 http://www.legislation.gov.uk/ukpga/2013/32/pdfs/ukpga_20130032_en.pdf

⁵ The bill impact of LCCC and ESC operational costs is estimated by assuming that such costs faced by electricity suppliers are spread evenly across electricity sales. This provides a £/MWh cost which is multiplied by estimated average household consumption to calculate the bill figure, in this case, of around £0.30.

- Part 2 describes the proposal to amend the regulations to enable levies to be set in legislation for more than one financial year.
 - Part 3 sets out LCCC's estimated operating costs for 2018/19 to 2020/21 and electricity demand in Great Britain over each levy year. These estimates allow a £/MWh levy rate to be calculated for inclusion in the amending regulations. It also sets out ESC's estimated operating costs for 2018/19 to 2020/21 for inclusion in the amending regulations.
- 1.7. A list of consultation questions is set out below and responses are invited from all interested parties by 8 December 2017. Details on how to respond can be found on page 3.

Consultation questions

Consultation Questions

1.	Do you have any comments on our proposal to amend the regulations to allow levies to be set for more than one financial year in advance? And our proposal to set levies for the next three financial years?
2.	Do you have any comments on LCCC's estimated operational costs set out in this consultation document?
3.	Do you have any comments on the forecast electricity demand from which the £/MWh levy rates for LCCC are derived?
4.	Do you have any comments on ESC's estimated operational costs set out in this consultation document?

What happens next?

- 1.8. We will analyse responses and produce a Government response to this consultation, which we plan to publish in early 2018. Subject to the outcome of this consultation, we will amend the relevant legislation to enable three separate levies to be set for 2018/19, 2019/20 and 2020/21.
- 1.9. If there is a material increase to the total estimated operational costs of LCCC or ESC between the publication of this consultation document and the laying of the amending regulations in Parliament, we will publish an amendment to this document. In such circumstances, responses will be required to the amended document by the latest of two weeks from publication of the amended consultation, or by the original closure date. Should there be minor adjustments to the budget during consultation or as a result of the consultation process these will be outlined in the Government response to this document.
- 1.10. We intend that, subject to the will of Parliament, the amending regulations will come into force before the beginning of the 2018/19 financial year. However, if it is not possible to complete the parliamentary process within this time period the existing levies will continue to apply until such time as the regulations are amended.

- 1.11. If the amending regulations are delayed, in order that the estimated operational costs of LCCC can be collected in full, we would need to consider making an adjustment to the 2018/19 levy rate as set out in this consultation. Any necessary revision to the rate would be communicated in the Government response to this consultation. In the case of the ESC operational costs levy, we would expect to collect the difference between the 2017/18 levy and the 2018/19 levy amount as part of the March 2019 reconciliation (as part of the revised settlement cost levy calculations set out in paragraph 8, Schedule 1 of the Electricity Capacity (Supplier Payment etc.) Regulations 2014).

Part 1: Low Carbon Contracts Company and Electricity Settlements Company operational costs – background information

Overview

- 1.12. LCCC and ESC are responsible for delivering key elements of Contracts for Difference (CFDs) and the Capacity Market (CM) schemes respectively.
- 1.13. LCCC enters into and manages CFDs (including the Investment Contracts which have been transferred to it⁶) with low carbon generators, awarding top-up payments for qualifying generation. During 2018/19-2020/21 it will have particular responsibility for:
- managing the CFD portfolio, including the Hinkley Point C nuclear CFD, to ensure all pre-generation contractual milestones (Milestone Delivery Dates, Operational and Further Conditions Precedent) are met. Ensuring that generators are fulfilling their compliance and reporting obligations, including those relating to post-commissioning fuel monitoring, sampling and sustainability, and where appropriate, handling any disputes that may arise;
 - entering into new CFDs, which involves industry engagement and coordination with National Grid ahead of allocation rounds, dealing with requests for minor and necessary modifications to CFDs pre-allocation, signing and managing initial conditions precedent with successful applicants;
 - collecting from electricity suppliers the operational costs and the CFD Supplier Obligation (the levy on electricity suppliers to pay for the cost of low-carbon generation under the CFD scheme), which will involve:
 - setting the quarterly supplier obligation interim levy rate and total reserve amount;
 - collecting the supplier obligation levies, the total reserve amount and the suppliers' collateral payments;
 - providing projections for future quarterly supplier obligation interim levy rates and total reserve amounts and cash utilisation via an online Transparency Tool⁷;
 - making payments to generators as required under CFDs;
 - managing payments under the supplier obligation reconciliation process; and

⁶ Investment Contracts, which have been transferred to 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 a CFD in this document is to be treated as including any such Investment Contracts.

⁷ <https://sofm.lowcarboncontracts.uk/>

- metering verification of any private network generators that have been allocated a CFD.
 - contributing to CFD development:
 - supporting the ongoing review and development of existing and future CFD standard terms and conditions;
 - feeding into CFD consultations concerning potential changes to CFD structures, settlement activities, and any other related regulations; and
 - delivering revisions to the CFD settlement system to reflect policy changes, ensuring continued correct processing of transactions.
 - providing supporting services to ESC, which will be reimbursed at cost.
- 1.14. ESC is responsible for all financial transactions relating to the Capacity Market, including making capacity payments to capacity providers, managing supplier credit cover and capacity providers' auction credit cover. During 2018/19-2020/21, it will have particular responsibility for:
- collecting from electricity suppliers the operational costs levy, and the Capacity Market Supplier Charge, which supports capacity payments;
 - continuing, in the first half of 2018/19, to make payments to those successful in the 2017 Transitional Arrangements auctions⁸ and Early Capacity auctions⁹ for the October 2016 to September 2017 delivery year;
 - making payments to capacity providers successful in the 2017/18 T-1 capacity auctions and the 2014/15 T-4 capacity auction which are expected to secure around 55GW of capacity with a delivery year starting 1 October 2018;
 - in future years make payments to capacity providers in auctions that deliver capacity in the years 2019/2020 and 2020/2021;
 - managing the collection, holding, monitoring and, where appropriate, refund of credit cover collected from auction applicants; and
 - verifying the meter arrangements of those providers whose capacity agreement is conditional on ESC approving their meter configuration.
- contributing to Capacity Market development:
 - delivering revisions to the Capacity Market settlement system to reflect policy and rule changes, ensuring continued correct processing of transactions; and

⁸ The Transitional Arrangements auctions are aimed to encourage development of Demand Side Response (DSR) that can respond when needed to help balance supply and demand in the electricity grid.

⁹ The Early Capacity auctions are aimed to address emerging risks to energy security by bringing forward the start of the CM delivery period by a year, for example, an auction was held in January 2017 for delivery one year ahead, in 2017/18.

- Feeding into Capacity Market consultations from Government and Ofgem concerning potential changes to settlement activities and any other related regulations.

Governance

- 1.15. LCCC and ESC are private limited Companies wholly-owned by the Secretary of State for Business, Energy and Industrial Strategy. The Companies have day-to-day operational independence, subject to certain limited exceptions which require shareholder consent. The relationship between the Companies and the shareholder is set out in separate Framework Documents¹⁰.
- 1.16. Both documents contain a guiding principle. This requires that, in carrying out its activities, LCCC should seek to maintain investor confidence in the CFD regime and ESC should seek to maintain market participants' confidence in the Capacity Market settlement processes. The guiding principle also requires both Companies to minimise costs to consumers.
- 1.17. As Government-owned Companies, LCCC and ESC are subject to the Government's framework for managing public money¹¹.
- 1.18. The Accounting Officer (AO) of the Department for Business, Energy and Industrial Strategy (BEIS) is accountable to Parliament for the performance of the two Companies alongside the Chief Executive Officer of LCCC and ESC, who is the AO for these Companies. Two Shareholder Representative Directors sit on the Board of both Companies.

The Operational Cost Levies

- 1.19. The operational cost levies of LCCC and ESC have been designed so that the methodology of payment calculation and the frequency of payment are consistent with the principal supplier obligations for the CFD regime and the Capacity Market.

Low Carbon Contracts Company

- 1.20. The operational cost levy rate is calculated by dividing LCCC's proposed annual budget by the total forecast electricity demand for the corresponding financial year, as set out in Part 3 below.
- 1.21. The operational cost levy will be collected alongside the principal supplier obligation (the interim levy) in the same daily invoice using the same settlement system. The

¹⁰ The Framework Documents are published on the Companies' website – see <https://lowcarboncontracts.uk/corporate-governance>. The LCCC document is available at: <https://lowcarboncontracts.uk/sites/default/files/publications/Low%20Carbon%20Contracts%20Company%20Framework%20Document%20-%20August%202014%20-%20Signed.pdf> and the ESC document is available at: <https://lowcarboncontracts.uk/sites/default/files/publications/Electricity%20Settlements%20Company%20Framework%20Document%20-%20August%202014%20-%20Signe....pdf>

¹¹ Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/454191/Managing_Public_Money_AA_v2_-jan15.pdf

Settlement Service Provider (EMR Settlements Ltd, a wholly-owned subsidiary of Elexon) administers the collection process on LCCC's behalf.

- 1.22. Since the levy rate is based on estimates of LCCC's operating costs and the overall electricity supplied in the corresponding period, the amount collected is unlikely to match actual expenditure. Any surplus recorded at year-end will be reimbursed to suppliers in accordance with the Regulations¹². In the event of a forecast deficit, Government will in the first instance require LCCC to manage its costs within its available budget, including re-prioritising spend where possible. Government may also increase the levy rate in-year if there is a significant discrepancy between projected levy income and estimated expenditure which LCCC can justify but cannot manage. To do so, it would be necessary first to consult publicly, as any change to the levy rate would require amending legislation. Where appropriate, and solely at its discretion, BEIS can provide the Company with budget and grant-in-aid to cover any levy deficit or justifiable unplanned expenditure.

Electricity Settlements Company

- 1.23. The total amount levied on suppliers will be equal to the budget included under Regulation 9 in the Electricity Capacity (Supplier Payment etc.) Regulations 2014, as amended. Operational costs will be budgeted, and the levy set, for the financial year. The initial monthly amount charged to suppliers will be proportionate to their share of the total electricity supplied during the previous winter's 'period of high demand' (4 to 7pm on working days between November and February inclusive). Suppliers' shares of the levy are then revised after 16 March to reflect actual supply data relating to the 'period of high demand' for the current levy period (for example, for the 2018/19 levy, demand 4 to 7pm on working days between November 2018 to February 2019).
- 1.24. The Settlement Service Provider administers the collection process on behalf of ESC.
- 1.25. In the event that the total amount of levy collected exceeds ESC's actual operational costs, the surplus at year-end will be reimbursed to suppliers. As with LCCC, where there is a deficit, Government will in the first instance require ESC to manage its costs from within its own budget, including re-prioritising spend where necessary. Government may also seek to increase the levy in-year if there is a significant discrepancy between projected levy income and estimated expenditure which ESC can justify but cannot manage. Again, it would be necessary to consult on, and obtain Parliamentary approval for, any change in the levy. Where appropriate, and solely at its discretion, BEIS can provide the Company with budget and grant-in-aid to cover any levy deficit or justifiable unplanned expenditure.
- 1.26. Details of the operational expenditure for both LCCC and ESC is published in their annual report and accounts, which are audited by the National Audit Office and made available on the Companies' website¹³.

¹² Contracts for Difference (Supplier Obligation) Regulations 2014

¹³ The 2016/17 Annual Report and Accounts are available at:

<https://lowcarboncontracts.uk/sites/default/files/publications/LCCC%20Annual%20Report%2020162017%20FIN%20AL%200.pdf> and

Key assumptions underpinning cost estimates

- 1.27. The cost estimates presented in this consultation document are underpinned by a number of assumptions, which are subject to some uncertainty. In setting the budget, a balance must be struck between ensuring that the Companies have sufficient resources to perform their role effectively, while minimising:
- the risk of over collection (notwithstanding that any surplus will be reimbursed to suppliers); and
 - the uncertainty that could be caused for suppliers by the need to change the levy rate in-year.

LCCC key assumptions

- 1.28. LCCC currently manages 57 CFDs to which it is a direct counterparty (including the nuclear CFD for Hinkley Point C).
- 1.29. The proposed budget includes some provision to manage potential additional CFDs that would result from further CFD allocation rounds.

ESC key assumptions

- 1.30. ESC manages credit cover pre-and post-auctions and capacity payments commencing 1 October every year resulting from two annual auctions a year (T-1 and T-4). As the number of applicants for the two annual auctions carries on increasing, there will be increasing meter assurance activity required for those providers whose capacity agreement is conditional on ESC approving their meter configuration.
- 1.31. In addition ESC will continue to make payments to capacity providers successful in the Transitional Arrangements auctions and Early Capacity auctions in the latter half of the delivery year beginning 1 October 2017.

Part 2: Amendment to the Regulations

Proposal for setting levies for more than one financial year

- 2.1. Presently the operational cost levies for LCCC and ESC are set for a corresponding financial year. However, in order to offer stakeholders and parliament greater visibility of the estimated operational costs moving forward, to reduce the administrative burden on LCCC and ESC, and to save parliamentary time, we are proposing to amend the regulations so that the levies can be set more than one financial year in advance.
- 2.2. We propose using this flexibility to set operational cost levies for LCCC and ESC for financial years 2018/19, 2019/20 and 2020/21 in a single statutory instrument. The levies would be calculated on the basis of the estimated operational costs set out in Part 3. Collection will continue to take place during the relevant financial year.
- 2.3. This is a simple change to the regulations and does not affect the basic principles and processes for how the levy is calculated or how any surplus is returned, as outlined in paragraphs 1.20 to 1.25.

Consultation Question

- | | |
|----|---|
| 1. | Do you have any comments on our proposal to amend the regulations to allow levies to be set for more than one financial year in advance? And our proposal to set levies for the next three financial years? |
|----|---|
-

Part 3: The Companies' estimated costs for 2018/19, 2019/20 and 2020/21

Low Carbon Contracts Company

- 3.1. The total estimated budget for the Low Carbon Contracts Company for 2018/19 is £16.519m, representing a £1.731m increase on the £14.788m budget for 2017/18. The total estimated budget for 2019/20 is £17.020m, representing a £0.501m increase on 2018/19, and for 2020/21 £17.485m, representing a £0.465m increase on 2019/20.
- 3.2. LCCC has sought to keep its 2018/19 budget (excluding a provision set aside should the Company need to enter into and defend a dispute(s)) equivalent to that for 2017/18. Utilising its experience to deploy its resources more efficiently, the Company has achieved this despite a higher level of CFDs (57 at the beginning of 2018/19 compared to 41 at the start of 2017/18). A small increase in headcount to manage the larger CFD portfolio, an IT strategy review and higher settlement costs have been offset by a reduction in contractor and insurance costs. The increase in the LCCC budget in 2019/20 and 2020/21 across payroll and professional spend reflects the estimated increase in the number of CFDs under management over the period following future allocation rounds.
- 3.3. A breakdown of the total estimated operational costs for 2018/19 to 2020/21 is provided in Table 1, together with comparative figures for the 2017/18 budget.
- 3.4. Further information can be found below on the areas of spend.

Table 1.

Description	Budgeted costs – 2017/18 £000s	Estimated costs – 2018/19 £000s	Estimated costs – 2019/20 £000s	Estimated costs – 2020/21 £000s
Payroll costs	5,862	6,549	6,997	7,342
Professional fees	3,623	5,622	6,086	6,265
Contractors	467	272	-	-
Premises costs	425	417	414	434
Settlement Service	3,215	3,523	3,479	3,309
IT and telephony costs	672	890	880	715
Insurance	434	274	324	375
Other costs	1,064	990	1,000	1,258
Depreciation	654	649	596	580
Recharge	(1,628)	(2,667)	(2,756)	(2,793)
Total	14,788	16,519	17,020	17,485

Payroll costs

- 3.6. Based on an average of 67 employees plus 6 Board members, estimated payroll costs for 2018/19 are £6.549m. A breakdown of the costs is included in Table 2. Estimated payroll costs are £0.687m higher than those budgeted for 2017/18. This reflects an increase of seven employees compared to current levels and an annual pay review. Five of the new employees relate to the increased investment in ESC (see section on ESC costs below) and the payroll costs will be recharged to ESC accordingly.
- 3.7. LCCC has budgeted for two additional staff over the remaining period. This takes the expected overall headcount to 69 employees by 2020/21.

- 3.8. Whilst LCCC is classified as a public sector organisation, its staff are not Civil Servants and so they have separate terms and conditions, pay and benefit packages.
- 3.9. The Company's organisational structure has been designed to ensure that LCCC has the optimal structure for undertaking expected operational activities in an efficient way. Senior salaries have been benchmarked against organisations carrying out similar activities and against other relevant Government arm's length bodies. The salaries of senior executives are published in LCCC's annual report and accounts and, where those salaries are £150k and above, they will also be published online by the Cabinet Office in the interests of transparency. In accordance with Government rules, any pay that is above the Prime Minister's salary is cleared by BEIS Ministers and, where such pay relates to Ministerial Board appointments, it is cleared additionally by HM Treasury Ministers.

Table 2.

Description	Estimated costs – 2018/19 £000s	Estimated costs – 2019/20 £000s	Estimated costs – 2020/21 £000s
Gross salary costs ¹⁴	4,741	5,114	5,369
Employers' National Insurance	622	670	703
Employee benefits ¹⁵ , bonus ¹⁶ and pension ¹⁷	1,034	1,101	1,158
Recruitment costs	143	103	103
Payroll outsourcing	9	9	9
Total	6,549	6,997	7,342

Professional and legal fees and contractors

- 3.10. The total cost of professional and legal fees, together with contractor costs, has been estimated at £5.894m for 2018/19, increasing to £6.265m by 2020/21. Costs associated with professional services, legal fees and technical advice are incurred

¹⁴ Includes Board costs.

¹⁵ Includes life assurance, private medical cover, personal accident and income protection insurance.

¹⁶ The amount budgeted is based on bonuses of up to 20% salary for Executive Directors, up to 12% for senior managers and up to 6% for other staff, if all staff achieve a bonus. Bonus payments will be subject to staff meeting agreed performance criteria.

¹⁷ The pension employer contribution rate is 10% for Executive Directors and 8% for other staff.

to support effective management of CFDs and other compliance activity (see Table 3).

- 3.11. Changes in professional fees over the period 2018/19 to 2020/21 reflect the existing portfolio of CFDs and the potential increase in the number of CFDs under management over the period following future allocation rounds. Events requiring professional fees include planned events such as facilities reaching contractual milestones, and generator driven events such as approvals of changes to Fuel Monitoring Sampling and Sustainability plans from thermal generators, or handling force majeure or qualifying change in law claims. The cost per contract under management is projected to fall by around 30% over the three years. This reflects the Company's aim to carry out routine work in-house and to use outside resource efficiently when required to provide additional capability.
- 3.12. The professional fees budget also includes a contingency provision should the Company need to enter into and defend a dispute(s) over the next three financial years.

Table 3.

Description	Estimated costs – 2018/19 £000s	Estimated costs – 2019/20 £000s	Estimated costs – 2020/21 £000s
Professional services and legal fees	4,740	4,860	5,001
Technical advice	492	492	492
Audit, assurance and compliance	125	305	265
Fuel monitoring, sustainability, metering	265	321	399
Contractors	272	108	108
Total	5,894	6,086	6,265

Settlement Service

- 3.13. Estimated total operational costs related to the settlement system, including the costs of the Settlement Service Provider and software upgrades are set out in Table 4 below. These costs relate to the daily collection of the operational cost levy and principal supplier obligation and making payments to generators under CFDs. The audit and assurance costs include the costs for the provision of meter verification services for any private network generators that may be offered a CFD. Meter assurance services will be undertaken by the Settlement Services Provider as Metering Agent using Siemens as their sub-contractor.

- 3.14. There is a continued requirement for changes to the settlement system which includes changes associated with CFD allocation rounds, the impact of code changes on the settlement system and operational improvements. The Company has budgeted around £0.6m per annum for this.
- 3.15. The increase in total cost from 2017/18 to 2018/19 of £0.308m (see Table 1) is mainly due to the costs relating to change to the settlement system. The total settlement cost falls in subsequent years due to expected operational efficiencies.

Table 4.

Description	Estimated costs – 2018/19 £000s	Estimated costs – 2019/20 £000s	Estimated costs – 2020/21 £000s
Resource and sub-contractors	1,665	1,635	1,496
Infrastructure costs	468	457	450
Licences and data	461	473	471
Settlement system change	644	637	615
Metering assurance	98	89	88
Audit and assurance	187	188	189
Total	3,523	3,479	3,309

Electricity Settlements Company cost recharge

- 3.16. To maximise efficiencies in the operation of LCCC and ESC, ESC contributes at cost for its use of shared facilities, back-office functions and the staff it requires for its corporate functions and operational activities. The contribution that LCCC expects to apportion to ESC is netted off against LCCC's estimated budget, see Table 1. The recharge agreement is explained in more detail under ESC costs (see paragraphs 3.35 to 3.38).

Premises Costs

- 3.17. LCCC continues to be based at Fleetbank House, Blackfriars, where it rents accommodation from BEIS. The total premises cost of the rental agreement is expected to remain at £35k per month over the next three financial years, which is inclusive of rent, council tax and service charge (which includes heating, water and power supply).

IT and telephony costs

- 3.18. Total IT and telephony costs have increased slightly compared to the 2017/18 budget and are estimated at £0.890m for 2018/19 and £0.880m for 2019/20 due to costs relating to a review of the IT architecture, before reducing to £0.715m for 2020/21.

Insurance

- 3.19. Insurance is procured on a commercial basis, using an insurance broker engaged under the Crown Procurement framework. The level of cover reflects the activity that LCCC expects to be undertaking in the next three financial years. The level of indemnity cover taken in 2017 cost less than budgeted and these savings are expected to continue in 2018/19.

Other costs

- 3.20. Other costs include stakeholder engagement and communications, training, travel and subsistence, printing and stationery. In addition, as LCCC's operational cost levy is based on a £/MWh rate, its levy funding will vary with the amount of electricity actually supplied. A £0.5m contingency is therefore included for 2018/19 and 2019/20 (under 'other costs') to cover any reduction in volume of electricity supplied (e.g. due to warm weather). This contingency will increase to £0.75m in 2020/21 due to increased uncertainty forecasting three years in advance.

Depreciation

- 3.21. Expected annual depreciation charges of £0.649m in 2018/19, £0.596m in 2019/20, and £0.580m in 2020/21 are included in the operational cost budget. These charges relate to the assets LCCC has purchased using funding initially provided by BEIS, such as the IT hardware and the development and build of the settlement system for CFDs. The cash collected through the levy for depreciation will be repaid to the Department in accordance with the loan agreements in place.

Low Carbon Contracts Company Levy rate

- 3.22. LCCC's operational cost levy is calculated on the basis of a gross electricity demand projection. For 2018/19, LCCC expects to use a projected gross demand of 290.50 TWh to calculate the levy rate, for 2019/20 288.68 TWh, and for 2020/21 285.83 TWh. 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 generation¹⁸; it also considers the long-term variability of weather.
- 3.23. A breakdown of the estimated operating costs, forecast electricity demand and corresponding operational cost levy rate for each year is provided in Table 5.

¹⁸ Embedded generation is generation that is connected to the distribution network rather than the transmission grid.

Table 5.

Year	Estimated costs (£000s)	Forecast Electricity Demand (TWh)	Levy rate (if applied from 1 April 2018) (£/MWh)
2018/19	16,519	290.50	0.0569
2019/20	17,020	288.68	0.0590
2020/21	17,485	285.83	0.0612

- 3.24. As set out previously, if it is not possible to complete the parliamentary process in time for the levy for 2018/19 to come into force by 1 April 2018, the current rate will continue to apply until such time as the regulations are amended.
- 3.25. If the amending regulations are delayed, in order that the estimated operational costs of LCCC can be collected in full, we would need to consider making an adjustment to the 2018/19 levy rate. Any necessary revision would be communicated in the Government response to this consultation.

Consultation Questions

2.	Do you have any comments on LCCC's estimated operational costs set out in this consultation document?
3.	Do you have any comments on the forecast electricity demand from which the £/MWh levy rates for LCCC are derived?

Electricity Settlements Company

- 3.26. The total estimated budget for the Electricity Settlements Company for 2018/19 is £7.629m, representing a £1.388m increase on the £6.241m budget for 2017/18. The total estimated budget for 2019/20 is £7.554m, representing a decrease of £0.075m on the budget for 2018/19, and for 2020/21 £7.502m, representing a further decrease of £0.052m on 2019/20.
- 3.27. Since the 2017/18 budget was prepared, ESC has gone through the first delivery year for the Transitional Arrangements auction. As the Capacity Market is becoming fully operational ESC is managing increased capacity (0.6GW for 2016/17 to 55GW in 2017/18) and an increase in the number of Capacity Providers (46 in 2016/17 to 447 in 2017/18). The market complexity and requirement for change is expected to increase further as the first T-4 auction reaches its delivery year (2018/19) and capacity providers trade their agreements. Examples of increased market complexity include the in-year change in Demand Side Response (DSR) components (2018/19), different vintages of capacity agreements, and a more diverse range of capacity providers due to increased numbers of small scale generators and DSR.
- 3.28. ESC requires further investment to manage this activity and has budgeted for professional fees and 5 full time staff. As ESC does not employ staff, the costs will be accounted for under the LCCC payroll budget and recharged to ESC accordingly.
- 3.29. A breakdown of the estimated operational costs for 2018/19 to 2020/21 is provided in Table 6, together with comparative figures for the 2017/18 budget. The subsequent paragraphs provide an explanation for each row of Table 6.

Table 6.

Description	Budgeted costs – 2017/18 £000s	Estimated costs – 2018/19 £000s	Estimated costs – 2019/20 £000s	Estimated costs – 2020/21 £000s
Professional fees	-	650	450	450
Settlement Service	3,747	3,686	3,715	3,620
Insurance	79	71	78	85
Depreciation	507	510	510	509
Low Carbon Contracts Company cost recharge	1,628	2,667	2,756	2,793
Other costs	280	45	45	45
Total	6,241	7,629	7,554	7,502

Professional Fees

3.30. The budget required is estimated to be £0.650m in 2018/19, £0.450m in 2019/20 and 2020/21. This reflects the investment required to ensure that the company has the appropriate organisational set-up, sufficient resources for data validation and systems, operational interface management and change delivery.

Settlement Service

3.31. The costs of providing the settlement service, as set out in Table 7, include the estimated cost of:

- administering and monitoring bid bonds and collateral;
- making payments in respect of Transitional Arrangement auctions and other Capacity Market auctions;
- collecting ESC's operational costs levy for 2018/19, 2019/20 and 2020/21;
- audit and assurance, including the verification of meter arrangements for providers whose capacity agreements are conditional on ESC approving their metering configuration and external audit costs for the operational settlement services.

3.32. Table 7 breaks down the provision of settlement services. The budget includes a provision to fund software upgrades to the settlement system required over the next

three financial years. There continues to be a requirement for upgrades to the settlement system to implement regulatory and rule changes to the Capacity Market. The main source of change over the next 3 years is likely to relate to Capacity Market Rule changes proposed by Ofgem or BEIS and would be subject to consultation. There is also some provision for operational improvements.

Table 7.

Description	Estimated costs – 2018/19 £000s	Estimated costs – 2019/20 £000s	Estimated costs – 2020/21 £000s
Resource and subcontractors	1,202	1,215	1,150
Infrastructure costs	117	114	112
Licences and data	207	212	203
Settlement system change	1,160	1,150	1,115
Metering assurance	633	656	671
Audit and assurance	367	368	369
Total	3,686	3,715	3,620

Insurance

- 3.33. Insurance is procured on a commercial basis, using an insurance broker engaged under the Crown Procurement framework. The level of cover reflects the activity that ESC expects to be undertaking in 2018/19, 2019/20 and 2020/21.

Depreciation

- 3.34. Expected annual depreciation charges of £0.510m in 2018/19, £0.510m in 2019/20, and £0.509m in 2020/21 are included in the operational cost budget. These charges relate to the development and build of the Capacity Market settlement system funded by BEIS in previous years. The charges that are collected to cover depreciation costs will be paid to BEIS in the year that it is collected.

Low Carbon Contracts Company cost recharge

- 3.35. In order to reduce costs as far as possible, ESC will continue to share services and back-office functions with LCCC and so has no employees of its own. Under this arrangement, ESC pays LCCC to provide the functions it requires. This cost is based on an estimate of the time LCCC employees will spend on ESC activities during the levy year, together with an appropriate allocation of overhead costs (including rent, service charges, IT infrastructure, telephony support and other non-

core assets). For core systems which are shared between LCCC and ESC, and where the capital expenditure has been initially funded through LCCC, a charge for the use of these assets will be made to ESC based on a notional depreciation charge. The recharged costs also include a proportion of corporate service costs, legal and professional fees, and the salaries of the ESC Board members. Although LCCC undertakes corporate activities on behalf of ESC, the ESC Board retains responsibility and accountability for the quality and cost of services provided.

- 3.36. This approach avoids ESC replicating functions that LCCC already has in place. LCCC must therefore have sufficient capacity in 2018/19-2020/21 to ensure ESC has the necessary resources to perform all of its functions in relation to the Capacity Market and fulfil its purpose and activities under the shareholder framework document and the relevant legislation.
- 3.37. For 2018/19 LCCC and ESC have agreed a recharge of £2.667m, for 2019/20 £2.756m and for 2020/21 £2.793m, which will be payable by ESC in monthly instalments. In general, this amount will remain fixed and will not be subject to amendment. However, if actual costs prove to be materially in excess of the estimated costs, LCCC will be entitled to amend the level of recharge accordingly. If costs prove to be materially less than estimated, resulting in actual cost savings to LCCC, the amount payable by ESC would be reduced accordingly.
- 3.38. As the activity associated with the Capacity Market increases, a higher proportion of support costs paid for by LCCC are allocated to ESC. The recharge increases by £1.0m which results in a higher recharge rate for 2018/19 of 14% of LCCC budget, compared with 10% in 2017/18.

Other costs

- 3.39. In addition to the above, there are a number of other directly charged costs which ESC will incur. These relate primarily to the annual audit fee for the completion of the statutory annual report, stakeholder management and ESC-specific assurance activity.

Consultation Questions

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| 4. | Do you have any comments on ESC's estimated operational costs set out in this consultation document? |
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