18 December 2014

Low Carbon Contracts Company sets level of CFD Supplier Obligation for the first quarterly obligation period

The Low Carbon Contracts Company (LCCC) has today announced the level of the Contracts for Difference (CFD) Electricity Supplier Obligation Interim Rate and the Total Reserve Amount that will apply for the first quarterly obligation period, which runs from 1 April to 30 June 2015. The **Interim Rate of 3.5p per Megawatt hour** and the **Total Reserve Amount of £1,061,400.00** were determined at the Board meeting which took place on 16 December 2014.

Earlier this year, LCCC was designated as the CFD counterparty under the Energy Act 2013 and has operated independently since 1 August 2014, playing a key role in the implementation of the government's Electricity Market Reform (EMR) programme.

LCCC's key deliverables for its first 12 months of operation are:

1) Setting CFD Supplier Obligation by 31 December 2014;
2) Signing CFDs allocated in the 2014 Round (dependent on the timing of the auction run by National Grid);
3) Collecting the CFD Supplier Obligation from suppliers and paying generators from 1 April 2015.

Today's announcement delivers the first of these key milestones. To help our stakeholders understand how we have determined the Interim Rate and Total Reserve Amount we have also launched a new Transparency Tool microsite.

What is the CFD Supplier Obligation?

The CFD Supplier Obligation is a levy that must be paid by all licensed electricity suppliers in Great Britain from 1 April 2015. Suppliers will need to make pre-payments consisting of a unit cost fixed 'Interim Rate', chargeable as a £/MWh rate on a daily basis, and lump sum 'Reserve' payments at the start of each quarterly obligation period. **Interim Rate** payments are intended to provide funds to enable LCCC to make expected payments to CFD generators, whilst **Reserve** payments is designed to ensure that 19 times out of 20, LCCC has sufficient resources to make all payments due to CFD generators. Amounts collected can only be used to make payments to low carbon generators under CFDs being managed by LCCC.

How have we determined the Interim Rate?

LCCC has calculated the size of the Interim Rate for this first period using the formula required by regulations:

$$Interim\ Rate\ _{(£/MWh)} = \frac{Total\ (expected)\ Quarterly\ Net\ Payments\ to\ Generators_{(£)}}{Total\ (expected)\ Quarterly\ Eligible\ Supply_{(MWh)}}$$

The Interim Rate therefore depends upon a number of key variables for that particular quarterly obligation period, such as:

1) The generators that are expected to have CFDs and generate within the quarterly obligation period – their capacity, load factor and strike price;
2) The expected reference price against which the contracts are assessed; and
3) The expected eligible supply.

LCCC has used a **Forecasting Model** to provide predictions of these key variables using probabilistic simulations. The biggest uncertainty at present is which projects will be allocated CFDs in the 2014 Allocation Round (being operated by National Grid), which is not expected to conclude until early 2015.

Amount of CFD generation

The amount of CFD generation during the first quarterly obligation period cannot be known with certainty, as it depends on what generators hold CFDs, when they start generating, their load factor and any outages. For this first period, a particular source of uncertainty is the outcome of the 2014 Allocation Round, which will not be known until early 2015. In order to allow for contracts that might be awarded as a result of the Allocation Round, LCCC has made assumptions about the capacities, load factors and strike prices, which are fully explained on our Transparency Tool microsite. This enables us to make payments to generators, should they be awarded a CFD and be able to generate within the first quarterly obligation period. It should be noted that the size of the CFD Supplier Obligation is expected to increase over the coming periods, assuming that CFD payments made out under the scheme increase.

Why have we set an Interim Rate now?

LCCC is required under the CFD Supplier Obligation Regulations to determine, by 31 December 2014, the size of the Interim Rate and Total Reserve Amount that will apply to the first quarterly obligation period, which runs from 1 April to 30 June 2015. This process will be repeated for every quarterly obligation period, with the Interim Rate and Total Reserve Amount being determined before the start of the quarter preceding the quarterly obligation period in which they apply. The Interim Rate payments received will be reconciled at the end of each quarter against the actual levy rate, using daily CFD generation and electricity supply data.

Why do we need a Reserve?

LCCC is required by regulation to set a Total Reserve Amount for the same period so that there is a 19 in 20 (i.e. 95%) probability of LCCC being able to make all the payments required to CFD generators during the quarterly obligation period. The Total Reserve Amount is designed to alleviate the uncertainties which could lead to payments being higher than forecast in the calculation of the Interim Rate by providing LCCC with working capital if payments to generators occur before the Interim Rate payments are received from suppliers. All licensed electricity suppliers will receive, by 31 December 2014, a notice from EMR Settlement Limited, on behalf of LCCC, confirming each company's share of the Total Reserve Amount and how this should be paid. Any surplus money will be reconciled at the end of each quarterly obligation period.

What is the purpose of the Transparency Tool?

LCCC is committed to working as transparently as possible to inform our stakeholders of how we have arrived at this forecast. We have developed the **Transparency Tool** site in partnership with Lane Clark & Peacock to provide our stakeholders with insight into our assumptions and calculations. The site is aimed at making our forecasting process as transparent as possible for stakeholders by giving them access to the assumptions, inputs and outputs from the model.

How have we engaged with relevant industry groups?

As a part of this process, LCCC has engaged with stakeholders through two Expert Groups established to provide us with challenge and guidance on the development of the Forecasting Model and the Transparency Tool. Members of these groups, consisting of representatives from electricity suppliers, consumer groups, market consultants and risk analysts, were selected for relevant experience following nominations sought via industry and consumer trade associations.

LCCC's role in the implementation of the government's EMR Programme

Under the Electricity Market Reform (EMR) programme, LCCC plays a key role in working with industry to ensure they are prepared for key CFD implementation milestones. We provide support in the following ways:

- Maintaining and publishing regular updates of the CFD Implementation Plan;
- Providing targeted CFD implementation events for generators and suppliers;
- Coordinating with other EMR delivery partners such as National Grid, Elexon and Ofgem in communication with industry stakeholders.

For further information on the aims of the EMR programme see the DECC website.

Further information

Anyone requiring more information about LCCC or our activities should email us at info@lowcarboncontracts.uk or by telephone on 0207 211 8357.