



Annual Performance Report 2016

Electricity Settlements Company

December 2016

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1. Introduction

1. As the appointed Settlement Body for the Capacity Market (“CM”), the Electricity Settlements Company (“ESC”) must, in accordance with regulation 84 of the Electricity Capacity Regulations 2014 (as amended) (“the principal regulations”), produce an annual report on the performance of its functions in respect of each capacity year¹. The annual report must, no later than three months after the end of the capacity year to which it relates, be provided to the Secretary of State and published. This annual performance report covers the period 1 October 2015 to 30 September 2016 (the end of the capacity year) and is the second such report produced by ESC.
2. The CM was introduced as part of the government’s Electricity Market Reform programme, designed by the then Department for Energy and Climate Change (“DECC”). The CM is aimed at ensuring security of supply during times of peak demand through capacity agreements awarded to providers via an auction. These capacity agreements provide a steady, predictable revenue stream upon which capacity providers can base their future investments, with the aim of ensuring security of supply in future years at least cost to consumers.
3. ESC is a private limited company wholly owned by the Secretary of State for Business, Energy and Industrial Strategy (“BEIS”) which performs an integral role in the delivery of the CM. It oversees the settlement of the CM to ensure that regular payments are made to capacity providers who have agreed to provide capacity or reduce demand at times of system stress.
4. ESC has a range of functions which it must perform. The principal function is that of settlements, as set out in Part 6 (Payments) of the principal regulations. ESC will be making its first capacity payments in December 2016, but throughout 2016 has performed a range of activities, in accordance with, and in order to enable it to meet its regulatory responsibilities. These activities, which are included within the scope of this report, include the administration of credit cover, performing metering tests, and collection of the settlement costs levy which funds ESC’s administrative functions. In addition, this report sets out the progress made by ESC in ensuring the necessary arrangements are in place in order for it to collect the supplier charge and make capacity payments in the delivery year commencing 1 October 2017.

¹ “Capacity year” is defined in regulation 2(1) of the principal regulations and means “a period of one year starting on 1 October and ending on the following 30 September”.

2. Credit Cover

1. In order to participate in the capacity auctions run by National Grid, some capacity providers are required at the 'pre-qualification' stage to lodge credit cover with ESC² (in the form of cash or letter of credit, or a combination of both). Within the period covered by this report, ESC had finalised processing credit cover for the T-4 auction (held in December 2015) and the Transitional Arrangements ("TA") auction (held in January 2016), and had begun processing credit cover for those auctions to be held between December 2016 and March 2017.

T-4 auction (December 2015) and TA auction (January 2016)

2. Credit cover relating to these auctions was covered in the previous Annual Performance Report. At the time of the publication of that report, however, the total value of credit cover had yet to be determined. ESC confirms that following the conclusion of the prequalification stage, it collected credit cover totalling £45.1m in a combination of cash and letters of credit: £44.6m relating to the T-4 auction and £0.5m relating to the TA auction. As at the end of September 2016, ESC held credit cover valued at £4.5m and £0.1m with respect to each of these auctions. The credit cover currently held is a combination of the credit cover ESC is required (by the Delivery Body, National Grid³) to hold or credit cover for which applicants have yet to request a refund.

T-4 auction (December 2016), Early auction (January 2017) and TA auction (March 2017)

3. Following the prequalification window (1 - 26 August 2016) for the T-4 auction, Early Auction⁴ and TA auction, ESC collected over £210m of credit cover (in a combination of cash and letters of

² The amount of applicant credit cover to be provided is set out in regulation 59 of the principal regulations.

³ National Grid is the EMR Delivery Body and is responsible for administering key elements of the Capacity Market including prequalification.

⁴ The Government confirmed on 8 July 2016 that it would hold an 'Early Auction' to secure over 50GW of reliable capacity for delivery in 2017/18. <https://www.gov.uk/government/collections/capacity-market-parameters-for-t4-auction-for-202021-and-early-auction-and-transitional-arrangements-auction-for-20172018>

credit) from prospective capacity providers: £147.6m relating to the T-4 auction; £62.9m relating to the early auction; and over £286,000 relating to the TA auction.⁵

4. ESC is also responsible for making repayments of credit cover to those capacity providers unsuccessful in capacity auctions. This information will be included in the next Annual Performance Report.

3. Metering tests

1. Capacity Providers seeking to participate in a Capacity Auction must, as part of the Capacity Market pre-qualification process, undertake a Metering Assessment. From the Assessment National Grid will determine whether a metering test is required. ESC is required to perform these tests, which seeks to ensure a Capacity Provider's metering arrangements correctly reflect the flow of electricity supplied, generated and consumed within a site. Meter testing is therefore crucial in providing confidence in the integrity of the Capacity Market and the metered data that underpins it.
2. ESC's priority over the period covered by this report has been to perform metering tests relating to capacity procured in the TA auction held in January 2016 and for delivery in the year commencing 1 October 2016. With respect to the TA auction, ESC undertook 109 tests in total, 106 for new build/existing generators and 3 for demand side response capacity providers. The tests covered 12 Capacity Market Units (CMUs) amounting to 183 MW of capacity, out of a total of 57 CMUs amounting to 803 MW. The outstanding CMUs were either not required to have a metering test or, where they were required, decided not to request a test (resulting in termination of their capacity agreement).
3. ESC also completed a procurement process, resulting in awarding EMRS a three-year contract as ESC's metering management services provider.

4. Settlement costs levy

1. ESC's day-to-day operational costs are funded by suppliers via the settlement costs levy that is set by the relevant Capacity Market regulations. The levy amount is updated annually following

a robust and detailed annual business planning and management process, and subsequent public consultation process⁶.

2. The settlement costs levy for 2016/17 was set at £4.283m, an increase of £0.392m on the previous year's levy of £3.891m. The increase in costs are driven by new or increased activities, including increased meter assurance and fraud prevention activities; and increased settlement operations activities as ESC moves to full operational service for the capacity market.
3. ESC delivered a solid financial performance in financial year 2015/16, half of which falls within the period covered by this report, meeting all operational requirements. As a result, the company was in a position to return £1.181m of settlement costs levy collected from suppliers during 2015/16 back to suppliers in July 2016.
4. There have been a number of contributory factors to this positive performance, including setting up a Group VAT registration status between ESC and its sister company, LCCC, which has resulted in VAT savings on services charged between the two companies and management's decision to place greater reliance on in-house skills and capabilities rather than depending on external consultancy support. A large part of the refund, some £0.683m relates to lower depreciation primarily associated with the Capacity Market settlement system, reflecting a delay in the commissioning date for delivery of the fully automated system. The next section sets out further detail on the delivery of the Capacity Market settlement system.

5. Settlement

1. One of ESC's core activities is to perform the settlement role as set out in Part 6 (Payments) of the principal regulations. This role requires ESC to make payments to and receive payments from capacity providers who hold capacity agreements with National Grid⁷. ESC obtains the funds to make payments to capacity providers from electricity suppliers.
2. The design and build of the CM settlement system is being undertaken by EMR Settlement Ltd⁸ (EMRS) and overseen by ESC. The settlement system is funded via a grant arrangement between

⁶ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/474061/LCCC_ESC_2016-17_operational_costs_condoc.pdf. See also the Government response: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/494454/160121_-_2016-17_Op_Costs_-_Government_Response_-_FINAL.pdf

⁷ ESC will also receive payments from capacity providers in the form of penalties should they not make capacity available when required.

⁸ EMR Settlement Ltd (EMRS) is a wholly owned subsidiary of ELEXON Ltd and is the EMR Settlement Services Provider. EMRS delivers settlement services on behalf of the Low Carbon Contracts Company Ltd for Contracts for Difference and on

BEIS, ELEXON Ltd and its subsidiary EMRS. Development of the Capacity Market settlement system commenced in late 2014, with an expected completion date of June 2015. However, as a result of continuing delays in the build and testing of the main original system, the systems development contract between EMRS and its principal subcontractor was terminated on 9 November 2015.

3. Consequently, ESC has overseen the development by EMRS of a new, sustainable settlement system solution. ESC has sought to minimise the risks associated with this development on the CM scheme through an orderly sequencing of system development activities. Planned payments to capacity providers for the delivery year commencing 1 October 2016 will be implemented as originally envisaged. Future scheduled activities are also expected to be delivered to time, for example, the ability to manage penalty and over delivery payments, and secondary trading of capacity obligations.

6. The year ahead

1. ESC's third annual performance report will cover the period, 1 October 2016 to 30 September 2017. The report will cover, amongst other things, ESC's performance relating to the Capacity Market's first delivery year.

