

05 January 2018

Dear Jeremy,

The Low Carbon Contracts Company (LCCC) welcomes the opportunity to respond to the [Cost of energy review: call for evidence](#).

The LCCC is a private company wholly owned by the Secretary of State for Business, Energy and Industrial Strategy (BEIS), whose primary role is to be the counterparty to Contracts for Difference (CFDs) awarded to low carbon generators. As part of this role, LCCC forecasts and sets the Supplier Obligation Levy that funds CFD payments. LCCC currently has approximately £65bn of contracts under management.

LCCC also plays a significant role in the delivery of the Capacity Market (CM) scheme, on behalf of the Electricity Settlements Company (ESC), including managing credit cover ahead of auctions and post-auction meter verification and payments. Under the CM, ESC is currently forecast to pay approximately £1bn to CM agreement holders for the delivery year starting in October 2018.

The LCCC has a Guiding Principle conferred on it by our Framework Agreement with the Government to maintain investor confidence in the CFD scheme and minimise costs to consumers. Our sister company, the ESC, has a similar Guiding Principle for the CM scheme.

We believe that it is core to our role to assist Government in understanding the investor and consumer interactions with the schemes that we operate, how these are likely to evolve with the changing market and how they would be impacted by proposals in the Cost of Energy Review.

Our response to the Call for Evidence does not go into detail on such points but rather focuses, from an operational perspective, on what approach Government could take to future reforms that could provide clarity and avoid disruption in the short and medium term and as Government considers its long-term strategy.

This response has been developed under the understanding that it would be made publicly available.

Kind Regards,

Neil McDermott
Chief Executive Officer

Ruth Herbert
Head of Strategy & External Relations

LCCC/ESC Response to “Cost of energy review: call for evidence”

Introduction

1. The reduction in the cost of renewable and flexible technologies provides confidence that both security of supply and decarbonisation, in the build up to 2030, can be achieved affordably providing the right market arrangements are in place.
2. In the short to medium-term, the Electricity Market Reform (EMR) schemes will continue to be integral market-based mechanisms driving all new-build large-scale investment in this sector. These schemes will need to evolve to keep up with the transition that the electricity sector is going through – such as technological, financial, and regulatory changes – in order to avoid suboptimal outcomes for consumers.
3. We welcome this call-for-evidence and we hope that it will stimulate a healthy debate on future market arrangements. We also suggest that, as a starting point, defining key principles to underpin the continuous feedback we provide to the ongoing development of the EMR schemes would start delivering improvements and value for consumers in the short term.

What are the longer-term challenges for electricity generation?

4. Decarbonising the electricity sector whilst maintaining security of supply and minimising costs to consumers remain the primary challenges in securing our future electricity generation needs. In the short to medium term, keeping costs of this investment in new build generation down for consumers will rely on sustained competitive tensions in the CFD and CM auctions.
5. Maintaining investor confidence during such a period of change will therefore be critical to ensuring that there is a healthy pipeline of potential new build projects that will exceed future demand. This investor confidence is also critical to supporting the necessary investment in the supply chain and innovation needed to drive down costs.
6. In the period to 2030 and beyond, the requirement for new build projects is significant and the pipeline must be well in excess of this demand if benefits of cost reduction are to be secured in auctions for consumers. Maintain investor confidence must therefore be at the heart of any successful strategy.
7. We therefore believe that to ensure the best outcome for consumers the Government should set out to provide investors with a clear direction of travel on:
 - Its vision for future market arrangements; and
 - How, in the short to medium-term, existing schemes and delivery landscape are expected to drive investment and evolve in a way that maintains investor confidence.

What matters should the Government take into account in considering the policy framework for electricity generation?

8. Development of future market arrangements is a complex task, requiring difficult decisions about the scope and pace of change necessary to meet long-term goals.
9. We believe there is a need to separate the long-term strategic decisions from short to medium-term ones related to the evolution of the EMR schemes. To do this successfully short-term decisions need to be consistent with both ongoing market developments and the long-term vision as it emerges.

10. Indeed, it is key that the evolution of the EMR schemes takes place in a structured manner with a clear direction of travel and at a pace that can be adequately managed by Delivery Bodies to ensure operational integrity. This will be vitally important to maintain investor confidence.
11. Such a direction of travel would provide the Government with early opportunities to address concerns raised by the Cost of Energy Review on the risks associated with the complexity and lack of cost reflectivity of the current market arrangements which may create risks of suboptimal outcomes for consumers.
12. We therefore believe that if the Government provides a clear vision upfront, based on principles (or success criteria), these could provide helpful early signals and bring clarity for short to medium-term decisions on the evolution of existing schemes that would be aligned with the long-term agenda.
13. We believe some principles emerge from this work that could underpin the evolution of the CFD and CM in the short to medium term and these are:
 - Simplification
 - Coherence
 - Cost reflectivity
 - Removing barriers to participation
14. LCCC can identify opportunities for improving the operation of the CFD and CM schemes in line with the above principles or indeed other principles that Government might use to guide its work on future market design.
15. We believe working to clear and common principles would deliver better alignment in the short to medium-term between the CFD and CM schemes, between the EMR schemes and the ongoing regulatory change process, as well as with any future direction of travel that might emerge in response to the Cost of Energy Review.
16. Such an approach would start delivering results quickly by addressing the risks of suboptimal outcomes in the short term and in doing so it would help enable desirable long-term changes whilst supporting investor confidence.

What additional evidence should the Government consider to reduce the cost of electricity generation in the longer term?

17. Feedback from CFD generators, Capacity Providers and LCCC/ESC and other delivery organisation data and insights on scheme operations are essential inputs to considering how to embark on further market reforms.
18. In particular, we continually provide feedback on how well certain rules and provisions are achieving stated policy objectives via the various BEIS chaired CFD and CM boards. However this is, to some extent, backwards-looking, as it is based on what was intended to be achieved when the schemes were initiated.
19. The independent operational feedback from the existing EMR Government schemes is key evidence and should be integral to the change process and the various evaluation and statutory reviews, however to maximise the value of this feedback we need clarity around the objectives.
20. We are therefore keen to engage with BEIS officials in order to understand the forward looking key principles that should underpin our feedback thus ensuring the best possible outcome for consumers.