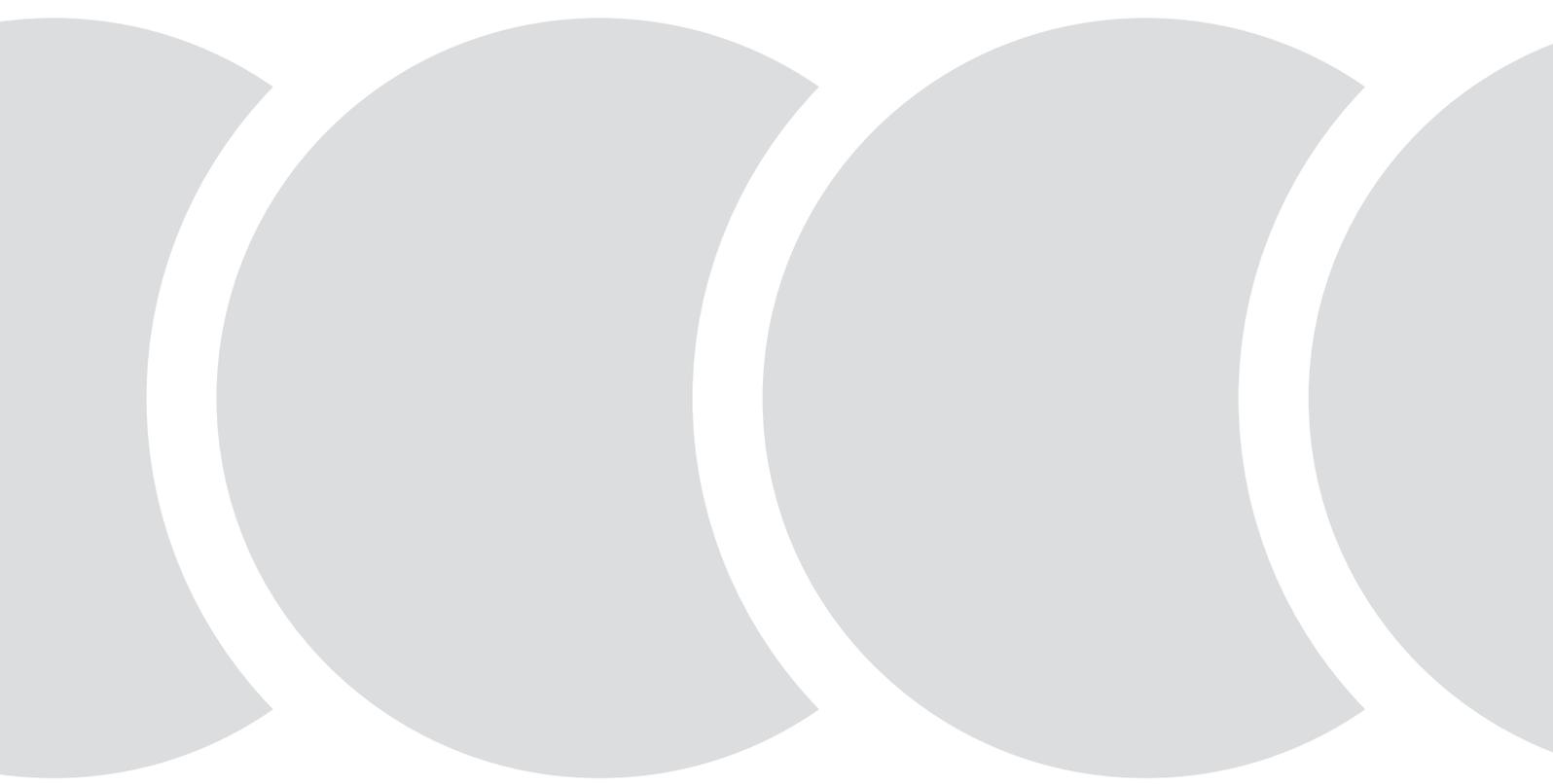


Annual Performance Report 2019

Electricity Settlements Company

December 2019



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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 for Business, Energy and Industrial Strategy (“BEIS”) and must be published. This annual performance report covers the capacity year starting on 1 October 2018 and ending on 30 September 2019.
2. The CM was introduced as part of the government’s Electricity Market Reform (EMR) programme, through the Energy Act 2013. 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 the least cost to consumers.
3. ESC is the designated Settlement Body for the CM and its principal functions are to collect from electricity suppliers the funds to pay out to Capacity Providers in accordance with the relevant regulations. ESC is a private limited company, wholly owned by the Secretary of State for 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. On 15 November 2018 the judgment of the General Court of the Court of Justice of the European Union had the effect of annulling the European Commission’s State Aid approval for the CM and introduced a standstill period. This standstill period covered the period from 15 November 2018 until 25 October 2019, being almost the entirety of the capacity year to which this report relates. During the standstill period, ESC suspended the collection of funds from suppliers and payments to Capacity Providers, but other aspects of the CM continued. This report will focus on activity that continued through the standstill period.

2. Auctions

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 ESC (in the form of cash or a letter of credit, or a combination of both). However, as the Capacity Market was in standstill the scheduled T-1 and T-4 Auction were not commenced during early 2019 as previously planned.
2. The T-1 auction was replaced by a Conditional T-1 Auction (held in June 2019 during standstill). To limit the burden on Capacity Providers during standstill the credit cover requirements were waived for this auction and instead replaced by the introduction of an “unproven capacity fee” and changes to termination fee provisions (as mentioned in the Settlements Section).
3. The T-4 Auction was replaced by a T-3 Auction due to be held in early 2020 following a positive State Aid decision to restart the CM.
4. Due to the changes to the auction arrangements caused by standstill, there were no credit cover requirements for Capacity Providers within the period covered by this report.

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”.

3. Metering tests

1. Capacity Providers seeking to participate in a capacity auction must, as part of the CM prequalification process, carry out a metering assessment. From the information provided at the metering assessment, National Grid will determine whether or not a metering test is required. ESC is required to perform these metering tests. The tests seek 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 CM and the metered data that underpins it.
2. ESC undertook 62 component tests for 20 CMUs; 12 for new build/existing generators and 8 for unproven demand side response (DSR) Capacity Providers. ESC also completed 3 metering site visits throughout the 2018/19 delivery year as part of its metering assurance programme. The metering information of 372 CMU Components has been validated for the 2019/20 Delivery Year.

4. Settlement costs levy

1. ESC's day-to-day operational costs are funded by suppliers via the settlement costs levy set by the relevant CM regulations. The levy amount is updated annually following a robust and detailed annual business planning and management process.
2. The settlement costs levy for the financial year 2018/19 was set at £7.629m, an increase of £1.388m on the previous year's levy of £6.241m. The increase in costs are driven by new or increased activities, including increased meter assurance activities and updates to the settlement system and processes (see further below) to prepare for the CM restart after the standstill period.
3. ESC delivered a solid financial performance in financial year 2018/19, 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 £387k of settlement costs levy collected from suppliers during 2018/19 despite the increased activities and preparing for the CM restart.

5. Settlement

1. As outlined above, 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. ESC obtains the funds to make payments to Capacity Providers from electricity suppliers. However, due to the CM being in standstill during most of the 2018/19 capacity year, no payments to or from Capacity Providers were made during the period covered by this report.
2. Following a BEIS Consultation in January 2019, ESC implemented a number of settlement system changes to facilitate and prepare for the restart of the Capacity Market post-standstill, including functionality to:
 - a. process the credit cover requirements for more than two auctions simultaneously (necessitated by postponed auctions during standstill period);
 - b. process CM restart trigger dates and then calculate and generate standstill invoices including:
 - i standstill supplier charge payments;
 - ii mutualisation payments, including functionality for supplementary mutualisation if called upon;
 - iii standstill capacity payments;
 - iv residual standstill capacity payments if called upon;
 - v calculate and generate fees associated with delivering the late T-1 Conditional Auction including "unproven capacity fee" payments, new termination fee payments and overcharged penalty repayments; and
 - c. incorporate Standstill Payments into the Reconciliations calculation process.
3. Ofgem's annual industry consultation process resulted in further changes to the CM rules and regulations in 2019. ESC implemented the following settlement system changes as a result of these changes:
 - a. Final Consumption Levy exemption;
 - b. clarifications on CMUs providing Relevant Balancing Services (CP279, CP289, CP290); and
 - c. component reallocation and metering information improvements (Of12)
4. Despite the scale and complexity of the additional activities, ESC has consistently met all its operational targets, delivering new capabilities successfully.

6. High level comparison of the 17/18 and 18/19 reports

| | 2018 Annual Report | 2019 Annual Report (standstill) |
|--------------------------|--------------------|---------------------------------|
| Metering component tests | 113 | 62 |
| Metering site visits | 346 | 3 |
| Settlement costs levy | £6.241m | £7.629m |
| Credit Cover collected | £227.9m | £0 |

7. The year ahead

1. On 25 October 2019, the Secretary of State notified ESC of the European Commission's decision confirming that the GB Capacity Market scheme is compatible with EU State Aid rules and that the deferred capacity payment trigger event and T-1 capacity agreement trigger event had occurred for the purposes of the relevant regulations. The occurrence of these trigger events means capacity payments can restart under the GB Capacity Market scheme. It also confirmed that payments in respect of these agreements for the standstill period can now be made.
2. The standstill supplier charge for the 2018/19 capacity year covered by this annual report was £1,005,192,678.70. There were an additional 2 months of standstill which will be included in next year's report, with confirmation of capacity provider standstill payments.
3. There are a number of conditions from the EC decision that will require additional changes to systems and processes to be delivered within the next delivery year. These were related to;
 - a Agreement lengths and demand side response (DSR);
 - b Minimum capacity threshold;
 - c The amount of T-1 set aside capacity; and
 - d New technology types being accepted into the CM.
4. The next delivery year 19/20 will be critical for ESC to finalise standstill collections from suppliers and ensure the delivery of payment to Capacity Providers.
5. It was a challenging capacity year with the standstill and preparing for restart, but there have also been many improvements delivered which will stand ESC in a good position going into the next delivery year.