



**Electricity
Settlements
Company**

Annual Report and Accounts 2015/16



The Government's energy and climate change objectives are to:¹

- ensure the UK has a secure and resilient energy system
- keep energy bills as low as possible for households and businesses
- secure ambitious international action on climate change and reduce carbon emissions cost effectively at home
- manage the UK's energy legacy safely and responsibly.

The delivery of these objectives is supported through two key schemes: the Capacity Market and Contracts for Difference (CFDs). The Capacity Market contributes to security of supply by ensuring that there is sufficient reliable capacity to secure the supply of electricity.² CFDs incentivise investment in low carbon electricity generation by removing generators' long term exposure to electricity price volatility.

The Department of Energy and Climate Change (DECC) created two companies to help deliver these schemes:

- Electricity Settlements Company Ltd (ESC) to oversee settlement of the Capacity Market agreements
- Low Carbon Contracts Company Ltd (LCCC) to be the counterparty to and manage CFDs throughout their lifetime.

ESC is governed by a Framework Document³ with its sole shareholder, the Secretary of State for Energy and Climate Change. The Framework Document, published on LCCC's website, is one of the company's primary governance documents, which sets out its relationship with its shareholder and its Guiding Principle.



ESC's Guiding Principle is to maintain market participants' confidence in the Capacity Market settlement process and minimise costs to consumers.

¹ DECC Single departmental plan: 2015 to 2020, available at <https://www.gov.uk/government/publications/decc-single-departmental-plan-2015-to-2020/single-departmental-plan-2015-to-2020>

² DECC Consultation of further reforms to the Capacity Market, 1 March 2016, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/504217/March_2016_Consultation_Document.pdf

³ <https://lowcarboncontracts.uk/corporate-governance>

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Senior team



Martin Read
Chairman



Helen Turner
Chief Finance Officer



Neil McDermott
Chief Executive



Claire Williams
Head of Legal and
Company Secretary



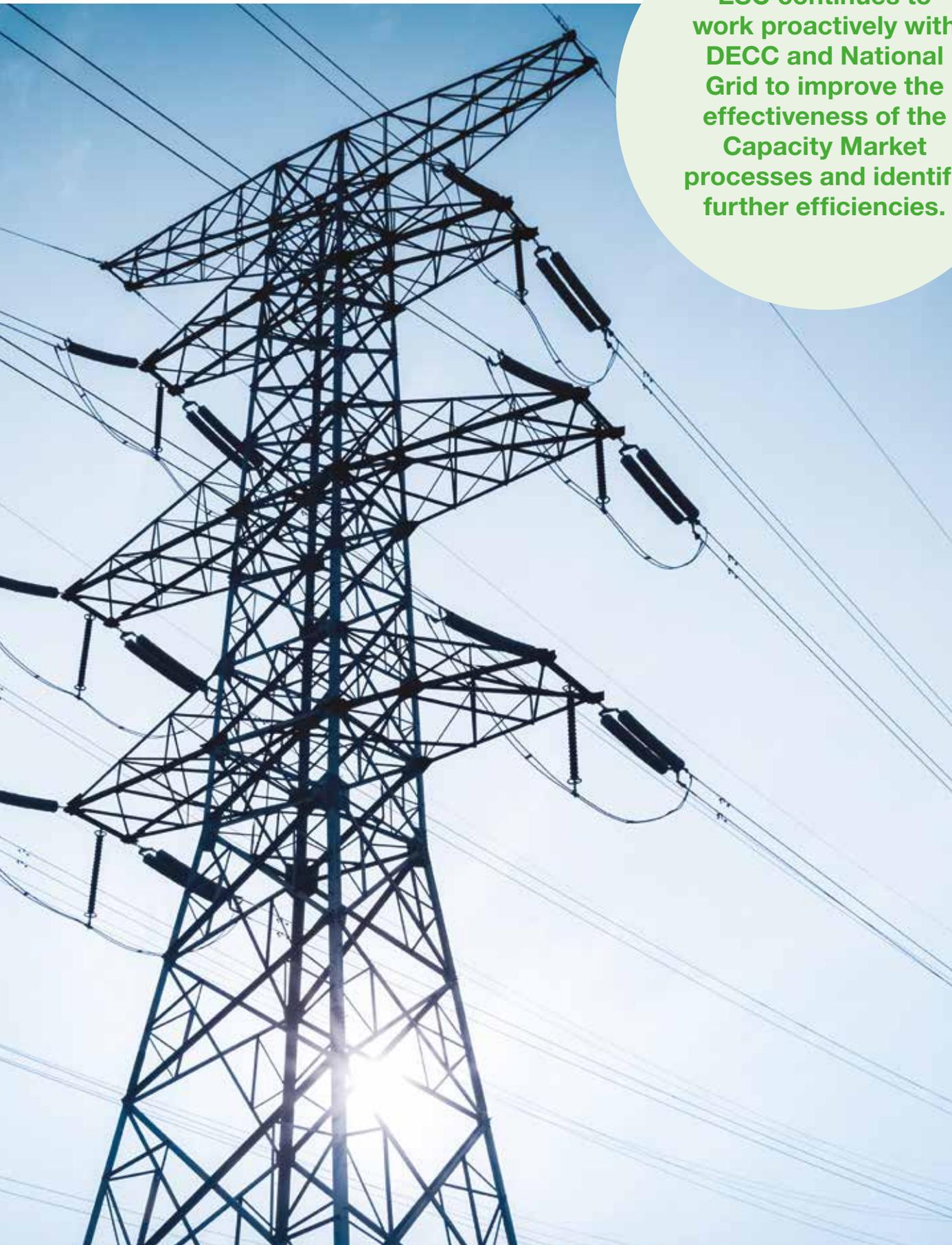
Matthew Taylor
Head of Strategy
and External Relations



James Rushton
Head of Commercial



Cynthia Duodu
Head of Corporate Services



ESC continues to work proactively with DECC and National Grid to improve the effectiveness of the Capacity Market processes and identify further efficiencies.

A year of progress

“
2015 has been our first full year of operations. We met all our milestones, continuing our excellent track record since the creation of the company in August 2014.
”



Playing a crucial role in energy security

ESC plays a key role in the Capacity Market scheme. This scheme was introduced as part of the Government's Electricity Market Reform programme to ensure the security of electricity supply at least cost to the consumer.⁴

This has been our first full year of operations. We met all our key milestones, continuing our excellent track record since the creation of the company in August 2014.

ESC's activities will increasingly grow in importance as additional Capacity Market auctions are held and payments to capacity providers commence. It is expected that the company will be making around £1bn of payments by 2018/19.

Delivering key services

The operations of ESC are being delivered in conjunction with our sister company, LCCC, to deliver synergies and minimise costs to consumers.

During the financial year 2015/2016, we have continued to set up our operational business functions. This has included the development of the system for settling payments to and from Capacity Market participants under capacity agreements.

Ahead of the Capacity Market auctions in December 2015 and January 2016, ESC collected credit cover from Capacity Market participants. This supports the integrity of the Capacity Market by ensuring that auction participants are credible and committed to delivering the capacity they are offering.

We have also commenced work to ensure the compliance of the metering facilities used by capacity providers. This work is crucial for providing confidence in the integrity of the Capacity Market and the metered data that underpins it.

Board changes

One of my key priorities when we set up the company was to establish an experienced and collaborative Board of Directors, able to provide clear leadership and guidance to the company. I was therefore sorry to lose our two founding shareholder nominated directors in the latter part of 2015. I would like to express my sincere thanks to both Jonathan Mills and Anthony Odgers for their hard work and contribution. We wish them every success as they take on new responsibilities for the Government. They are replaced by David Long, a Director at UK Government Investments (formerly the Shareholder Executive) and Simon Elliston, a Director at DECC.

Our People

Our success this year is a direct result of the high calibre people that we have recruited into the business and their hard work and commitment. I should like to thank all our colleagues for the contribution they have made to a most successful year. We now have in place a very strong and experienced team.

Looking forward

We will continue to work alongside our industry partners to play our part in delivering the Government's energy policy, securing electricity supply and maintaining the confidence of market participants in the Capacity Market settlement process.

We will use the detailed knowledge we have acquired to drive continuous improvement, not only in the work for which we are directly responsible but also in supporting DECC in the evolution of low carbon electricity.

We look forward to taking on additional activities to help DECC deliver its objectives in the years ahead.



Dr Martin Read CBE

Chairman

⁴ Security of Supply and the Capacity Market: Written Statement HCW S560, available at, <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2016-03-01/HCWS560/>

ESC's key role in Capacity Market

“

In 2014, we set our Delivery First priority for ESC, focusing on the delivery of all our key milestones and, in doing so, building confidence in our company.

”



Delivery of settlement activity

In 2014, we set our Delivery First priority for ESC, focusing on the delivery of all our key milestones and, in doing so, building confidence in our company and in Electricity Market Reform (EMR). Our approach has been to focus on effective operational delivery and continuous improvement.

ESC has three key roles in the Capacity Market:

- delivery of settlement operations under the electricity Capacity Market payment regulations
- undertaking credit cover collection in relation to the Capacity Market auctions
- undertaking metering assurance, including checking that metering systems are compliant with the rules and regulations governing the Capacity Market.

In 2015/16, we have been working with our delivery partner to develop the settlement system for the Capacity Market collections and payments which commence in October 2016. Despite delays in the delivery of the original proposed settlement system, and a subsequent restructuring of the delivery model for the project, I am pleased to say that the systems are on track to deliver full settlement functionality for Capacity Market operations in 2016/17.

We have successfully managed the credit cover process for the T-4 and Transitional Arrangements auctions. This has involved both the collection and refunding of credit cover to Capacity Market participants.

Under the Capacity Market rules and regulations, participants must have metering systems that measure accurate volumes of capacity, with such data being used to calculate payments.

This year, we have been working on establishing our meter assurance framework, with a particular focus on ensuring that the required level of assurance is in place in time for the first capacity payments being made. We also completed audit and compliance activities, such as fraud prevention assurance in relation to the Capacity Market.

I am pleased with the progress we have made this year in these three critical roles that the ESC undertakes. We are seeking to provide robust, reliable and transparent operations of those areas of the Capacity Market for which we are responsible, in order to minimise costs to consumers.

Delivering efficiencies

In order to further drive efficiency and minimise costs to consumers, ESC outsources the performance of its day to day operations and project delivery activities to LCCC. I am pleased that this has enabled ESC to deliver synergies and minimise costs to consumers.

Looking forward

ESC continues to work proactively with DECC and National Grid to improve the effectiveness of the Capacity Market processes and identify further efficiencies. This year, we have contributed to the enhancement of the Capacity Market by taking part in stakeholder events that have sought to identify improvements to the functioning of the market.

As we enter our second year of operations, we continue to demonstrate the vital role that we play in supporting capacity provider confidence in this market whilst seeking to minimise costs to consumers. In this way, ESC is contributing towards the Government's priority of secure and affordable energy supplies.



Neil McDermott
Chief Executive

Corporate Report



What is the Capacity Market?

The aim of the Capacity Market is to ensure security of supply in future years at the least cost to consumers⁵. Participants in the Capacity Market ('capacity providers') can be new or existing generators, electricity storage providers and significant users of electricity who provide voluntary demand reduction. Capacity providers provide capacity under either a capacity agreement or a Transitional Arrangement agreement.

The Capacity Market provides successful participants in a Capacity Market auction with an agreement that delivers a steady, predictable revenue stream upon which they can base their future investments.

How does the Capacity Auction work?

Potential capacity providers participate in the Capacity Market auction for a capacity agreement. This secures the right to revenue streams generated by capacity payments. The competitive auction sets the level of the capacity payment.

The capacity agreements resulting from the 2014 Capacity Auction will require capacity to be delivered in the delivery year commencing 2018/19. Those agreements awarded in 2015 will be required to deliver capacity from 2019/20.

What are capacity agreements?

Capacity agreements are arrangements between National Grid (as System Operator) and capacity providers. In return for the predictable revenue stream generated by the capacity agreements, capacity providers must deliver energy at times of system stress or face penalties.

Images © Martin Capek / Cardaf / Shutterstock

⁵ DECC Press Release, available at <https://www.gov.uk/government/news/reforms-to-capacity-market-to-improve-energy-security-for-families-and-businesses>

Transitional Arrangements

What are Transitional Arrangements?

Transitional Arrangements were introduced by DECC to support participation of Demand Side Response (DSR) providers and generating units of less than 50MW in the Capacity Market.

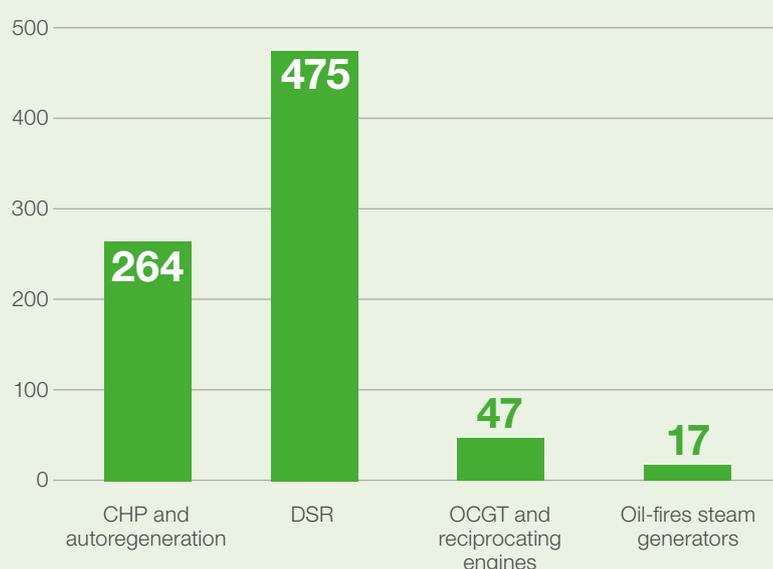
What is Demand Side Response (DSR)?

DSR helps to manage the demand for electricity. It involves changing the usage patterns of electricity users (the “demand side”) in response to incentives. It is used to match supply with demand when unpredictable fluctuations occur. It provides a mechanism through which demand can be reduced in peak times when system capacity is tight, thereby minimising the amount of additional generation capacity being brought onto the electricity transmission system (or grid).

What is a Transitional Arrangements auction?

Transitional Arrangements Auctions are aimed at providing targeted support to DSR providers and generating units of less than 50MW during the period prior to 2018/19, which is the delivery year relating to the first Capacity Auction. These one year ahead auctions have been designed by DECC with the aim of supporting the development of this sector in the run up to the Capacity Market being in full operation. The most recent Transitional Arrangements Auction was held in January 2016.

Figure 1: Breakdown of Awarded Capacity (MW) by type



Source: National Grid Final Auction Results, Transitional Capacity Market Auction for 2016/17

DSR is seen as having the potential to help to lower consumer bills via lower electricity system costs.

Building strong foundations

Who we are

ESC plays a key role in delivering the EMR programme by managing the Capacity Market settlement process.

Our role is to:

- provide accountability, governance and delivery of settlement operations under the electricity Capacity Market payment regulations.
- hold and monitor credit cover from applicants in Capacity Market auctions and Transitional Arrangements Auctions.
- ensure meter checks on capacity providers.
- resolve Capacity Market settlement disputes.
- monitor and review the regulations relating to the settlement functions of the Capacity Market.

Our objectives

Two main themes encapsulate our objectives: delivery first and striving for excellence

ESC's Guiding Principle is to maintain market participants' confidence in the Capacity Market settlement process and minimise costs to consumers.

Delivery First

Objective: Provide accountability, governance and delivery of settlement operations under the Capacity Market payment regulations.

One of ESC's core activities is to perform the settlement role set out in the Capacity Market regulations. This role requires ESC to collect payments from electricity suppliers and make payments to capacity providers.

We will commence collecting monies from suppliers in October 2016, to make capacity payments to capacity providers who were successful in the January 2016 Transitional Auction.

Working with our delivery partners, DECC, National Grid and EMR Settlement Ltd, we are developing and implementing all the operational processes and interfaces required for us to deliver our Capacity Market operations.

This includes the design and build of the Capacity Market settlement functionality, which is being undertaken by EMR Settlement Ltd and overseen by ESC and LCCC. The settlement system functionality, necessary to collect monies, from suppliers, and then make payments to capacity providers is scheduled to be operational in the summer 2016, in time for the commencement of settlement operations in October 2016.

As part of the pre-qualification process for the December 2015 Capacity Auction and the January 2016 Transitional Auction, ESC collected and processed £45m of credit cover (in a combination of cash and letters of credit) from 90 applicants. £31m has been returned to those participants who were either unsuccessful in the auction or met the relevant project commitments by the reporting date.

This year we continued to develop the meter assurance framework. This framework will ensure that Capacity Market applicants are in a position to achieve certified meter status prior to the delivery periods covered by their capacity agreements. The undertaking of metering verification tests will be integral to the transparent operation of the Capacity Market.

Striving for excellence

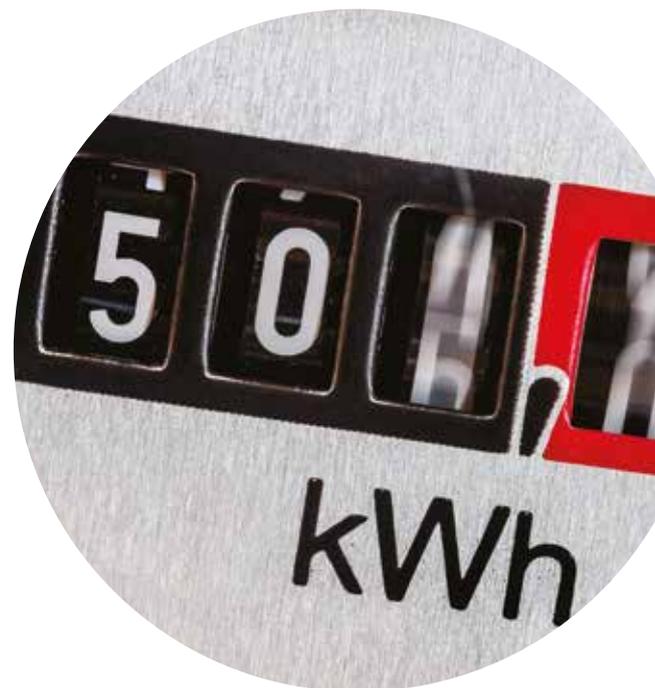
Objective: Strive for operational excellence, through robust, reliable and transparent operations delivered efficiently and sustainably, to minimise costs to consumers.

Our role in the Capacity Market contributes towards ensuring security of electricity supply in future years. We work to improve our systems and processes and embed best practice into our operations, working closely with our delivery partners.

In the past year we have implemented a number of measures in support of this objective. This has helped us to return £0.702m in operational cost savings to suppliers in August 2015, in respect of the 2014/15 financial year. For the 2015/16 financial year we will be returning £1.181m to suppliers as soon as practicable after approval of the 2015/16 accounts.

A contributing factor to this has been our decision to place greater reliance on in-house skills and capabilities, rather than depending on external consultancy support. This has allowed the company to maximise its retention of key knowledge and experience accumulated through implementing the regulations and setting up the associated processes and systems.

For the 2015/16 financial year we will be returning £1.181m



Environment Report

The company does not have any employees. Its role is performed by its agent, LCCC. The company accordingly does not itself have any Scope 1, Scope 2 or Scope 3 emissions. The company is, however, committed to ensuring its sustainability objective and will work closely with LCCC in this regard.

Our role is to provide accountability, governance and delivery of settlement operations under the electricity Capacity Market payment regulations.



Image: Photovoltaic (PV) solar cells © pavelgr / Shutterstock

Strategic Report

The company

The company was incorporated on 26 March 2014, but only commenced active operations on 1 August 2014.

ESC is an organisationally independent, private law company that plays a key role in the Capacity Market scheme introduced as part of the Government's EMR programme. The Capacity Market, which aims to ensure security of supply in future years at least cost to consumers, is a key cornerstone of the Government's EMR programme. EMR has been designed by DECC to provide incentives for the investment in UK energy infrastructure which is required to deliver secure, sustainable and affordable electricity for the future.

The company's Guiding Principle requires that, in carrying out its functions, activities and role, the company shall seek to maintain market participants' confidence in the Capacity Market scheme and minimise costs to consumers.

The company's strategy is to focus on delivery first, given ESC's crucial operational role in key elements of a major government programme. ESC's strategy also requires the company to be ready to deliver change within the EMR delivery landscape.

The principal activities of the company are described on pages 7. The company's functions are performed through LCCC. The company has no plans to change this business model.

The company's performance

The company monitors its progress against its strategic objectives through key performance indicators ("KPIs"). The company's KPIs for 2015/16 have been defined by reference to the key milestones required for it to be ready to perform its primary functions and the subsequent performance of those key functions as required during the implementation and operation of the Capacity Market. The KPIs for 2015/16 are set out below.

The company has performed well in this, its first full year of operations. It has built upon the good performance in 2014/15, which saw the company achieving all of its key functional milestones and delivering on all its operational requirements.

Key performance indicator	Deadline	Status
Efficient and effective collection, processing and release of credit cover from applicants participating in Capacity Auctions and Transitional Arrangements auctions in accordance with regulatory requirements	For 2015 Capacity and Transitional Auctions	Achieved
Delivering Capacity Market settlement system functionality in accordance with the requirements for Capacity Market operations	As required for operations	Achieved
Documentation of the processes for metering assurance and implementation of required processes	December 2015 and ongoing	Achieved – in particular, procedures documented, arrangements made with service provider to provide initial metering assurance services and procurement process commenced for long term arrangements
Delivering its role within its operational costs budget	31 March 2016	Achieved (£1.181m to be returned to suppliers)
Provision of Capacity Market ESC annual report in accordance with the relevant regulations	By 30 September 2015	Achieved

Financial Overview

The company was set up by the Secretary of State for Energy and Climate Change as a departmental arm's length body to perform an integral role in the delivery of the Capacity Market. The company's main function is to perform the settlement role set out in the Electricity Capacity Regulations 2014 (as amended) and the Electricity Capacity (Supplier Payment etc.) Regulations 2014 (as amended) (the "Regulations").

The Capacity Market has been designed by DECC to offer capacity providers who have been awarded capacity agreements with a steady, predictable revenue stream upon which they can base their future investments, with the aim of ensuring security of supply in future years at least cost to consumers. This revenue is known as capacity payments.

As the first delivery year is not until 2018/19, Transitional Arrangements have been put in place by DECC. As part of the Transitional Arrangements, DSR providers agree to reduce electricity demand at times of high (or peak) demand. These agreements are put in place following a Transitional Arrangements auction. Transitional Arrangements auctions are "one year ahead" auctions aimed at providing for capacity prior to the first capacity agreement delivery year of 2018/19. A Transitional Arrangements auction was held in January 2016 for capacity to be delivered in the 2016/17 delivery year. These auctions are also open to generating units of less than 50MW.

The company also collects credit cover provided by applicants to Capacity Auctions and Transitional Arrangements auctions, paying the credit cover back to unsuccessful applicants and processing the credit cover of successful applicants in accordance with the requirements of the Regulations. This credit cover provides some security for the performance by capacity providers of their obligations under the Regulations.

The company obtains the funds to make capacity payments to capacity providers from levies upon electricity suppliers as set out in the Regulations. Suppliers are obliged to pay their respective levies within three working days of receipt of a notice to pay, but the company, for its part, does not have to make capacity payments until, depending on the type of payment, either 29 working days after the end of each relevant month or 29 working days after the end of the relevant year. This insulates the company against liquidity timing issues. In addition, suppliers must lodge credit cover as security against their failure to pay amounts for which they are liable. If, in due course, this credit cover is called upon and proves insufficient to cover the amount due from a particular supplier, the shortfall is "mutualised" between the remaining suppliers (i.e. the remaining suppliers have to make up the shortfall between them).

Where the company receives monies from capacity providers, it pays these monies to suppliers. If a capacity provider fails to pay an amount due from it and, as a result, the company does not make an expected payment to suppliers, the shortfall is borne by suppliers (i.e. it is shared between them). The company has no obligation to make up any shortfall.

The day to day operational costs of the company are funded by suppliers under the Capacity Market settlement costs levy that is set by the relevant Capacity Market regulations. The amount is updated annually by amending regulations made subsequent to a public consultation process. The settlement costs levy for 2015/16 was fixed at £3.891m and for 2016/17 is fixed at £4.283m.⁷

The company applies prudent financial management in order to ensure that its commitments are accommodated within the timing of its collection of the settlement costs levy. It also undertakes a robust and detailed annual business planning and management process to establish its operational cost requirement for each financial year.

ESC's role is to "settle" the Capacity Market or, in other words, to make capacity payments to capacity providers who hold capacity agreements with National Grid. It may also receive payments from capacity providers in the form of penalties should they not make this capacity available.

⁷ DECC, Consultation on the Low Carbon Contracts Company's and the Electricity Settlements Company's operational costs 2016/17, Government Response, para 26, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/494454/160121_-_2016-17_Op_Costs_-_Government_Response_-_FINAL.pdf

The company has delivered another solid financial performance in 2015/16, meeting all operational requirements within the budgeted levels of spend set in line with the relevant regulations. As a result, the company will be in a position to return £1.181m of settlement costs levy collected from suppliers during 2015/16 back to suppliers as soon as practicable after the approval of the 2015/16 accounts. 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. However, a large part of the refund, some £0.683m relates to lower depreciation primarily associated with the Capacity Market settlement system, which reflects a delay in the commissioning date for delivery of the fully automated system.

The company has continued to invest in the Capacity Market settlement system during 2015/16. ESC has been working with its delivery partner, EMR Settlement Ltd, on the delivery of an enduring settlements solution that is expected to be fully functional in the latter half of 2016. The settlement system is funded via a grant arrangement between DECC, ELEXON Ltd and its subsidiary EMR Settlement Ltd.

Development of the Capacity Market settlement system was commenced by EMR Settlement Ltd in late 2014, with an expected completion date of June 2015. As a result of continuing delays in the build and testing of the main original system, the systems development contract between EMR Settlement Ltd and its principal subcontractor was terminated on 9 November 2015. There is ongoing consideration of the parties' legal rights in this matter. As a result of the termination, management has assessed the carrying value of the settlement system asset and determined that the most appropriate method for valuing the settlement system is using its recoverable amount. An impairment charge of £0.891m has been recognised in the statement of comprehensive income, representing the amount by which the asset's carrying amount exceeds its recoverable amount (after reflecting the derecognition of accrued capital costs). Offsetting the impact of this impairment charge in the statement of comprehensive income is an equal and opposite accounting entry resulting from the reduction in the associated finance lease obligations. Therefore, the impairment has no net impact on the profit of the company or on the net assets of the company.

Funding for shared systems between LCCC and ESC for supporting activities such as finance, IT and communications is initially made through LCCC, with ESC contributing to the shared elements of these systems by payment of a use of asset charge to LCCC. The use of asset charge equates to the depreciation charged over the estimated useful life of the specific asset.

Key judgements and estimates exercised in the preparation of the financial statements

As mentioned above, in November 2015 a decision was taken by EMR Settlement Ltd to terminate the development contract for the settlements system with its principal contractor. As a result of this decision, the carrying value of the intangible asset has been reviewed and subsequently adjusted to its recoverable amount. In total, the asset value has been reduced by £1.634m reflecting an impairment charge of £0.891m and an asset derecognition of £0.743m. The derecognition reflects the reversal of accrued capital costs which, when aggregated with the impairment charge, reduces the carrying value of the settlement system asset to its recoverable amount. The derecognition and the impairment charge are matched with a reduction in the finance lease obligations (see notes 8 and 15 to the accounts).

There are no post balance sheet events to be recognised or disclosed.

The company has delivered another solid financial performance in 2015/16, meeting all operational requirements within the budgeted levels of spend set in line with the relevant regulations.

Viability Statement

The directors have assessed the company's prospects, taking into account the company's current position and the principal risks faced by it over the projected plan period of three years.

The financial arrangements relating to the company minimises the risk of the company being unable to meet its liabilities. As set out in the preceding Financial Overview, the company is not obliged to make payments to capacity providers unless and until it has the funds to do so. The company also applies prudent financial management to ensure that its operating costs are covered by the settlement costs levy.

As part of the strategic planning process, the directors have analysed the regulatory and legal environment in which the company operates and do not foresee any changes that will affect the operation of the company within the three year plan period. The directors have also carefully considered the way in which the company manages its principal risks. They do not believe these risks will bring into question the company's viability.

Based on their analysis, the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due.

Principal opportunities and risks

As outlined in the Corporate Report, the company's business model is to deliver on its strategic focus, in particular by identifying opportunities for achieving the company's objectives of "delivery first" and "striving for excellence". As the Capacity Market scheme is still new to the industry, there is scope for identifying opportunities to streamline the company's processes and expand its provision of stakeholder engagement and dissemination of knowledge and information. As part of the company's strategy to be "ready for change", the company will participate in lessons learned processes and provide feedback and advice to DECC on the Capacity Market, including on any improvements and amending regulations. The company will be ready to implement any changes or improvements to the Capacity Market.

The directors have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity.

Risk management is a fundamental element of the company's approach to discharging its responsibilities. The company's approach to risk management is detailed in the Corporate Governance Report on pages 27 to 29 of this report.

The board considers the matters outlined below to be the principal risks and uncertainties that could adversely impact the company's operations, its strategy and its ability to deliver against its mission.



Image: High power electricity poles © urbans / Shutterstock

Risk or uncertainty	Risk brief description	Main mitigating actions
Readiness to provide full settlement system functionality	There is a risk that delays occur in the build of the full functionality of the settlement system and/or that key processes are not adequately designed, documented and implemented, which could potentially lead to functionality and processes not being in place when required to collect payments from or make payments to capacity providers and suppliers.	<ul style="list-style-type: none"> • Good project governance is in place • Regulatory requirements have been recorded in a single matrix document • Process documentation is in place • Independent external assurance review of processes and arrangements (including manual work arounds) has taken place • Operational services have been successfully delivered, thereby providing assurance • Internal workshops, end to end testing and 'day in the life of' walkthroughs are taking place • External resource has been engaged to provide project management support • Required staff are trained and in place • Contingency arrangements are being developed
Budget provision	There is a risk that inaccuracy in data or in the budgeting and forecasting process or that regulatory change or changes to assumptions might mean that the settlement costs levy is set too low.	<ul style="list-style-type: none"> • Key financial controls are documented and implemented • Monthly forecasting of levy income and operating costs and cash position • Budget setting process and review in place • Potential to apply for grant-in-aid funding to DECC • Potential to apply for in-year adjustment to the settlement costs levy • 'Pay as paid' for capacity payments provides protection • Ability to limit certain expenditure and delay low priority projects
Metering assurance readiness	There is a risk to the company's delivery of metering readiness if the company does not have adequate resources in place to conduct all required metering tests or if other delivery bodies are not ready to deliver on their interfaces or do not provide data of adequate quality.	<ul style="list-style-type: none"> • Member of the Capacity Market board together with other delivery bodies • Liaison with DECC and Ofgem in relation to the potential for initial sample testing and other relevant rule changes • Contact is being made with capacity providers to obtain early submission of meter test documentation and requests for tests • Ramp up of meter assurance testing is being implemented
Policy and market change	There is a risk of policy change which could impact the operations of the company or require additional operations in respect of which the company has not been given the time to fully prepare or which affects the scope of its operations.	<ul style="list-style-type: none"> • Regular shareholder meetings and liaison with government • Media and policy monitoring • Awareness of policy and industry issues and consultations • Ongoing industry engagement • Company strategy work and work to ensure readiness for change
Fraud and security risk	There is a risk of fraudulent activity from individuals or third parties.	<ul style="list-style-type: none"> • Key finance and fraud controls are in place, including embedded segregation of duties in finance processes and systems access controls • External control environment assurance report obtained of settlement systems service provider and settlement system controls has taken place • Know your client checks are in place • Compliance and checking processes developed against fraud control matrix, including use of data analytics • Internal audit function is in place and internal audit activity has been undertaken • Initial metering assurance and inspection process is in place and long term arrangements are being procured • IT security is in place • IT security policy and process are in place • Operational staff training and awareness and specialist staff member is being recruited
Data Privacy/Security	There is a risk of there being a breach of data security or systems security.	<ul style="list-style-type: none"> • Plan for recovery from cyber attack being prepared • Ongoing training and awareness of staff, including ISO 27000 training for IT team • Further controls on internal access controls and third party accesses implemented • Further controls on change request validation implemented • Ongoing security review and scheduled penetration prevention testing

Risk or uncertainty	Risk brief description	Main mitigating actions
Communications, stakeholder and shareholder relations	There is a risk that the company is unable to liaise effectively with its shareholder and other delivery bodies prior to these parties making public communications or announcements which impact the company's operations, thereby affecting staff and industry confidence.	<ul style="list-style-type: none"> • Clear stakeholder and communications strategy • Stakeholder engagement and communications • Regular shareholder meetings
Strategic delivery	There is a risk of insufficient focus on the development and implementation of the company's strategic goals.	<ul style="list-style-type: none"> • Measurements of strategic focus are being developed • Strategy refresh is under way • Regular reporting against strategy and business plan • Strategy is flowed down through company and staff objectives and key performance indicators (KPIs) • Scheduling of board strategy review is embedded • Internal and external communications strategy is in place
Litigation and dispute process	There is a risk of disputes or claims in relation to operational matters leading to additional costs, impacting resources and staff time and potentially industry and stakeholder confidence.	<ul style="list-style-type: none"> • Strong governance and compliance processes are in place • Competent and experienced staff are in place • In house legal department is integrally involved in operations and processes • Business process traceability matrix is in place which records the regulatory requirements

Signed on behalf of the Board
28 June 2016



Neil McDermott
Chief Executive

The Board of Directors



Martin Read
Chairman



Jim Keohane
Senior Independent
Director



Neil McDermott
Chief Executive



Helen Turner
Chief Finance Officer



Anne Baldock
Non-executive Director



Tony Bickerstaff
Non-executive Director



Tony White
Non-executive Director



Marion King
Non-executive Director



Simon Orebi Gann
Non-executive Director



Simon Elliston
shareholder
nominated director



David Long
shareholder
nominated director

“I would like to express my thanks to Jonathan Mills and Anthony Odgers. They both played a key role in the set-up of the company. I would like to welcome Simon Elliston and David Long who took up their positions on the board in their roles as shareholder nominated directors in 2015.”

Martin Read
Chairman

Directors Report

The directors present their annual report on the affairs of the company, together with the financial statements and auditors' report for the year from 1 April 2015 to 31 March 2016. The company's registered number is 8961281.

Board

The board is responsible for the overall strategy and direction of the company. Details of the board's composition are set out on page 28.

Directors and Corporate Governance

Full details of the directors and corporate governance matters are set out on pages 22 to 31.

Position of the Company

Information relating to the strategy and to the development, performance and the future prospects of the company are set out in the Strategic Report and on page 11.

Employees

The company does not have any employees.

Environment

Details are set out on page 12 in the Environment Report.

Payment to Suppliers

The company pays its suppliers in accordance with the provisions of its contracts with suppliers, subject to compliance by the suppliers with their obligations.

Charitable and Political Contributions

During the year, the company made no charitable or political contributions.

Results and Dividends

The company has prepared its 2015/16 financial statements in accordance with International Financial Reporting Standards 'IFRS'. The audited financial statements for the year ended 31 March 2016 are set out on pages 36 to 51.

The company is a not-for-profit company. The settlement role it performs ensures that the capacity payments it is required to make to capacity providers holding capacity agreements are matched with the levies it collects from suppliers. The company's costs are funded by the settlement costs levy referred to on page 14. The amount of any excess settlement costs levy collected above requirement is refunded to suppliers. This refund is recognised through the financial statements and matched with the income collected. On this basis the financial results for the year reflect a neutral profit position i.e. nil gain-nil loss.

The company does not pay a dividend. For a more detailed review of the results for the year and a more detailed explanation of the accounting profit, see the financial statements on pages 36 to 51, the Corporate Report on pages 8 to 11 and the Strategic Report on pages 13 to 18.

Directors' Third Party Indemnity Provisions

The directors have been granted an indemnity against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 2006. Such qualifying third party indemnity remains in force as at the date of approving this Directors' Report.

Going Concern

The directors have a reasonable expectation that the company has adequate resources to continue to operate for the foreseeable future. The financial statements have therefore been prepared on a going concern basis. The basis of this view is outlined in more detail in note 2.2 to the financial statements.

Directors' Responsibilities Statement

The directors are responsible for preparing the annual report and financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the company financial statements in accordance with IFRS as adopted by the European Union and in accordance with applicable law. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs and profit or loss of the company for that period.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the directors, whose names and functions are described herein, confirms that to the best of his or her knowledge:

- the financial statements, which have been prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets and liabilities, financial position and the profit or loss of the company; and

- the Directors Report and Strategic Report include a review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that it faces.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The directors consider that the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for the shareholder to assess the company's position, performance, business model and strategy.

Auditors

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the company's auditor, each director has taken all the steps that he/she is obliged to take as a director in order to make himself/herself aware of any relevant audit information and to establish that the auditor is aware of that information.

The company's auditors have expressed a willingness to continue in office. A resolution to reappoint them will be proposed at the relevant time.

By order of the Board
28 June 2016



Claire Williams
Company Secretary

Corporate Governance Report

The company was set up to be and appointed by the Secretary of State for Energy and Climate Change as the Capacity Market settlement body. The Secretary of State for Energy and Climate Change is the sole shareholder of the company.

While the company was set up as and is a private law company, it is also a governmental arm's length body that is funded by and manages compulsory levies. Compulsory levies are normally classified as taxation, which effectively means that the company is managing public monies.

The company accordingly, both as a private company and as an entity having responsibilities for the administration of public monies, adopts the highest standards of governance and works to the highest standards of probity. The company recognises the importance of operating with regularity and propriety, the need for effectiveness and prudence in the administration of public resources and the need to secure value for public money. The company also recognises the importance of embedding the seven principles of public life (selflessness, integrity, objectivity, accountability, openness, honesty and leadership) into its culture and operations.⁸

This Corporate Governance Report outlines the company's governance structure and demonstrates how its arrangements align with the guidelines and principles set out in the UK Corporate Governance Code. An explanation is given below where any aspect of the Code has not been fully applied.

The company's activities in the year are described on pages 10 and 11 and in the Strategic Report on pages 13 to 18.

Framework Document

The company's main governing documents are its Articles of Association and the Framework Document. The Framework Document, which establishes the fundamental relationship between the shareholder and the company, is published on the company's website to provide transparency of the relationship.

The Framework Document reflects the basic tenet that functional independence is compatible with financial oversight of an arm's length body by its parent department. The Framework Document makes it clear that the company has day-to-day operational independence, subject to certain limited exceptions set out in legislation, the company's Articles of Association and in the Framework Document itself. The limitations on the company's independence are those which are either:

- common to government owned entities and necessary to satisfy government and Parliamentary budgeting and accountability requirements; or
- provide the shareholder with specific controls in respect of policy implementation matters which it is the company's responsibility to execute.

The Framework Document recognises that the company is a separate corporate entity and that its governance, and decision making processes, flow through its board, with its executives reporting to that board.

The Framework Document establishes that in carrying out its functions, activities and role the company shall seek to maintain market participants' confidence in the Capacity Market process and minimise costs to consumers. This is known as the "Guiding Principle". The company recognises the importance of this Guiding Principle.

⁸ The 7 Principles of Public Life, available at <https://www.gov.uk/government/publications/the-7-principles-of-public-life>

UK Corporate Governance Code

The company is required by the Framework Document to comply with the UK Corporate Governance Code as it applies to small quoted companies (other than Section E relating to relations with shareholders) or specify and explain any non-compliance in its annual report. The board considers that the company has complied in full with the Code, otherwise than as explained in this Corporate Governance Report. Any non-compliance is due to the requirements of the company's shareholder as reflected in company's Articles of Association and the Framework Document.

The company additionally believes that the adoption of the UK Corporate Governance Code is important as a means of recognising and embedding best practice in corporate governance.

Role of the board

The board is committed to ensuring high standards of corporate governance. It accepts that good governance is based on the underlying principles of accountability, transparency, probity and focus on the sustainable success of the company over the longer term.

The board is collectively responsible for the long term success of the company and is ultimately responsible for its strategy, management, direction and performance. The board sets the company's strategic aims, ensures that the necessary financial and human resources are in place for the company to meet its objectives, reviews progress towards the achievement of objectives and reviews the performance of management.

The board establishes the values, culture, ethics and standards of the company and sets the framework for prudent and effective controls, which enables risk to be assessed and managed.

The board has delegated authority to its committees to carry out the tasks defined in the committees' terms of reference. The committees are – the audit, risk and assurance committee and the nomination committee. The written terms of reference of both committees are available on the company's website. The board has delegated the day to day management of the company to the Chief Executive.

Composition of the board

The Framework Document and the Articles of Association provide that the shareholder's approval is required for all board appointments. The Framework Document and the Articles of Association also state that the shareholder has the right to appoint the Chairman, the Senior Independent Director and two shareholder nominated directors.

The shareholder has appointed the Chairman (Martin Read), Senior Independent Director (Jim Keohane) and two suitably qualified persons as its shareholder nominated directors.

Martin Read was appointed as Chairman designate in early 2014 and as Chairman on 22 July 2014. Jim Keohane was appointed in early 2014 as Senior Independent Director designate and, on 22 July 2014, as Senior Independent Director. The two shareholder nominated directors are currently David Long (appointed on 27 October 2015) and Simon Elliston (appointed on 16 December 2015). The previous shareholder nominated directors were Jonathan Mills and Anthony Odgers, both of whom resigned on 27 October 2015.

Neil McDermott, the Chief Executive, was appointed as a director on 22 July 2014 and Helen Turner, the Chief Finance Officer, was appointed as a director on 22 July 2014.

After obtaining the consent of the shareholder in accordance with the Framework Document and Articles of Association, the board, on 11 November 2014, appointed an additional five independent non-executive directors (Anne Baldock, Tony Bickerstaff, Marion King, Simon Orebi Gann and Tony White).

The details of all board members, any changes in the year and attendance at board meetings are listed on page 28. All directors, with the exception of the two shareholder nominated directors have written terms of appointment. These terms of appointment are available for inspection at the company's registered office during normal business hours. The shareholder nominated directors are, respectively, a civil servant employed by central government and a public servant employed by a government wholly owned company.

The Chairman was independent on appointment. The board considers all non-executive directors to be independent of the company, with the exception of David Long and Simon Elliston (and prior to them, Jonathan Mills and Anthony Odgers) who were appointed by the shareholder as its nominated directors.

The independent non-executive directors are appointed for a term of three years as set out in the Framework Document, subject to statutory and appropriate other provisions relating to the cessation of their appointment. The shareholder nominated directors are appointed for the period required by the shareholder.

The board and its committees have an appropriate, effective and broad balance of skills, experience, independence and knowledge, which enables them to discharge their respective duties and responsibilities effectively.

New directors receive an induction programme that is tailored to their individual needs.

The company maintains a register of directors' interests.

Board governance

The board meets sufficiently regularly to discharge its duties effectively, currently meeting eight times per year (with additional ad hoc meetings as required). The board also held a separate strategy meeting.

The Chairman has held a meeting with the non-executive directors without the executives being present. The non-executive directors, led by the Senior Independent Director, have met without the Chairman and executive directors being present.

The board is supplied in a timely manner with the appropriate information to enable it to discharge its duties. The Chairman, executive directors and Company Secretary have review processes in place to ensure the quality of the information provided to the board and its committees. The board and committees concluded, after assessing the question as part of their annual evaluation processes, that they were being provided in a timely manner with appropriate information of the required quality. Board members have access to the company secretary and also to independent legal advice if appropriately required.

There is a formal schedule of matters specifically reserved to the board. In high level terms, the day to day management of the company is delegated to the Chief Executive and senior management with the matters reserved to the board including:

- strategy and leadership
- financial statements
- annual business plan and budget
- risk management, financial reporting and the system of internal control

- oversight of the company's operations
- terms of reference of board committees.

The main roles and responsibilities of the Chairman, Chief Executive, Senior Independent Director and non-executive directors are summarised in high level terms below. There is a written division of responsibilities between the Chairman and the Chief Executive, which has been approved by the board.

The Chairman:

- leads the board and is responsible for its operation, effectiveness and governance
- is responsible for promoting a culture of openness and debate by facilitating the effective contribution of the non-executive directors
- ensures constructive relations between the executive and non-executive directors
- speaks on behalf of the board and represents the board to the shareholder
- is responsible for setting the board's agenda and ensuring that adequate time is available for the discussion of all agenda items, in particular, strategic issues
- is responsible for ensuring that the directors receive accurate, timely and clear information.

The Chief Executive:

- fulfils his responsibilities as Accounting Officer⁹
- leads the executive team in the day-to-day running of the company
- makes and executes operational decisions
- implements the strategy agreed by the board
- ensures delivery within the annual budget
- ensures appropriate internal controls and risk management processes are in place
- facilitates effective communication to the shareholder and external stakeholders, including service providers, industry parties, regulatory and governmental authorities and the community.

The Senior Independent Director:

- works alongside the Chairman and provides a sounding board for the Chairman
- is available as an intermediary to other directors when necessary
- leads the meeting(s) with the other non-executive directors without the Chairman being present, including to appraise the performance of the Chairman.

⁹ The responsibilities of an Accounting Officer are described in HM Treasury guidance "Managing Public Money". They include accountability for the activities of the company, the stewardship of public funds and the extent to which key performance targets and objectives are met.

Non-executive directors:

- Non-executive directors (including via their activities in relevant committees) contribute to the performance by the board of its responsibilities, including in relation to strategy, monitoring the performance of management and satisfying themselves as to the integrity of financial information and that there is in place robust internal controls and a sound system of risk management.

Board evaluation

The board has undertaken a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. The committees also each separately undertake an annual evaluation process. The evaluations have concluded that the board and the committees are working effectively, they are performing their role in a proper, good and appropriate manner and there is strong corporate governance in place. The Chairman has discussed with each director their training and development needs, including as part of his one to one discussions with the directors.

The non-executive directors, led by the Senior Independent Director, are responsible for performance evaluation of the Chairman, taking into account the views of executive directors.

Audit, Risk & Assurance Committee

This committee was established by the board on 16 December 2014.

At year end, the membership of this committee comprised by five non-executive directors, namely Tony Bickerstaff (chair), Jim Keohane, Marion King, Simon Elliston (appointed 16 December 2015) and Simon Orebi Gann. Jonathan Mills was a member of the committee until his resignation on 27 October 2015.

The chair of the committee is a qualified accountant with recent and relevant financial experience. The committee is composed of four independent non-executive directors and one shareholder nominated non-executive director. The Framework Document, as permitted by the Articles of Association, requires the committee to include a shareholder nominated director.

The committee met four times in the financial year 2015/16, with meetings in May, June and September 2015 and in January 2016. The company's external auditor attends committee meetings.

The Chief Executive (as Accounting Officer), Chief Finance Officer, Head of Internal Audit, Company Secretary and external auditors are invited to attend each meeting. The Accounting Officer, Chief Finance Officer, Head of Internal Audit and the external auditors also have access to the chairman of the committee outside formal

committee meetings. The Head of Internal Audit and the external auditors each separately also meet informally with the committee after every scheduled committee meeting.

The main responsibilities of the committee include:

- monitoring the assurance needs of the company in relation to risk, governance and the control framework
- reviewing the company's internal controls (including financial controls) and risk management systems
- monitoring the integrity of the company's financial statements and reviewing and reporting to the board on significant financial reporting issues and judgements
- monitoring the effectiveness of the company's internal audit function
- making recommendations to the board in relation to the appointment, re-appointment and removal of the external auditor and approving the remuneration and terms of engagement of the external auditor
- reviewing external auditor independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements
- reporting to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken
- reporting to the board on how it has discharged its responsibilities
- undertaking an evaluation of its own performance.

The committee has reviewed arrangements by which employees are able, in confidence, to raise concerns about possible improprieties in matters of financial reporting or other matters.

The committee applies an external auditor independence policy to safeguard auditor objectivity and independence where the company's auditors have provided non-audit services. The external auditor has not provided any non-audit services.

In the financial year, the committee discussed the following matters:

- Going Concern and Post Balance Sheet Events
- External Auditors Report for 2014/15
- Letters of Representation for 2014/15
- Recommendation of Annual Report and Accounts for 2014/15
- Risk Register
- Reappointment of External Auditor for 2015/16

- Approval of External Audit Fee for 2015/16
- Review of Financial Performance
- Annual Evaluation
- Fraud Risk Update
- Risk Management and Internal Control Framework
- Risk Register Review and Specific Risk Deep Dive
- Options for Identification and Assessment of Risk
- Annual Report Process for 2015/16
- Update on External Auditor Response to Requirements for 2015/16
- External Audit Plan and Update on Period 9 Work for 2015/16
- Internal Audit Plan and Objectives and Updates
- Status on Significant Accounting Estimates, Judgements and Special Issues.

The minutes of the meeting are circulated to the board.

The re-appointment of the external auditor was approved by the board in October 2015 upon the recommendation of the audit, risk and assurance committee. The committee's recommendation to re-appoint, and the approval of the re-appointment by the board, took into account the fact that the Framework Document stated the strong presumption that the company would appoint the National Audit Office (NAO) as its auditor and also that shareholder consent was required for the appointment of any external auditor. They also noted the significant benefits of appointing the NAO based on value for money, the potential synergies with DECC's audit requirements and the NAO's understanding of both the complex environment within which the company operates and the wider government and public sector context.

The committee assessed the effectiveness of the external audit process and provided its comments on the effectiveness to the external auditor.

Nomination Committee

At year end the committee comprised Martin Read (Chairman), Anne Baldock, Marion King, Simon Orebi Gann and Tony White. A majority of members of the nomination committee are independent non-executive directors.

The committee met in October 2015 to discuss the appointment of board directors. Under the Articles of Association and the Framework Agreement, the shareholder has reserved the right to approve the appointment of directors.

As the committee was not established until December 2014 and the company did not commence active operations until 1 August 2014, and taking into account the appointment rights of the shareholder, the committee has not led the process for board appointments. The shareholder appointed the Chairman and Senior Independent Director during the early part of 2014. The Chairman and the Senior Independent Director led the process for the other board appointments and recommended the proposed appointments to the shareholder. The shareholder consented to these appointments. The shareholder appointed the two original shareholder nominated directors in early 2014 and appointed replacement shareholder nominated directors in late 2015.

An external search consultancy, Odgers Berndtson, was used in the appointment of the Chairman, the Senior Independent Director and all other directors, with the exception of the shareholder nominated directors who are civil or public servants selected by the shareholder. Odgers Berndtson does not have any other connection with the company or with the directors.

The search process for the appointment of the Chairman, Senior Independent Director and other independent directors was formal, rigorous and transparent and the search was conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender.

The committee's responsibilities include:

- regularly reviewing the structure, size and composition of the board including skills, knowledge, diversity and experience
- reviewing plans for the orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board
- undertaking an evaluation of its own performance.

The minutes of meetings are circulated to the board.

Remuneration Committee

The membership and responsibilities of this committee are described in the Remuneration Report on pages 30 to 31.

Board and Committee Membership

The table overleaf sets out the dates of appointment of the members to the board and the committees and details of those board members who resigned in year.

Board and Committee Meetings

The table overleaf shows the number of board and committee meetings of the company held during the year ended 31 March 2016, and the attendance of the individual directors.

All directors are expected to attend all board meetings and all members of committees are expected to attend all committee meetings.

It should be emphasised that the table does not fully reflect the contribution made to the company's business by many of the directors who have also attended other meetings and events relating to the company's business and activities during the year.

Relations with shareholder and stakeholders

The company in accordance with its Framework Document maintains an appropriately regular dialogue with its shareholder. The shareholder has appointed two shareholder nominated directors.

The company has also engaged in regular communication with industry and other stakeholders, including by stakeholder engagement events and via its website.

As a non-traded entity the company does not propose to have an annual general meeting.

Maintenance of a sound system of internal control

The board has overall responsibility for the company's risk management and system of internal controls and for reviewing their effectiveness.

The key elements and procedures established to provide effective risk management and internal controls have been established. All important systems are in place and there has been no lapse in protective security. The systems are monitored and embedded and are as set out below:

Control and assurance environment

- The board is responsible for the company's system of internal control and for reviewing its effectiveness. The company's system of internal control is designed to manage and where possible to mitigate the risks facing the company, safeguard the assets and provide reasonable (although not absolute) assurance against material financial misstatement or loss. The audit, risk and assurance committee assists the board in discharging its responsibilities (as further described below and in the section headed Audit, Risk and Assurance Committee on pages 25 to 27).

- The board, with the assistance of the audit, risk and assurance committee, has reviewed and is satisfied with the effectiveness of the company's systems of risk management and internal control.
- There is an appropriate quality assurance framework in place and applied to all business critical models.
- The importance of a strong system of internal control and risk management is recognised and promoted by the leadership of the company, who work to ensure that it is embedded into the culture of the organisation.

Risk

- The identification, mitigation and continued monitoring of significant business risks is the responsibility of senior management. Each functional department of the company maintains a risk register identifying the business risks and allocating responsibility for appropriate monitoring and mitigating controls. Departmental risk registers and the company's strategic risk register are kept under regular review by the senior management team and reported to the board and audit, risk and assurance committee, with the top strategic risks receiving particular attention. A risk workshop attended by senior employees was held during the year.
- The audit, risk and assurance committee formally reviews the risk position at each scheduled meeting (in 2015/16, in May and September 2015 and in January 2016) and is updated on any significant risk matter which falls outside its formal review cycle. The Board also reviews risk twice per year (c. June and October). The reports to the audit, risk and assurance committee and the board include a report from management on the state of risk management and internal control, any significant failings or weaknesses identified during the period and actions taken to remedy any significant weaknesses.
- The board has reviewed, with the assistance of the audit, risk and assurance committee, and is satisfied that a comprehensive and robust process for identifying, assessing and managing the company's principal risks is in place, including in respect of those risks that would threaten its business model, future performance, solvency or liquidity. Reference is made to the more detailed risk report on pages 16 to 18.

Board and committee membership

Board and Committee Member	Role	Appointed to Board/Resigned	Appointed to Audit, Risk & Assurance Committee	Appointed to Nomination Committee
Anne Baldock	non-executive director	App. 11/11/2014		16/12/2014
Tony Bickerstaff	non-executive director	App. 11/11/2014	16/12/2014	
Simon Elliston	shareholder nominated director	App. 16/12/2015	16/12/2015	
Jim Keohane	non-executive director	App. 22/07/2014	16/12/2014	
Marion King	non-executive director	App. 11/11/2014	16/12/2014	16/12/2014
David Long	shareholder nominated director	App. 27/10/2015		
Neil McDermott	Chief Executive	App. 22/07/2014		
Jonathan Mills	shareholder nominated director	App. 26/03/2014* Res. 27/10/2015	16/12/2014	
Anthony Odgers	shareholder nominated director	App. 20/07/2014* Res. 27/10/2015		
Simon Orebi Gann	non-executive director	App. 11/11/2014	16/12/2014	16/12/2014
Martin Read	Chairman	App. 22/07/2014*		16/12/2014
Helen Turner	Chief Finance Officer	App. 22/07/2014		
Tony White	non-executive director	App. 11/11/2014		16/12/2014

Member attendance record

	Board	Audit, Risk & Assurance Committee	Nomination Committee
Number of meetings held	8	4	1
Anne Baldock	7		1
Tony Bickerstaff	5	4	
Simon Elliston*	3	1	
Jim Keohane	8	3	
Marion King	7	2	1
David Long*	3		
Neil McDermott	8	X (attends but not a member)	
Jonathan Mills*	5**	3	
Anthony Odgers*	4		
Simon Orebi Gann	7	4	1
Martin Read	8		1
Helen Turner	8	X (attends but not a member)	
Tony White	8		1

* Appointed part way through the year

** Represented on 27/10/2015 by alternate

Internal audit

- The company has an internal audit function that provides the audit, risk and assurance committee with independent, objective assurance regarding internal controls and the risk management process as part of the company's risk management and assurance regime. The audit, risk and assurance committee agrees a programme of internal audit work annually and reviews progress at each of its meetings.

Financial Management and reporting

- There is a comprehensive strategic planning, budgeting and forecasting process within the company, with the business plan (including the annual budget) being approved by the board.
- The company's operational costs are set out in the annual budget. The process for establishing the annual budget involves a number of stages which provide challenge and accountability to ensure that a robust and prudent annual budget is prepared which also ensures cost control and value for money for consumers. The draft budget is reviewed by the board, subsequent to which it is submitted to the shareholder for further review. The shareholder then undertakes a public consultation on the proposed budget. Subsequently the settlement costs levy, which funds the company's budget, is laid before Parliament in the form of regulations.
- The company must manage within its operational budget so as not to exceed the settlement costs levy.
- An update on the company's progress, forecasts and results is reported in the management information report submitted to each board meeting.
- Senior management meet regularly with the Chief Executive and Chief Finance Officer to discuss business progress and review management accounts.
- There is shareholder oversight of financial management as set out in the Framework Document and the Finance and Reporting Letter from the shareholder to the company dated 1 August 2014, including monthly reporting.
- The company is required to comply with the requirements set out in the Framework Document and the Finance and Reporting Letter, including the requirement to comply with the relevant requirements in HM Treasury guidance entitled "Managing Public Money"

Operational

- The senior management team meets on a weekly basis to review the operations of the company, its delivery, progress, issues and challenges. The Chief Executive has regular meetings with each member of the senior management team.
- The Chief Executive and the senior management team meet regularly with the shareholder and other stakeholders.

Procurement

- The company has in place an effective procurement policy and is required to procure all goods and services in compliance with the relevant requirements in *Managing Public Money*, certain Cabinet Office controls and the public procurement regulations.
- The company is required to carry out procurement and project appraisal objectively and fairly, using cost benefit analysis and generally seeking good value for money.

Legal and compliance

- There is a system for monitoring and embedding compliance, including by company policies and procedures as well as training and guidance to support compliance (e.g. relating to anti-bribery, whistle-blowing, anti-money laundering, health & safety and other legislative and good practice requirements). External obligations are driven primarily by key legal, statutory and regulatory requirements.

Treasury management

The finance department:

- operates within policies agreed by the audit, risk and assurance committee
- uses its resources efficiently, economically and effectively, avoiding waste and extravagance
- uses management information systems to gain assurance about value for money and the quality of delivery and so make timely adjustments
- uses internal and external audit to improve its internal controls and performance.

Insurance

- Appropriate insurance is in place, with insurance cover being reviewed annually by the board.

Signed 28 June 2016



Neil McDermott

Chief Executive and Accounting Officer

Remuneration Report

Employees

The company (registered no.8961281) does not have any employees. The company performs its functions through LCCC.

Non-executive Directors

Fees are payable to all non-executive directors (except the shareholder nominated directors). For reasons of synergy, operational efficiency and cost effectiveness, the board of directors of the company and LCCC are identical. The fees paid to directors therefore relate to work for both companies. All fees are paid by LCCC, with a fair and properly allocated amount relating thereto being “recharged” by LCCC to the company under the “recharge” arrangements described in note 2.4 to the financial statements.

Levels of remuneration for those non-executive directors who receive remuneration as directors reflect the time commitment and responsibilities of the role and reflect the advice on remuneration for directors provided in 2014 by Odgers Berndtson (an external recruitment consultancy). Odgers Berndtson has no other connection with the company. No director is involved in deciding his or her own individual remuneration.

Executive Directors

The executive directors are employed and paid by LCCC. They therefore do not receive any remuneration from the company. LCCC charges the company for its services, with an amount relating to full cost of the executive directors to LCCC forming a fair and properly allocated component of that charge. This arrangement is detailed in the “recharge” arrangements described in note 2.4 to the financial statements.

Director fees

The company does not directly pay fees to the directors. It has the same board members as the LCCC board. LCCC pays the fees to the directors (with the exception of the shareholder nominated directors, who do not receive remuneration from the company or LCCC), with the allocated portion relating to the company being recouped via the “recharge” arrangements described in note 2.4 to the financial statements. Essentially, 20% of the total fees paid in 2015/16 in relation to each director is allocated to the company. This allocation is illustrated in the table opposite.

Director fees

Name	2015/16 Fees £	Principal positions held elsewhere at 31 March 2016
Anne Baldock	20% of £25,000 2014/15: 20% of £9,679 – director in place for part year only	<ul style="list-style-type: none"> • LCCC – non-executive director • Hydrogen Group – non-executive director • Thames Tideway Tunnel – non-executive director • Cancer Research – trustee • Tumber Services Limited – director/shareholder • 375 Greyhound Residents Ltd – director/shareholder
Tony Bickerstaff	20% of £31,000 2014/15: 20% of £12,002 – director in place for part year only	<ul style="list-style-type: none"> • Costain Group Plc – Group Finance Director • CBI Economic Growth Board – member • LCCC – non-executive director
Simon Elliston	0 (shareholder nominated director – civil servant)	<ul style="list-style-type: none"> • DECC – Director of Finance and Commercial • LCCC – non-executive director
Jim Keohane	20% of £40,000 2014/15: 20% of £40,000	<ul style="list-style-type: none"> • Gas & Electricity Markets Authority – non-executive member • Harwich Haven Authority – Chairman • LCCC – non-executive director
Marion King	20% of £25,000 2014/15: 20% of £9,679 – director in place for part year only	<ul style="list-style-type: none"> • Royal Bank of Scotland – Group Director of Payments • LCCC – non-executive director • UK Payments Council – director
David Long	0 (shareholder nominated director – public servant)	<ul style="list-style-type: none"> • UK Government Investments – Executive Director • LCCC – non-executive director
Neil McDermott	N/a – see above	<ul style="list-style-type: none"> • LCCC – Chief Executive and director
Jonathan Mills	0 (previous shareholder nominated director – civil servant)	<ul style="list-style-type: none"> • At date of resignation: Director Electricity Market Reform – DECC
Anthony Odgers	0 (previous shareholder nominated director – civil servant)	<ul style="list-style-type: none"> • At date of resignation: Deputy Chief Executive & Director Corporate Finance Practice Shareholder Executive, Department of Business and Innovation
Simon Orebi Gann	20% of £25,000 2014/15: 20% of £9,679 – director in place for part year only	<ul style="list-style-type: none"> • LCCC – non executive director • Next Generation Data Ltd – non-executive director • Aspen Technology Inc (NASDAQ: AZPN) – USA – non-executive director
Martin Read	20% of £120,000 2014/15: 20% of £120,000	<ul style="list-style-type: none"> • Laird plc – Chairman • Remuneration Consultants Group – Chairman • LCCC – Chairman • UK Government Senior Salaries Review Body – Chairman • Lloyds of London (Franchise Board) – non-executive director
Helen Turner	N/a – see above	<ul style="list-style-type: none"> • LCCC – Chief Finance Officer and Director
Tony White	20% of £25,000 2014/15: 20% of £9,679 – director in place for part year only	<ul style="list-style-type: none"> • LCCC non-executive director • Crown Estates – non-executive director • Combined Heat and Power Association – Vice President • Green Energy Options – non-executive director • 2OC – non-executive director • BW Energy Ltd – director • First Utility Trust – Trustee

The above fees (paid by LCCC with a proportion recharged to the company) are the only form of remuneration that each relevant non-executive director receives.

Independent Auditor's Report to the sole shareholder of the Electricity Settlements Company Ltd

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2016 and of the profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been properly prepared in accordance with the Companies Act 2006.

Opinion on regularity

In my opinion, in all material respects the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Basis of opinions

I have audited the financial statements of the Electricity Settlements Company Ltd ('the company') for the year ended 31 March 2016 which comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows, the Statement of Changes in Equity and the related notes.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union, as applied in accordance with the provisions of the Companies Act 2006. I have also audited the information in the Directors' Remuneration Report that is described as having been audited.

The regularity framework that has been applied constitutes: the Companies Act 2006; the articles of association of the company; the framework document between the Secretary of State for Energy and Climate Change and the company; and HM Treasury authorities and other relevant legislation to the extent they are applicable to the company.

Overview of my audit approach

Risks significant to my audit

Those risks that had the greatest effect on my overall audit strategy, the allocation of resources in my audit and directing the efforts of the audit team in the current year are documented below.

I have also set out how my audit addressed these specific areas in order to support the opinion on the financial statements as a whole, and any comments I make on the results of my procedures should be read in this context.

This is not a complete list of all risks identified by my audit but only those areas that had the greatest effect on my overall audit strategy, allocation of resources and direction of effort. I have not, for example, included information relating to the work I have performed around the presumed risk of management override of controls under International Standard on Auditing (UK & Ireland) 240, the Auditor's Responsibility Relating to Fraud in Financial Statements, an area where my work has not identified any matters to report.

- Valuation of the Settlement System:
The contract for the development of the settlement system which existed between EMR Settlement Ltd (the main subcontractor to the company for delivery of the settlement system) and EMR Settlement Ltd's principal subcontractor was terminated during the financial reporting period and the construction of a replacement system has been undertaken. The termination of the development contract has resulted in the impairment of costs that had previously been capitalised and costs that retain value as they can be used in the replacement system. A risk of material misstatement arose from the potential for management to incorrectly capitalise or expense development costs; or to apply an incorrect level of impairment to the intangible asset under construction brought forward from the prior year.

To address this risk, I assessed the controls and monitoring procedures in place over determining the extent of impairment required and the classification of expenditure relating to the settlement system as either revenue or capital. I reviewed the impairment calculations provided by the company and carried out focused work to enable me to verify if the calculations had been accounted for in accordance with IAS 36: Impairment of Assets. I also performed targeted testing on expenditure incurred on the settlement system to assess whether or not it had been accounted for in accordance with IAS 38: Intangible Assets. Following this work, I am satisfied that in all material respects the contract termination has been properly treated.

Application of materiality

I applied the concept of materiality both in planning and performing my audit, and in evaluating the effect of misstatements on my audit and on the financial statements. This approach recognises that an audit is designed to provide reasonable, rather than absolute, assurance that the financial statements are free from material misstatement or irregularity. A matter is material if its omission or misstatement would, in the judgement of the auditor, reasonably influence the decisions of users of the financial statements.

Based on my professional judgement, I determined overall materiality for the company's financial statements at £72,000, which is approximately 2% of gross expenditure. I chose this benchmark given that I consider it to be of principal interest to users of the financial statements.

As well as quantitative materiality, there are certain matters that, by their very nature, would influence the decisions of users if not corrected, for example, any errors in reported Directors' Remuneration. My assessment of such matters would need to have regard to the nature of the misstatement and the applicable legal and reporting framework, as well as the size of the misstatement.

I applied the same concept of materiality to my audit of regularity. In planning and performing audit work in support of my opinion on regularity, and evaluating the impact of any irregular transactions, I took into account both quantitative and qualitative aspects that I consider would reasonably influence the decisions of users of the financial statements.

I agreed with the audit, risk and assurance committee that I would report to it all corrected and uncorrected misstatements identified through my audit in excess of £1,500 and differences below that threshold that, in my view, warranted reporting on qualitative grounds.

We identified no errors above this threshold in the company financial statements.

My audit approach is risk-based, informed by a good understanding of the company's operations. In designing my audit approach, I assessed and took account of the risk of material misstatement in the financial statements and the risk of material irregularity in the underlying transactions. This approach focuses effort towards higher risk areas, such as management judgments and estimates and areas that are considered significant based upon size or complexity.

In my audit, I tested and examined information, using sampling and other auditing techniques, to the extent I considered necessary to provide a reasonable basis for me to draw conclusions. I obtained audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

Scope of my audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the company; and
- the overall presentation of the financial statements.

In addition I read all the financial and non-financial information in the annual report to identify any material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on other matter prescribed by the Companies Act

Directors' remuneration

In my opinion the part of the Remuneration Report to be audited has been properly prepared in accordance with the Companies Act.

I also report to you if, in my opinion, certain disclosures of directors' remuneration required have not been made. I have nothing to report arising from this duty.

The strategic and directors' reports

In my opinion, based on the work undertaken in the course of the audit, the information given in the strategic and directors' reports for the financial year are consistent with the financial statements and have been prepared in accordance with applicable law.

Based on my knowledge and understanding of the company and its environment obtained during the course of the audit, I have identified no material misstatements in these reports.

The corporate governance statement

In my opinion, based on the work undertaken in the course of the audit, the information given in the corporate governance statement in respect of internal control and risk management systems in relation to financial reporting processes, and about share capital structures, is consistent with the accounts and has been prepared in accordance with applicable law.

Based on my knowledge and understanding of the company and its environment obtained during the course of the audit, I have identified no material misstatements in this information.

Matters on which I report by exception

Adequacy of accounting records information and explanations received

I report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records; or
- I have not received all of the information and explanations I require for my audit.

I have nothing to report arising from this duty.

Consistency of other information in the Annual Report

Under International Standards on Auditing (UK & Ireland), I am required to report to you if, in my opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, the knowledge of the company that I acquired in the course of performing my audit; or
- otherwise misleading.

In particular, I am required to consider:

- whether I have identified any inconsistencies between the knowledge that I acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable; and
- whether the annual report appropriately discloses those matters that I communicated to the Audit and Risk Committee which I consider should have been disclosed.

I have nothing to report arising from this duty.

The directors' assessment of principal risks and future prospects

Under International Standards on Auditing (UK and Ireland), I am required to report to you if I have anything material to add, or to draw attention to, in relation to the directors' disclosures in the annual report and financial statements:

- confirming that they have carried out a robust assessment of principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity;
- describing those risks and explaining how they are being managed or mitigated;
- on whether they considered it appropriate to adopt the going concern basis, and their identification of any material uncertainties to the entity's ability to continue over a period of at least twelve months from the date of approval of the financial statements; and
- explaining how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

I have nothing material to add, or to draw attention to, on these matters.

Respective responsibilities of the directors and the auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.



Matt Kay

Senior Statutory Auditor
28 June 2016

For and on behalf of the
Comptroller and Auditor General
(Statutory Auditor)

National Audit Office
157-197 Buckingham Palace Road
London SW1W 9SP

Financial statements and notes to the accounts 2015/16

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Statement of comprehensive income for the year ended 31 March

		2016	*2015
	Note	£'000	£'000
Other income	6	3,601	672
Other operating costs	7	(3,601)	(672)
Profit for the year		-	-
Other comprehensive income for the year		-	-
Total comprehensive income for the year		-	-

All operations are continuing operations.

*For the period from incorporation on 26 March 2014 to 31 March 2015.

The notes on pages 42 to 51 form part of these accounts.

Statement of financial position as at 31 March

		2016	2015
	Note	£'000	£'000
Non-current assets			
Intangible assets	8	1,546	2,207
Current assets			
Settlement costs levy receivable	9	3	1,374
Prepayments and other receivables	10	198	12
Cash and cash equivalents	11	6,088	3,470
Total current assets		6,289	4,856
Total assets		7,835	7,063
Current liabilities			
Settlement costs levy payable	12	(1,345)	(702)
Trade and other payables	13	(4,942)	(3,499)
Borrowings	14	(4)	(655)
Finance Lease Obligations	15	(128)	(331)
Total current liabilities		(6,419)	(5,187)
Non-current liabilities			
Finance Lease Obligations	15	(1,405)	(1,876)
Borrowings	14	(11)	–
Total non-current liabilities		(1,416)	(1,876)
Total liabilities		(7,835)	(7,063)
Net assets		–	–
Shareholders' equity and other reserves			
Share capital	16	–	–
Retained earnings		–	–
Total equity		–	–

The notes on pages 42 to 51 form part of these accounts.

The financial statements were approved by the board of directors on 28 June 2016 and signed on its behalf by:



Neil McDermott
Chief Executive and Accounting Officer



Helen Turner
Chief Finance Officer

Statement of changes in equity for the year ended 31 March

	Share capital	Retained earnings	Total equity
	£'000	£'000	£'000
As at 26 March 2014	-	-	-
Share capital issued	-	-	-
Total comprehensive income for the period	-	-	-
Balance as at 31 March 2015	-	-	-
Share capital issued	-	-	-
Total comprehensive income for the year	-	-	-
Balance as at 31 March 2016	-	-	-

As at 31 March 2016 the company has one authorised ordinary share issued and fully paid.

The notes on pages 42 to 51 form part of these accounts.

Statement of cash flows for the year ended 31 March

		2016	*2015
	Note	£'000	£'000
Cash flows from operating activities			
Profit for the year		–	–
Adjustment to reconcile profit before tax to net cash flows:			
Amortisation of intangible assets	8	2	–
Working capital adjustments:			
Decrease/(increase) in settlement costs levy receivable	9	1,371	(1,374)
Increase in prepayments	10	(186)	(12)
Increase in settlement costs levy payable	12	643	702
Increase in trade and other payables	13	1,443	3,499
Net cash inflow from operating activities		3,273	2,815
Cash flows from investing activities			
Purchase of intangible assets	8	(15)	–
Net cash outflow from investing activities		(15)	–
Cash flows from financing activities			
(Decrease)/increase in borrowings	14	(640)	655
Net cash (outflow)/inflow from financing activities		(640)	655
Net increase in cash and cash equivalents in the year		2,618	3,470
Cash and cash equivalents at the beginning of the year		3,470	–
Cash and cash equivalents at the end of the year	11	6,088	3,470

*For the period from incorporation on 26 March 2014 to 31 March 2015.
The notes on pages 42 to 51 form part of these accounts.

Notes to the financial statements for the year ended 31 March 2016

1. Authorisation of financial statements

The financial statements of Electricity Settlements Company Ltd (the “company”) for the year ended 31 March 2016 were approved and authorised for issue in accordance with a resolution of directors on 28 June 2016.

The company is a company limited by shares, incorporated and domiciled in the UK. The company’s registered office is at Fleetbank House, 2-6 Salisbury Square, EC4Y 8JX. It is unlisted and wholly owned by the Secretary of State for Energy and Climate Change (the “shareholder”) making it the company’s ultimate controlling party.

1.1 Principal activities

The company has been established to act as the settlement body for the Capacity Market. The company will also undertake such other activities in relation to Electricity Market Reform (EMR) that the board considers to be consistent with the company’s functions, duties and obligations.

2. Accounting policies

2.1 Basis of preparation

These financial statements are presented in pounds sterling and all values are rounded to the nearest thousand pounds (£’000).

The financial statements of the company have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and applied in accordance with the provisions of the Companies Act 2006 applicable to companies reporting under IFRS.

These accounts have been prepared under the historical cost convention as modified for the treatment of financial instruments.

The Capacity Regulations as identified below are defined hereafter as the “Regulations”:

- i. The Electricity Capacity Regulations 2014;
- ii. The Electricity Capacity (Supplier Payment etc.) Regulations 2014;
- iii. The Electricity Capacity (Amendment) Regulations 2015; and
- iv. The Electricity Capacity (Amendment) (No. 2) Regulations 2015.

Certain prior year balances have been reclassified for consistency with the current year presentation. These reclassifications have had no effect on the reported results of the operations for 2014/15. In 2015/16, the company has concluded that it is appropriate to report its settlement costs levy payable and receivable separately in the statement of financial position. Previously, the settlement costs levy receivable had been reported net of the settlement costs levy payable.

These changes have no material effect on the previously reported statement of cash flows or on the statement of comprehensive income.

2.2 Going concern

The Directors have a reasonable expectation that the company has adequate resources to continue to operate for the foreseeable future. The financial statements are, therefore, prepared on a going concern basis.

In forming this view, the directors note that the company:

- i. applies prudent financial management in order to ensure that its commitments are accommodated within the timing of its collection of its settlement costs levy;
- ii. undertakes a robust and detailed annual business planning and budgeting process to establish its operational costs requirements for each financial year; and
- iii. has considered the potential impact of credit risk and liquidity risk detailed in note 3.

The day to day operational costs of the company are funded by electricity suppliers under the Capacity Market “settlement costs levy” which is set by the Regulations.

The settlement costs levy is re-set by new regulations made each year. The directors note the low risk that annual regulations may not be made (resulting in the settlement costs levy set in relation to the previous year continuing to apply) or may not be made until after the commencement of the relevant financial year (resulting in the company experiencing a timing mismatch on its funding requirement). The directors are of the view that there is no reason to believe that future re-setting regulations will not be forthcoming.

The directors also note the risk that the total settlement costs levy set for a year will be insufficient or that a timing mismatch might arise between the time when monies are raised by the levy and the time when monies are required to meet a spend commitment made by the company.

During the course of a year, the company may, where it identifies that there is likely to be a shortfall in the collection of the settlement costs levy against its requirements, request DECC to support an in-year adjustment to the applicable levy rate. Such an adjustment would be subject to public consultation and the making of new regulations in accordance with the same process that applies to the setting of the annual settlement costs levy. The company can also request a working capital loan from DECC if there is a shortfall in its operating cash flow.

The requirement to pay capacity payments to capacity providers is set out in the Regulations.

The payments to be made to capacity providers are funded by suppliers under the Regulations. It should be noted that the Regulations state that the company's obligation is to pay when paid (i.e. the company has no obligation to pay the capacity providers until it receives adequate funds from suppliers to perform its obligation).

2.3 Settlement costs levy income

Under the Regulations, the company is entitled to recover its operational costs through the settlement costs levy on suppliers referred to above. The total amount of the levy is re-set annually. Any surplus at the year end is reimbursed to suppliers by issuing credit notes against the following year's levy and is classified as a settlement costs levy payable under current liabilities.

Settlement costs levy income is recognised as 'other income' in the financial year to which it relates and is presented net of any settlement costs levy repayable to suppliers.

The settlement costs levy is collected through monthly invoices. The settlement services provider, EMR Settlement Ltd, administers the collection process.

2.4 Recharges

The company is recharged a proportion of costs which it shares with LCCC. LCCC is a sister arm's length body owned by the Secretary of State for Energy and Climate Change which is responsible for acting as the CFD counterparty for Contracts for Difference (CFDs). In order to maximise operational cost efficiency, LCCC provides certain services to the company and makes certain payments on its behalf. Typically this includes common costs such as shared IT infrastructure and the use of shared resources and facilities. The recharge also includes costs

incurred on those activities that allow the company to perform its functions in relation to the Capacity Market.

This recharge is based on an estimate of the time LCCC's employees will spend on the company's activities during the relevant financial year, together with an appropriate allocation of overhead costs (including rent, service charge, IT infrastructure and telephony support) and a 'use of asset' charge. It also includes a proportion of the salaries of the board members who divide their time between the two companies. LCCC undertakes these activities on behalf of the company and the company's board retains responsibility and accountability for the quality and cost of services provided by LCCC.

The company and LCCC became part of the same VAT group from 1 January 2016, therefore no VAT is charged on costs recharged by LCCC from this date onwards. The company's income is outside the scope of VAT so it will be unable to recover its input VAT on any of its expenditure.

2.5 Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the company will comply with all the attached conditions.

The benefit of a below-market rate of interest on the working capital loan for operational costs, if material, is recognised in the statement of comprehensive income over the period of the loan.

2.6 Financial assets

The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. Management determines the categorisation of financial assets at initial recognition and re-evaluates this designation at each reporting date.

The only financial assets held by the company at the reporting date are cash and cash equivalents.

2.7 Financial liabilities

The company classifies financial liabilities as 'other financial liabilities'. Other financial liabilities include trade and other payables, borrowings and finance lease obligations.

The categorisation depends on the purpose for which the financial liability is held or acquired. Management determines the categorisation of financial liabilities at initial recognition and re-evaluates this designation at each reporting date.

2.7.1 Recognition and measurement

Other financial liabilities are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortised cost using the effective interest rate method, with interest expense recognised on an effective yield basis.

2.7.2 Derecognition of financial liabilities

Financial liabilities are derecognised when, and only when, the obligations are discharged, cancelled or they expire.

2.8 Intangible assets

Intangible assets are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses (if any). Intangible assets have finite lives and are amortised over their useful economic life, assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period.

Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the statement of comprehensive income in the expense category that is consistent with the function of the intangible assets.

Intangible assets are amortised over the following period:

Settlement system	5 years
Other IT Software	5 years

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the statement of comprehensive income when the asset is derecognised.

2.9 Impairment of non-financial assets

Intangible assets are only subject to amortisation to the extent that they are available for use. Intangible assets, which are not available for use, are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. At each reporting date, the company reviews the carrying amounts of its intangible assets to determine whether there is any indication that those assets have suffered an

impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of any impairment loss.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows (cash-generating units). Impairment losses are charged to the statement of comprehensive income and prior impairments of non-financial assets are reviewed for possible reversal at each reporting date.

2.10 Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at the inception of the lease. The arrangement is, or contains, a lease if fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset or assets, even if that right is not explicitly specified in an arrangement.

A lease is classified at the inception date as a finance lease or an operating lease. Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

2.10.1 Finance leases Company as a lessee

The lease of the settlement system where the company has substantially all the risks and rewards of ownership is classified as a finance lease. Finance leases are capitalised at commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. The present value of the minimum lease payments of the settlement system approximates to its fair value.

The settlement system acquired under a finance lease is amortised over the shorter of the useful life of the asset and the lease term.

2.11 Segmental reporting

The company operates solely within the UK and within one business segment; hence no segmental reporting is required. This is consistent with the internal reporting provided to the directors of the company, who are considered the company's chief operating decision makers.

2.12 Borrowings

Borrowings represents a working capital loan from DECC. Borrowings are recognised initially at fair value, net of transaction costs incurred (if any). Borrowings are subsequently carried at amortised cost. Any working capital loan outstanding at the reporting date is repaid, through levy income received, within 60 days of the reporting date unless otherwise agreed.

3. Financial risk management

3.1 Financial risk management and financial risk factors

Due to the nature of its operational and financial arrangements the company is not exposed to any significant financial risk. The financial risk is minimal by virtue of the company's levy funding arrangements with licensed suppliers, which are set out below.

3.2 Credit and Liquidity risk

Under the legislation there is an obligation placed on licensed suppliers to fund in advance, via payment through a levy, the capacity payment obligations as they crystallise. The company has no obligation to pay the capacity providers until it receives adequate funds from suppliers to perform its obligations.

As the Capacity Market settlement timetable is structured such that monies to be received by the company are invoiced and collected prior to the issue of credit notes and payments out from the company, the liquidity risk is minimal.

4. Critical accounting judgements, estimates and assumptions

The preparation of the company's financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and other factors, including expectations or future events that are believed to be reasonable under the circumstances. The results form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources.

Revisions to accounting estimates are recognised in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

4.1 Estimates

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The company based its assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising that are beyond the control of the company. Such changes are reflected in the assumptions when they occur.

4.1.1 Estimating useful lives and residual values of Intangible assets

At each reporting date, the useful lives and residual values of intangible assets are reviewed. Assessing the appropriateness of useful life and residual value estimates requires the company to consider a number of factors such as the technological advancement, expected period of use of the asset by the company, and expected disposal proceeds (if any) from the future sale of the asset. An incorrect estimate of the useful life or residual value will affect the amortisation expense recognised in the statement of comprehensive income and the asset's carrying amount.

4.1.2 Impairment of the settlement system

Implementation of the Capacity Market settlement system commenced in late 2014 with an expected completion date of June 2015. EMR Settlement Ltd was appointed to provide the system, with it then subcontracting responsibility for the design, build and testing of the system to a third party subcontractor. As a result of continuing delays in the build and testing of the system, the contract between EMR Settlement Ltd and its subcontractor was terminated on 9 November 2015 and EMR Settlement Ltd is now leading on the implementation of an alternative settlements solution.

Due to the termination event, management has assessed the recoverable amount of the spend incurred to date on the settlement system, by using the replacement cost method. The replacement cost approach is considered the most appropriate method for valuing the settlement system as:

- i. there is no active market involving assets identical or comparable to the settlement system; and
- ii. the settlement system is not directly used to generate income, rather it is purely used as an administrative tool for undertaking settlement activities on behalf of the Capacity Market.

The impairment loss recognised in the statement of comprehensive income represents the amount by which the asset's carrying amount exceeds its recoverable amount. The intangible asset has therefore been written down by the amount of the impairment to its recoverable amount. However, as the settlement system is treated as a finance lease asset, the finance lease obligations related to the settlement system have been reduced and the release in obligations recognised as income in the statement of comprehensive income. The release in finance lease obligations is equivalent to the impairment loss of the settlement system asset.

4.2 Significant judgement

Management has made the following judgement in applying the company's accounting policy.

4.2.1 Capacity agreements

Capacity agreements are arrangements between National Grid (as System Operator) and capacity providers. They require the capacity provider to be ready to provide a certain amount of capacity in their applicable delivery years when called upon to do so by National Grid.

The company is not party to capacity agreements but is only responsible for acting as an administrator for the settlement process. A capacity market obligation for the company only arises when settlement levy payments are received from electricity suppliers (i.e. only pay when paid) and the capacity provider delivers the required capacity in line with the capacity arrangements. As a result no provision is raised in the statement of financial position and capacity agreements are not classified as financial instruments because the company's role is driven by statute rather than contract.

5. New standards, amendments and interpretations not yet adopted

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the company's financial statements are disclosed below. The company intends to adopt these standards, if applicable, when they become effective. The company has not sought early adoption of any standards or amendments. None of these standards are expected to have a significant effect on the financial statements of the company:

IFRS 9: Financial instruments

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. The standard is effective for accounting periods beginning on or after 1 January 2018.

IFRS 15: Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The principles in IFRS 15 provide a more structured approach to measuring and recognising revenue. The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2017 with early adoption permitted.

IFRS 16: Leases

IFRS 16 was issued in January 2016 and establishes principles for the recognition, measurement, presentation and disclosure of leases.

The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. The standard is effective for accounting periods beginning on or after 1 January 2019.

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation

The amendments are effective prospectively for annual periods beginning on or after 1 January 2016, with early adoption permitted and are not expected to have a material impact on the company.

Amendments to IAS 1: Disclosure Initiative

The amendments aim at clarifying IAS 1 to address perceived impediments to preparers exercising their judgement in presenting their financial reports. They are effective for annual periods beginning on or after 1 January 2016 with earlier application being permitted.

Annual improvements 2012-2014 Cycle

These improvements are effective from 1 January 2016 and are not expected to have a material impact on the company.

There are no other IFRS or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the company.

6. Other income

	2016	2015
	£'000	£'000
Settlement costs levy income	3,891	1,374
Less: amount repayable to suppliers	(1,181)	(702)
Net settlement costs levy income	2,710	672
Reversal of finance lease obligations	891	–
Other income	3,601	672

The reversal of finance lease obligations relates to the impairment of the settlement system asset. DECC has released the company from its obligation to repay in respect of the impaired amount. Finance lease obligations equivalent to the impairment of the settlement system asset are released to the statement of comprehensive income to match the impairment charge (see note 7 and note 8).

7. Other operating costs

	2016	2015
	£'000	£'000
Costs recharged by LCCC	1,382	336
Operational settlement costs	1,241	193
Impairment of the settlement system asset	891	–
Insurance	62	25
Auditor's remuneration	18	30
IT support and maintenance	2	18
Amortisation	2	–
Consultancy fees	–	68
Other costs	3	2
Other operating costs	3,601	672

8. Intangible assets

	Settlement System	Other IT Software	Total
	£'000	£'000	£'000
Cost			
As at 26 March 2014	–	–	–
Additions during the period	2,207	–	2,207
As at 31 March 2015	2,207	–	2,207
Additions during the year	960	15	975
Impairment	(891)	–	(891)
Derecognition of capital accruals	(743)	–	(743)
As at 31 March 2016	1,533	15	1,548
Amortisation			
As at 26 March 2014	–	–	–
Charge for the period	–	–	–
As at 31 March 2015	–	–	–
Charge for the year	–	2	2
As at 31 March 2016	–	2	2
Net book value as at 31 March 2015	2,207	–	2,207
Net book value as at 31 March 2016	1,533	13	1,546

The company leases the settlement system from DECC under a finance lease where all the risks and rewards of ownership rest with the company. The lease term is 5 years which is the period over which the asset will be depreciated. The settlement system has not been depreciated during 2015/16 as the asset is not available for use as at 31 March 2016.

The derecognition of capital accruals is associated with the impairment of the settlement system asset as a result of the termination of the system development contract. The derecognition of capital accruals reflects the reversal of accrued capital costs which, when aggregated with the impairment charge, reduces the carrying value of the settlement system asset to its recoverable amount. DECC has released the company from its obligation to repay in respect of the impaired amount. The derecognition of capital accruals and the impairment charge are matched with a reduction in the finance lease obligations (as outlined in note 15).

The settlement system is impaired equivalent to the amount by which the carrying value of the settlement system exceeds its recoverable amount (after reflecting the derecognition of capital costs). An amount equivalent to the impairment expense is recognised as income by releasing the finance lease obligations to match the impairment expense so the net impact in the statement of comprehensive income is neutral.

As the settlement system asset is matched with the associated finance lease obligations, so asset additions during the year are matched with an equivalent increase in the lease obligation and are therefore treated as non-cash transactions in the preparation of the statement of cash flows.

9. Settlement costs levy receivable

	2016	2015
	£'000	£'000
Settlement costs levy receivable	3	1,374

10. Prepayments and other receivables

	2016	2015
	£'000	£'000
Prepayments	21	12
Amounts owed by LCCC	177	-
Total prepayments and other receivables	198	12

Prepayments comprise the insurance charge relating to the next financial year, 2016/17, which has been paid in advance.

11. Cash and cash equivalents

	2016	2015
	£'000	£'000
Cash at bank	1,168	134
Bid bond collateral	4,920	3,336
Total cash and cash equivalents	6,088	3,470

For the purpose of the statement of cash flows, cash and cash equivalents only comprise of cash at bank and bid bond collateral as stated above. Bid bond collateral is a restricted cash balance and relates to credit cover provided by the capacity providers. Interest earned on bid bond collateral is returned to capacity providers.

12. Settlement costs levy payable

	2016	2015
	£'000	£'000
Settlement costs levy payable	1,345	702

The settlement costs levy payable relates to the difference between the operational costs which have been collected from electricity suppliers during 2015/16, based on estimated spend for the year, and the operational costs actually incurred during the year. The difference is refunded to suppliers in the following financial year, which in this case will be 2016/17.

13. Trade and other payables

	2016	2015
	£'000	£'000
Bid bond collateral	4,920	3,337
Accruals and other payables	22	83
Trade payables	-	27
Amounts owed to a related party	-	52
Total trade and other payables	4,942	3,499

Bid bond collateral relates to credit cover provided by the capacity providers.

Bid bonds will be held by the company until one of the following triggers set out in the Regulations occurs:

- the capacity auction is delayed;
- the potential capacity provider notifies that it no longer intends to bid in the capacity auction;
- the capacity auction takes place and the potential capacity provider does not win a capacity agreement; or
- the capacity provider demonstrates capacity in the manner required by the regulations.

14. Borrowings

	2016	2015
	£'000	£'000
Current:		
Grant in aid capital loan	4	-
Working capital loan	-	655
	4	655
Non-current:		
Grant in aid capital loan	11	-
Total borrowings	15	655

The grant in aid capital loan is interest free and repayable to DECC from funding received through the settlement costs levy collected from suppliers. The timing of the repayment of the loan is in line with the depreciation charged on the assets funded via the loan.

During 2014/15, DECC provided the company with a working capital loan to support the company in managing its operational costs until the company was able to collect the amounts owed from suppliers via the settlement costs levy. The loan was interest free and was repaid during 2015.

15. Finance lease obligations

	£'000
As at 26 March 2014	–
Finance lease acquired during the period	2,207
As at 31 March 2015	2,207
Finance lease acquired during the year	960
Finance lease obligations released	(1,634)
As at 31 March 2016	1,533

	2016	2015
	£'000	£'000
Less than 1 year	128	331
Between 1 and 5 years	1,405	1,766
Greater than 5 years	–	110
As at 31 March 2016	1,533	2,207

The finance lease obligation is held in respect of the settlement system asset which has been funded by DECC through EMR Settlement Ltd, a wholly owned subsidiary of ELEXON Ltd.

The finance lease obligations released relate to the requirement to write the carrying value of the associated settlement system asset down to its recoverable amount. DECC has released the company from its obligation to repay in respect of the impaired amount. Of the released amount, £0.891m relates to the impairment of the asset and £0.743m relates to the derecognition of capital accruals to ensure the asset is stated at its recoverable amount and the finance lease obligations match the recoverable asset value.

16. Share capital

	Number
Authorised shares	
Ordinary share capital £1 each	1
	£
Ordinary share capital issued and fully paid:	
As at 26 March 2014	–
Ordinary share capital issued £1 each	1
As at 31 March 2015	1
Share capital issued during the year	–
As at 31 March 2016	1

17. Related party transactions

The following table provides the total amount of transactions that have been entered into with related parties for the relevant financial year.

	Services from related parties	Amounts owed by related parties	Amounts owed to related parties
	£'000	£'000	£'000
Entities with significant influence:			
2015			
DECC	2,207	–	655
LCCC	336	–	52
2016			
DECC	960	–	1,548
LCCC	1,382	177	–

Services from LCCC comprise of shared costs of premises, staff and directors payroll costs, IT infrastructure and use of assets which are incurred in the first instance by LCCC but are then recharged to the company based on the estimated usage of those services. Services received from DECC relate to the receipt of the settlement system in the form of a finance lease arrangement (see note 15).

18. Financial assets and liabilities

		2016	2015
	Notes	£'000	£'000
Financial assets:			
Cash and cash equivalents	11	6,088	3,470
Amounts owed by LCCC	10	177	–
Total financial assets		6,265	3,470
Financial liabilities:			
Trade and other payables	13	4,942	3,499
Borrowings	14	15	655
Finance lease obligations	15	1,533	2,207
Total financial liabilities		6,490	6,361
Total current		5,074	4,485
Total non-current		1,416	1,876
Total financial liabilities		6,490	6,361

Glossary

Balancing and Settlement Code (BSC)	This code* is a legal document which defines the rules and governance for the balancing mechanism and imbalance settlement processes of electricity in Great Britain. (* https://www.elexon.co.uk/bsc-related-documents/)
Capacity Auction	At a Capacity Auction, applicants who offer the lowest bid can win a capacity agreement.
Capacity Market	The Capacity Market has been designed by DECC to offer capacity providers who have been awarded capacity agreements with a steady, predictable revenue stream upon which they can base their future investments, with the aim of ensuring security of supply in future years at least cost to consumers. Capacity providers can be new or existing generators, electricity storage providers and significant users of electricity who provide voluntary demand side reductions (DSR). Capacity providers provide capacity under either a capacity agreement or a Transitional Arrangement agreement.
Demand Side Response (DSR)	DSR helps to manage the demand for electricity. It involves changing the usage patterns of electricity users (the “demand side”) in response to incentives. It is used to match supply with demand when unpredictable fluctuations occur and provides a mechanism through which demand can be reduced in peak times when system capacity is tight, thereby minimising the amount of additional generation capacity being brought onto the grid. DSR is seen as having the potential to help to lower consumer bills, electricity system costs and carbon emissions produced by traditional peaking plant, such as oil, coal and gas-fired generation.
EMR	Electricity Market Reform (see inside front cover)
EMR Settlements Ltd	EMR Settlement Ltd is a wholly owned subsidiary of ELEXON Ltd and is the settlement services provider to ESC and LCCC. The parties have entered into a contract under which EMR Settlement Ltd will provide settlement services (including billing, collection and settlement) and provide and manage the operation of the settlement system. (EMRS website: https://www.emrs.co.uk/)
Meter assurance	Under the Capacity Market, capacity providers with complex or non-BSC metering arrangements need to undergo metering checks in accordance with ESC meter standards guidance. (https://www.electricitysettlementscompany.uk/)
Settlement system	The settlement system is used to settle all monies collected from suppliers to make payments to CFD generators and Capacity Market providers, and to settle all monies collected from CFD generators and Capacity Market providers which are payable to suppliers.
T-4 Auction	A capacity auction held during the auction window commencing not less than 4 years and not more than 5 years before the start of the delivery year for which the capacity auction is held.
Transitional Arrangements	Transitional Arrangements run by National Grid (as System Operator) are aimed at addressing electricity demand at times of high peak (see page 9 for more details).
Transitional Auctions	Transitional Auctions are one year ahead auctions for DSR (see page 9 for more details).

Visit
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