



Annual Performance Report 2015

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Introduction

1. The Capacity Market (“CM”) was introduced as part of the government’s Electricity Market Reform package. The CM has been designed by the Department for Energy and Climate Change (“DECC”) to make available to capacity providers who have been awarded capacity agreements, 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.
2. The Electricity Settlements Company (“ESC”) is a private limited company wholly owned by the Secretary of State which performs an integral role in the delivery of the CM. It oversees the settlement of the CM to ensure that regular payments are made to capacity providers who have agreed to provide capacity or reduce demand at times of system stress.
3. As the appointed Settlement Body for the CM, ESC must, in accordance with regulation 84 of the Electricity Capacity Regulations 2014 (as amended) (“the principal regulations”), produce an annual report on the performance of its functions in respect of each capacity year¹. The annual report must, no later than three months after the end of the capacity year to which it relates, be provided to the Secretary of State and published.
4. The annual performance report 2015 covers the period 1 October 2014 to 30 September 2015 (the end of the capacity year).

Scope of this annual performance report

5. ESC has a range of functions which it must perform in respect of a capacity year. The principal function is that of settlements, as set out in Part 6 (Payments) of the principal regulations. ESC will not, however, be performing its key settlement function until October 2016, as the first capacity payments due under the CM scheme will be those payments relating to the Transitional Arrangements capacity auction in January 2016.
6. This annual report does not therefore cover this and other functions yet to be performed, including ESC’s requirements under the Capacity Market Rules to undertake metering tests (which ESC is presently preparing for). It does, however, set out the progress made by ESC in ensuring the necessary arrangements are in place to make capacity payments at the appropriate time. This annual report also covers ESC’s performance with respect to the administration of credit cover and the settlement costs levy.

Settlement activities

7. One of ESC’s core activities is to perform the settlement role as set out in Part 6 (Payments) of the principal regulations. This role requires ESC to make payments to and receive payments² from capacity providers who hold capacity agreements with National Grid.

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

² ESC will also receive payments from capacity providers in the form of penalties should they not make capacity available when required.

8. ESC will obtain the funds to make payments to capacity providers from electricity suppliers³. ESC will commence collecting these supplier payments in October 2016, in order to make capacity payments to those capacity providers successful in January 2016's Transitional Arrangements ("TA") capacity auction⁴.
9. The design and build of the CM settlement system is being undertaken by EMR Settlements Ltd⁵ and overseen by ESC. The funding is provided by DECC via a grant. The settlement system functionality necessary to collect supplier payments and then make payments to capacity providers from October 2016 is scheduled to be operational in the spring 2016.

Credit Cover

10. In order to participate in a capacity auction, which is conducted by National Grid, some capacity providers are required at the 'pre-qualification' stage to lodge credit cover with ESC⁶ (in the form of cash or letter of credit, or a combination of both).

T-4 auction - December 2014

11. In October 2014, within months of its 1 August 'go-live' date, ESC managed £57m of credit cover received from 76 applicants, ahead of the first "T-4"⁷ capacity auction in December 2014. Of this £57m, £3m was returned to applicants due to overpayment and £42m to unsuccessful participants in the auction. ESC successfully returned all credit cover to those who were unsuccessful within three weeks.
12. The remaining £12m is held by ESC until it is released to capacity providers on completion of milestones monitored by National Grid. At the end of September 2015, ESC held credit cover to the value of £11.2m.

T-4 auction – December 2015 and Transitional Arrangements auction – January 2016

13. The pre-qualification process for December 2015's T-4 auction and January 2016's TA auction was conducted in parallel, including the processing of credit cover by ESC. As at 30 September 2015, the end date of the delivery year for this report, ESC had collected £7.3m in credit cover in relation to these auctions. The initial credit cover window was open from 28 September to 2 October and spanned over the end of the 2014/2015 delivery year.
14. As at 16 October 2015, ESC held £45.1m (in a combination of cash and letters of credit) from 90 applicants following the tier 1 appeal process. This amount may increase following the tier 2

³ In accordance with the Electricity Capacity (Supplier Payment etc.) Regulations 2014 ("the Supplier Payment Regulations").

⁴ The inaugural Capacity Market Transitional Arrangements ("TA") auction is scheduled for 26 January 2016 for delivery of capacity in the year commencing 1 October 2016. This auction is ring-fenced for DSR (Demand Side Response) and small-scale flexible generation (sub-50 MW). The target capacity of the TA auction is 1,500 MW.

⁵ EMR Settlement Ltd (EMRS) is a wholly owned subsidiary of ELEXON Ltd and is the EMR Settlement Services Provider. EMRS delivers settlement services on behalf of the Low Carbon Contracts Company Ltd for Contracts for Difference and on behalf of the Electricity Settlements Company Limited for the Capacity Market. For more information see: <https://emrsettlement.co.uk/>

⁶ The amount of applicant credit cover to be provided is set out in regulation 59 of the principal regulations.

⁷ The auction is referred to as a "T-4" auction because the auction is run approximately four years ahead of the delivery year, i.e. the year in which capacity is required to be available at times of system stress.

appeal process with the final date for applicants being able to lodge credit cover being 27 November 2015.

Settlement costs levy

15. ESC's day-to-day operational costs were funded directly by DECC until the end of July 2014. After 1 August 2014, ESC's operational costs were and continue to be, funded by suppliers via the Capacity Market settlement costs levy, which is collected by ESC.
16. The level of the levy is set via regulations and updated annually. The settlement costs levy for 2014/15, which covers the period 1 August 2014 to 31 March 2015, was fixed at £1.374m. ESC's settlement costs levy is fixed at £3.891m for the period 1 April 2015 to 31 March 2016. The period covered by this report (1 October 2014 to 30 September 2015) therefore spans part of both levy years 2014/15 and 2015/16.
17. ESC applies prudent financial management in order to ensure that its commitments are accommodated within the timing of its collection of the levy. It also undertakes a robust and detailed annual budgeting and management reporting process to establish its operational cost requirements for each financial year.
18. ESC has delivered a solid financial performance since it became operational on 1 August 2014, managing its cost base well within the external budgetary limits set by Parliament after public consultation. As a result, ESC returned £0.702m to suppliers in August 2015 with respect to the 2014/15 financial year. One of the contributing factors to this has been management's decision to place greater reliance on in-house skills and capabilities rather than depending on external consultancy support. This has also allowed the company to maximise its retention of key knowledge and experience accumulated through the operationalisation of the regulations and associated processes.

The year ahead

19. ESC's second annual performance report will cover the period, 1 October 2015 to 30 September 2016 and will cover ESC's preparations for making its first payments to capacity providers in October 2016, following January 2016's TA auction. This will include the outcome of the metering tests performed in relation to the TA auction; the development of the settlement system to enable capacity payments; and the management of credit cover lodged with ESC by suppliers so that they are in a position to cover their liabilities under the Capacity Market scheme.
20. The report will also cover the final outcome of the credit cover process initiated in September 2015.

Ends

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