



Annual Performance Report 2017

Electricity Settlements Company

December 2017

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1. Introduction

1. As the appointed Settlement Body for the Capacity Market (“CM”), the Electricity Settlements Company (“ESC”) must, in accordance with Regulation 84 of the Electricity Capacity Regulations 2014 (as amended) (“the Principal Regulations”), produce an annual report on the performance of its functions in respect of each capacity year¹. The annual report must, no later than three months after the end of the capacity year to which it relates, be provided to the Secretary of State for Business, Energy and Industrial Strategy (“BEIS”) and must be published. This annual performance report covers the period 1 October 2016 to 30 September 2017 (the end of the Delivery Year) and is the third such report produced by ESC.
2. The CM was introduced as part of the government’s Electricity Market Reform (EMR) programme, through the Energy Act 2013. The CM is aimed at ensuring security of supply during times of peak demand through capacity agreements awarded to providers via an auction. These capacity agreements provide a steady, predictable revenue stream upon which Capacity Providers can base their future investments, with the aim of ensuring security of supply in future years at least cost to consumers.
3. ESC is a private limited company wholly owned by the Secretary of State for BEIS which performs an integral role in the delivery of the CM. It oversees the settlement of the CM to ensure that regular payments are made to Capacity Providers who have agreed to provide capacity or reduce demand at times of system stress.
4. ESC has a range of functions which it must perform. The principal function is that of settlements, as set out in Part 6 (Payments) of the Principal Regulations. Throughout 2017, ESC has performed a range of activities, in accordance with, and in order to enable it to meet its regulatory responsibilities. These activities, which are included within the scope of this report, include payments to the Capacity Providers, administration of credit cover, performing metering tests, collection of the settlement costs levy which funds ESC’s administrative functions and collection of supplier charge which funds payment to the Capacity Providers.

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

2. Credit Cover

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

T-4 auction (December 2016), T-1 (EA, January 2017) and TA auction (March 2017)

2. ESC confirms that following the conclusion of the prequalification stage, it collected credit cover totalling £211m in a combination of cash and letters of credit: £147.7m for T-4 2016 auction, £62.8m for Early auction (EA) 2017 and £0.5m relating to the TA auction 2017. As at the end of September 2017, ESC held credit cover valued at £30m, £8.4m and £0.2m with respect to each of these auctions. The credit cover currently held is a combination of the current obligations for Capacity Providers participating in the delivery years associated with these auctions as well as credit cover refunds still to be requested from ESC as Capacity Providers pass regulatory milestones removing their credit cover requirements.

T-1 auction (January 2018), T-4 auction (February 2018)

3. At the time of the publication of this report (post 2016/17 Delivery Year), the final value of credit cover collection had yet to be determined. ESC confirms that following the conclusion of the pre-appeals stage, it collected credit cover totalling £144m in a combination of cash and letters of credit: £20m for T-1 2018 auction and £124m for T-4 2018 auction. ESC will refund the credit cover to the unsuccessful Capacity Providers once the auction is concluded.

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

3. Metering tests

1. Capacity Providers seeking to participate in a capacity auction must, as part of the CM pre-qualification process, carry out a metering assessment. From the metering assessment, National Grid will determine whether or not a metering test is required. ESC is required to perform these metering tests, which seek to ensure a Capacity Provider's metering arrangements correctly reflect the flow of electricity supplied, generated and consumed within a site. Meter testing is therefore crucial in providing confidence in the integrity of the CM and the metered data that underpins it.
2. ESC's priority over the period covered by this report has been to perform desktop metering tests relating to capacity procured in the early auction 2017 and TA auction 2017 for delivery in the year commencing 1 October 2017. With respect to the early auction and TA auction, ESC undertook 99 component tests for 70 CMUs; 54 for new build/existing generators and 16 for unproven demand side response (DSR) Capacity Providers. ESC will complete a number of metering site visits throughout the 2017/18 delivery year as part of its metering assurance programme.

4. Settlement costs levy

1. ESC's day-to-day operational costs are funded by suppliers via the settlement costs levy that is set by the relevant CM regulations. The levy amount is updated annually following a robust and detailed annual business planning and management process, and subsequent public consultation process³.
2. The settlement costs levy for the financial year 2016/17 was set at £4.283m, an increase of £0.392m on the previous year's levy of £3.891m. The increase in costs are driven by new or increased activities, including increased meter assurance and fraud prevention activities; and increased settlement operations activities as ESC moves to full operational service for the CM.
3. ESC delivered a solid financial performance in financial year 2016/17, half of which falls within the period covered by this report, meeting all operational requirements. As a result, the company was in a position to return £1.373m of settlement costs levy collected from suppliers during 2016/17.

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/474061/LCCC_ESC_2016-17_operational_costs_condoc.pdf. See also the Government response: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/494454/160121_-_2016-17_Op_Costs_-_Government_Response_-_FINAL.pdf

5. Settlement

1. One of ESC's core activities is to perform the settlement role as set out in Part 6 (Payments) of the Principal Regulations. This role requires ESC to make payments to and receive payments from⁴ Capacity Providers who hold capacity agreements. ESC obtains the funds to make payments to Capacity Providers from electricity suppliers.
2. Prior to the 2016/17 delivery year, ESC targeted the rollout of the settlement system CM functionality. Consequently, ESC was ready to start making capacity payments on time and in line with all requirements, and successfully paid its first Capacity Providers from the TA auction held earlier in 2016. The first payments to Capacity Providers, who were awarded agreements for the 2016/17 Delivery Year, were made in December 2016. Also, for the 2016/17 Delivery Year, ESC have paid out a total of £17m across 46 capacity agreements, for more than 600MW of available capacity. Additionally, as a result of Ofgem's annual industry consultation process which resulted in changes to CM rules and regulations in 2017, ESC implemented a number of settlement system changes. This included the introduction of the capability for secondary trading and volume reallocation. ESC, as the CM Settlement Body, is required to manage Volume Reallocation using a new Capacity Volume Register. This process will be administered by our settlement agent EMRS, and further information is available on their website.⁵
3. Despite the scale and complexity of the activities ESC is managing, ESC have consistently met all our operational targets, delivering new capabilities successfully and within agreed timescales.

6. The year ahead

1. ESC will continue to work with its delivery partners, BEIS, National Grid and Ofgem, to improve the effectiveness and efficiency of CM processes. ESC's fourth annual performance report will cover the period, 1 October 2017 to 30 September 2018. For the current Ofgem change proposal process which started in September 2017, ESC has submitted 12 change proposals out of a total of 103 received by Ofgem for consideration in its Spring 2018 consultation.⁶

⁴ ESC will also receive payments from capacity providers in the form of penalties should they not make capacity available when required.

⁵ <https://www.emrsettlement.co.uk/documents/2017/10/emr-circular-135-information-capacity-providers-delivery-year-2017-18.pdf>

⁶ <https://www.ofgem.gov.uk/publications-and-updates/capacity-market-rules-change-proposal-submissions-2>