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# **Annual Performance Report 2018**

**Electricity Settlements Company**

December 2018

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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 year<sup>1</sup>. 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 2017 to 30 September 2018 (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 the least cost to consumers. Following a judgment on 15 November 2018 by the European Court to annul the European Commission’s approval for the CM scheme, payments under the scheme are at a standstill pending re-approval of the CM State aid. The administration of CM agreements continues.
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 2018, 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, are 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.

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<sup>1</sup> “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 ESC<sup>2</sup> (in the form of cash or a letter of credit, or a combination of both). Within the period covered by this report, ESC processed credit cover for auctions held in February 2018.

### T-4 auction and T-1 auctions (February 2018)

2. ESC confirms that following the conclusion of the prequalification stage it collected credit cover totalling £227.9m, in a combination of cash and letters of credit: £205.8m for T-4 auction and £22.1m relating to the T-1 auction.

### Return of Credit Cover

3. Following the decision of the General Court of the Court of Justice of the European Union on 15 November 2019, ESC is in the process of cancelling letters of credit and returning all cash credit cover held once it is requested by a Capacity Providers. Further information on this process can be found in EMRS Circular 169.

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<sup>2</sup> 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 information provided at the metering assessment, National Grid will determine whether or not a metering test is required. ESC is required to perform these metering tests. The tests seek to ensure a Capacity Provider's metering arrangements correctly reflect the flow of electricity supplied, generated and consumed within a site. Meter testing is therefore crucial in providing confidence in the integrity of the CM and the metered data that underpins it.
2. ESC undertook 113 component tests for 61 CMUs; 53 for new build/existing generators and 8 or unproven demand side response (DSR) Capacity Providers. ESC also completed 34 metering site visits throughout the 2017/18 delivery year as part of its metering assurance programme.
3. In addition, ESC undertook desktop metering tests for the T-4 auction for delivery in 2019/20. The deadline for these tests on existing generating and proven DSR CMUs is 18 months before the start of the delivery year. ESC undertook 4 component tests for 2 existing generating CMUs

### 4. Settlement costs levy

1. ESC's day-to-day operational costs are funded by suppliers via the settlement costs levy set by the relevant CM regulations. The levy amount is updated annually following a robust and detailed annual business planning and management process, and subsequent public consultation process<sup>3</sup>.
2. The settlement costs levy for the financial year 2018/19 was set at £6.241m, an increase of £1.958m on the previous year's levy of £4.283m. The increase in costs are driven by new or increased activities, including increased meter assurance 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 2017/18, 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 £1.628m of settlement costs levy collected from suppliers during 2017/18.

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<sup>3</sup>[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/563422/LCCC\\_ESC\\_2017-18\\_operational\\_costs\\_consultation\\_doc\\_-\\_FINAL.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/563422/LCCC_ESC_2017-18_operational_costs_consultation_doc_-_FINAL.pdf). See also the Government response: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/589136/Annex\\_B\\_LCCC\\_ESC\\_Conduc\\_Gov\\_Response\\_final.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/589136/Annex_B_LCCC_ESC_Conduc_Gov_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 from<sup>4</sup> Capacity Providers who hold capacity agreements. ESC obtains the funds to make payments to Capacity Providers from electricity suppliers.
2. For the 2017/18 Delivery Year, ESC has paid out a total of £390.1m across 437 capacity agreements, for more than 54,745 MW of available capacity.

	Capacity Payments	Capacity Provided
T-1 Auction	£377.2	54,434MW
TA Auction	£12.9m	311MW
Total	£390.1m	54,745MW

3. This was funded by payments by electricity suppliers based on their market share. The market share is calculated based on electricity supply between 4pm and 7pm on working days in November to February. The total amount of electricity supplied in this period in 2017/18 was 12.4 TWh.
4. Ofgem's annual industry consultation process resulted in changes to CM rules and regulations in 2018. ESC implemented a number of settlement system changes. This included the following:
  - a. Meter data shift from Net to Gross (Electricity Capacity (Amendment) Regulations 2017);
  - b. System changes due to BSC CP1434;
  - c. Offsetting Capacity Penalties against Recovery of Capacity Payments;
  - d. Extending Satisfactory Performance Days to 6 from 3 (Ofgem CP169);
  - e. Allowing a CMU that is a subset of a BMU so ALFCO can be more accurately calculated (Ofgem CM Rules);
  - f. Updates to the Penalty Regime (The Electricity Capacity (Amendment) Regulations 2016)
  - g. Opening up Volume Reallocation trading to pre-qualified parties
  - h. Interconnector penalties (Ofgem CP294)
  - i. Introducing of Zonal Transmission Losses BSC P350

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

- j. Introducing Capacity Market Cumulation - Relevant Expenditure (The Electricity Capacity (Amendment) Regulations 2017)
  - k. AACO Clarifications (Ofgem CP237)
  - l. Avoid unnecessary DSR Tests and correct New (Joint) DSR Test rules (Ofgem CP244)
  - m. Extending Metering Test failure rectification plan window (Ofgem CP300)
  - n. Update Metering Statement for Metering Test (Ofgem CP301)
  - o. Update Metering requirements for a CMU that is subset of a BM Unit (Ofgem CP304)
  - p. Avoid Termination due to System Operator connection non-delivery (Ofgem CP329)
  - q. Update ESC permissions to visit generator offices (Ofgem CP305)
5. In May 2018, ESC co-ordinated a mock stress event with its delivery partners: EMRS and the National Grid EMR Delivery Body. This valuable exercise involved capacity providers sending real data to the delivery partners in exactly the same way as in a real stress event. The event provided opportunities for improvements which are being implemented by the delivery partners.
6. Despite the scale and complexity of the activities ESC is managing, ESC has consistently met all its operational targets, delivering new capabilities successfully and within agreed timescales.

## 6. High level comparison of the 16/17 and 17/18 reports

	2017 Annual Report	2018 Annual report
Metering component tests	99	113
Metering site visits	0	34
Settlements costs levy	£4.283m	£6.241m
Credit Cover collected	£211m	£227.9m

## 7. The year ahead

1. Although payments under the scheme are at a standstill pending re-approval of the CM State aid, the administration of agreements continues. ESC is continuing to work with its delivery partners, BEIS, National Grid and Ofgem, to improve the effectiveness and efficiency of CM processes.