Low Carbon Contracts Company Ltd

Framework Document

This framework document has been drawn up by the Department of Energy and Climate Change in consultation with the Low Carbon Contracts Company. It sets out the relationship between the Low Carbon Contracts Company and its sole shareholder, the Secretary of State for Energy and Climate Change, and the broad framework within which the Low Carbon Contracts Company will operate. It is signed and dated on behalf of the Secretary of State for Energy and Climate Change and the Low Carbon Contracts Company. Copies of the document and any subsequent amendments will be placed in the Libraries of both Houses of Parliament and made available to members of the public on the Low Carbon Contracts Company website.
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LOW CARBON CONTRACTS COMPANY LTD:
SHAREHOLDER RELATIONSHIP FRAMEWORK DOCUMENT

1 August 2014

A. INTRODUCTION

1. BACKGROUND

1.1 This framework document (the "Framework Document") has been drawn up by
the Department of Energy and Climate Change ("DECC") in consultation with the
Low Carbon Contracts Company Limited ("Company"). It describes:

(A) certain activities which the Company is required to perform and the guiding
principle with which the Company is expected to comply in performing those
activities;

(B) certain aspects of the relationship between the Secretary of State for Energy
and Climate Change as sole shareholder (the "Shareholder") and the
Company, and the manner in which it is expected that the Shareholder and the
Company will interact with each other, and

(C) the intention of the Shareholder to allow day-to-day operational independence
of the Company subject to certain limited exceptions provided for in this
Framework Document, legislation, and the Company’s constitutional
documents

1.2 A key principle in developing this Framework Document has been the creation of a
framework within which the Company can fulfil its purpose with appropriate
operational independence. There will be certain limitations on that independence
which are either (i) common to government-owned entities and necessary to
satisfy Government and Parliamentary budgeting and accountability requirements,
or (ii) specific to the controls the Shareholder requires over the policy
implementation that the Company has been mandated to execute. In particular

(A) it is recognised that the Company is a separate corporate entity and that the
governance, and decision-making processes, of the Company flow through its
board, with the executives reporting to that board; and

(B) this framework is not intended to replace or duplicate the Company’s own
internal corporate governance structure. It is intended to enable an effective and
clearly defined and aligned Company-shareholder relationship, appropriate to a
government-owned company, including facilitating the necessary information
and reporting flows and efficient dialogue.

1.3 It is agreed that the success of the relationship depends on the nature and quality
of the relationship between the Company Board and the Shareholder. The overall
responsibility for ensuring that the intentions of the Framework Document are
carried out in practice lies ultimately with the Chair and the Secretary of State
acting in his or her capacity as Shareholder. The Chair or relevant Company
representatives will maintain regular contact with the Secretary of State or an official nominated by the Secretary of State.

1.4 In addition to the regular reporting set out in section 8 (Information Flows) of this Framework Document, there will be quarterly shareholder meetings between the Company and DECC. The purpose of these meetings between relevant Company representatives and senior representatives of DECC is to provide a forum for information exchange and discussion on key aspects relevant to the Company's activities of mutual interest and to ensure alignment between the Company and DECC.

1.5 The Company was established on 18 December 2013 as a company limited by shares. It is wholly-owned by the Shareholder as the CFD counterparty pursuant to the Energy Act 2013 and related Regulations (the "Regulations") (together the "EA Legislation").

1.6 The Secretary of State for Energy and Climate Change or his relevant successor is the Minister ultimately responsible to Parliament for the Company and will account for the Company's business in Parliament.

B. PURPOSE AND REMIT OF THE LOW CARBON CONTRACTS COMPANY

2. LOW CARBON CONTRACTS COMPANY PURPOSE

2.1 The purpose and remit of the Company are set out in the objects clause of the Company’s Articles of Association as follows:

(A) to act as the counterparty to Contracts for Difference ("CFDs") and Investment Contracts and, in such capacity, to perform the functions, comply with the duties and obligations and exercise the rights, powers and discretions which are set out in, arise out of or in connection with or are provided for pursuant to the Energy Act 2013 or regulations made pursuant to the Energy Act 2013,

(B) to comply with any direction given by the Secretary of State for the Department of Energy and Climate Change or the national system operator\(^3\) by virtue of the EA Legislation;

(C) to enter into CFDs and become party to Investment Contracts as transferee of SoS and administer CFDs and Investment Contracts in the capacity of a CFD counterparty.

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\(^1\) CFD throughout the Framework Document means the CFD agreement and CFD terms and conditions

\(^2\) Investment Contract throughout the Framework Document means Investment Contracts and any related provisions or agreements that have been agreed by Government

\(^3\) As defined in the Energy Act 2013
(D) to perform all obligations, and satisfy all liabilities, of a CFD counterparty under, or arising out of or in connection with CFDs and Investment Contracts;

(E) to exercise all rights, powers and discretions of a CFD counterparty under, or arising out of or in connection with, CFDs and Investment Contracts;

(F) to enter into any agreement, deed, document or other arrangement under, or arising out of or in connection with, CFDs or Investment Contracts;

(G) (without prejudice to the generality of paragraph (A)) to administer and manage the operational and supplier obligation levy arrangements in accordance with the EA Legislation;

(H) to undertake such other activities in relation to Electricity Market Reform ("EMR") as the board considers to be consistent with the Company's functions, duties and obligations which are set out in, arise out of or in connection with or are provided for pursuant to the EA Legislation;

(I) to provide resources to the Electricity Settlements Company in return for payment, and

(J) to do all other things which the board considers ancillary, incidental or conducive to the attainment or fulfilment by the Company of the foregoing objects.

2.2 The Company will also provide advice and information to DECC about certain aspects of the workings of Electricity Market Reform.

(A) This role will include acting as Implementation Coordinator for the CFD regime. As Implementation Coordinator for the CFD regime the Company will be responsible for:

(i) co-ordinating the development of systems and processes of the different organisations responsible for CFD implementation, including co-ordinating the building and integration testing of systems and processes by multiple suppliers (where required, e.g. for the collection of the supplier obligation levy), managing dependencies and identifying issues from an implementation point of view, and identifying risks and coordinating management of them;

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4 Further detail of the supplier obligation is set out in Implementing Electricity Market Reform
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/324116/Implementing_Electricity_Market_Reform.pdf. The shareholder expects that the company will deliver the detailed policy that is not in the regulations, noting that the Company will have discretion on how policy intent is achieved.

5 Electricity Settlements Company is the body responsible for providing settlement services for the capacity market regime.
(ii) working closely with industry participants to give them the best opportunity to understand what is expected of them and by when to enable successful implementation of CFDs.

3. LOW CARBON CONTRACTS COMPANY OPERATIONAL PARAMETERS

3.1 The Company is a company wholly-owned by Government and also has obligations under the EA Legislation. It will undertake its activities in accordance with:

(A) its objects as specified in its Articles of Association;

(B) the terms of any relevant EU state aid approvals;

(C) all applicable laws and regulations;

(D) applicable constraints which apply to arm’s length bodies owned by Government where relevant;

(E) except as otherwise agreed by DECC (in the first instance), and (if required) HM Treasury, the principles, rules, guidance and advice in Managing Public Money;

(F) the Guiding Principle as defined in section 4 below (Company Guiding Principle); and

(G) the Shareholder Consent Matters as defined in section 5 below (Shareholder Consent Matters).

3.2 Subject to section 3.1 above, the Shareholder intends that the Company should:

i) operate as a commercially responsive and responsible company, which will include operating efficiently in a commercial timeframe, ensuring it has appropriate resources and personnel to do so; and

ii) in carrying out its purpose under section 2.1(G) (Low Carbon Contracts Company Purpose) be as open as is reasonably possible, subject to considerations of proprietary or commercially sensitive information and the cost and practicality of doing so.

3.3 The CFD and Investment Contract reflect Government’s policy intent and accordingly Government expects (subject to section 3.1 above) the Company to enforce contracts entered into by it in accordance with their respective terms.

4. COMPANY GUIDING PRINCIPLE

In carrying out activities under and associated with the Company’s purpose as set out in section 2 (Low Carbon Contracts Company Purpose) and within the operational parameters set out in section 3 (Low Carbon Contracts Company Operational Parameters), the Company shall seek to maintain investor confidence in the CFD regime and minimise costs to consumers (the “Guiding Principle”).
5. OPERATIONAL INDEPENDENCE AND SHAREHOLDER CONSENT MATTERS

The Shareholder intends that the Company should have day-to-day operational independence from Government, however, certain decisions, as set out in the Annex, will require the prior written consent of the Shareholder (the "Shareholder Consent Matters").
C. ACCOUNTABILITY AND CORPORATE GOVERNANCE

6. CORPORATE GOVERNANCE

6.1 The Company shall operate a corporate governance framework which, so far as practicable and in the light of the other provisions of this Framework Document or as otherwise may be agreed with the Shareholder, accords with corporate governance best practice. In particular (but without limitation), the Company shall comply with the provisions of the United Kingdom's Corporate Governance Code (the "Corporate Governance Code"), other than section E (Relations with Shareholder), as it applies to small quoted companies or specify and explain any non-compliance in its annual report. The Company shall also, as far as it is applicable, comply with the spirit and principles of the Corporate Governance in Central Government Departments Code of Good Practice\(^6\).

6.2 It is agreed that:

(A) the Company Board is to consist of no fewer than two and no more than twelve directors;

(B) the senior independent non-executive director and the independent non-executive directors are to constitute at least half of the Company Board;

(C) the Shareholder shall appoint the Company’s Chair and Senior Independent Director\(^7\) and shall appoint up to two suitably qualified persons as its representative directors (the "Shareholder Representative Directors"), and any other directors to the Company Board in accordance with the Articles;

(D) subject to the prior written consent of the Shareholder in accordance with the Articles, the Company Board shall appoint the other directors according to the recommendations of the Nominations Committee;

(E) the Company Board shall regularly ensure that suitably rigorous appraisals are made of the effectiveness of the Chairman and the members of the Company Board;

(F) non-Executive Company Board members will be subject to re-election every three years;

(G) the Company Board shall have due regard to the UK Corporate Governance Code’s principle that the search for board candidates should be conducted, and

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\(^6\) The Shareholder recognises that areas of the Code are not appropriate to a non-government department and expects the Company to exercise its judgement

\(^7\) The Chair and Senior Independent Director appointments shall be made by the Shareholder in line with Office of Commissioner of Public Appointments principles
appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender.

6.3 The Company Board should ensure that effective arrangements are in place to provide assurance on risk management, governance and internal control. The Company Board is expected to assure itself of the effectiveness of the internal control and risk management systems.

6.4 Individual board members should comply at all times with the Code of Conduct for Board Members of Public Bodies\(^8\) and with the rules relating to the use of public funds and to conflicts of interest, including:

(A) not misusing information gained in the course of their public service for personal gain or for political profit, nor seeking to use the opportunity of public service to promote their private interests or those of connected persons or organisations;

(B) complying with the Company Board’s rules on the acceptance of gifts and hospitality, and of business appointments.

6.5 The Company Board:

(A) will constitute as a minimum the following committees of the Company Board:

(i) Audit and Risk Committee;

(ii) Remuneration Committee, and

(iii) Nominations Committee

(B) will ensure that one Shareholder Representative Director may always be a member of the Remuneration Committee and of the Audit and Risk Committee;

(C) may establish other committees of the Company Board as it determines appropriate

6.6 The Shareholder expects remuneration arrangements for directors and senior management (including any performance related remuneration) to be recommended to the Company Board by the Remuneration Committee and approved by the Company Board, having due regard to the public sector status of the organisation as well as taking account of appropriate benchmarks within the private and public sectors.

6.7 However, the prior written consent of the Shareholder in accordance with the Articles will be required for:

(A) the approval of or agreement to (or material variation or amendment of) the remuneration, the terms and conditions on which such remuneration is to be paid or granted or the terms of employment or engagement of any director or the remuneration of any executive officer or other employee that is equal to or higher than the threshold outlined in the Cabinet office guidance for approval of senior pay\(^9\) (or equivalent pro-rata amount). This consent will apply to any new appointment or reappointment to a role regardless of whether this is at the same level as has been previously consented to by the Shareholder, or

(B) any pay rise for any director or employee of the Company whose fees or salary has been approved under section 6.7(A), which are material, where a 'material pay rise' is that which is considered to be above the current rate of the Consumer Price Index (CPI).

6.8 Gifts to staff must only be made in accordance with policies and processes agreed by the Board or the Remuneration Committee.

7. **RISK MANAGEMENT**

The Company shall ensure that, except as expressly agreed with the Shareholder, the risks that it faces are dealt with in an appropriate manner, in accordance with relevant aspects of best practice in corporate governance, and develop a risk management strategy. It should adopt and implement policies and practices to safeguard itself against fraud and theft, in line with the Treasury's guidance on tackling fraud\(^10\). Except in the case of directions given to the Company by National Grid as Delivery Body or the Shareholder to enter into Investment Contracts and CFDs and the initial appointment of a subsidiary of ELEXON Ltd as payment and settlement agent, it should also take all reasonable steps to appraise the financial standing of any firm or other organisation with which it intends to enter into a contract.

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\(^9\) The thresholds are currently (as of 1 August 2014) £142,500 for salaries and £17,500 for bonuses. The calculation of whether a salary is equal to or higher than the £142,500 threshold must include any bonus amount that is above £17,500.

D. OPERATIONAL AND FINANCIAL REPORTING

8. INFORMATION FLOWS

8.1 The following mechanisms will be used to ensure relevant information flows between the Secretary of State for Energy and Climate Change (the 'Shareholder') and the Company:

(A) a Monthly Financial Report in agreed form. The Shareholder will limit additional reporting requirements on the Company and where possible will rely on reports prepared for the Board.

(B) quarterly shareholder meetings as described in section 1.4 (Background) above,

(C) the Company will promptly and without delay disclose to the Shareholder any information regarding the Company which is likely to have a material adverse effect on the delivery of the Company's purpose as described in section 2 (Low Carbon Contracts Company Purpose), or is likely to result in the Company having insufficient funds to meet its operational costs or its obligations under CFDs or Investment Contracts,

(D) the Company will provide the Shareholder with copies of Board papers,

(E) the Company will promptly and without delay notify the Shareholder of any amendments to an Investment Contract to which the Company is a party, and provide the Shareholder with a copy of such amendments,

(F) the Shareholder will be entitled on reasonable notice to such information in relation to the affairs of the Company as it may reasonably require.

8.2 Any information provided to the shareholder under section 8.1 above will take into account any BSC11 related contractual confidentiality provisions and those set out in the CFDs and Investment Contracts.

9. FINANCIAL REPORTING REQUIREMENTS

9.1 The Company will provide DECC and/or HM Treasury with monthly notice (forecast) of its cash requirements as requested by the Shareholder.

9.2 The Company will provide reports of annual CFD expenditure and will participate in the relevant DECC forum as required.

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11 Balancing and Settlement Code
9.3 The Company will provide projected CFD expenditure, and other, projections as required for DECC and other parts of Government.
E. FINANCIAL RESPONSIBILITIES

10. DELEGATED FINANCIAL AUTHORITY

Delegated financial authorities will be agreed between the Shareholder and the Company.

11. LOW CARBON CONTRACTS COMPANY BUSINESS PLAN

The Company Board will prepare and maintain a three year Business Plan (setting out the operational delivery plan including capital costs) to be updated annually and agreed with the Shareholder. The first such plan will be submitted in 2015 to support the 2016/17 operational budget.

12. LOW CARBON CONTRACTS COMPANY OPERATIONAL BUDGET

12.1 The Company Board will prepare and maintain an operational budget (the "Budget") which is appropriate to ensure the fulfilment by the Company of its purpose as described in Section 2 (Low Carbon Contracts Company Purpose), and compliance with its associated obligations, as described in this Framework Document.

12.2 Every year the Company will submit to the Shareholder its proposed annual operational budget (relating to its next financial year set out in the context of the most recent Business Plan (as defined in section 11 (Low Carbon Contracts Company Business Plan)) in order to ensure DECC can comply with its obligation to consult on the operating costs of the Company and amend the levy rate in regulations. This must be provided in an agreed format with sufficient time and information to enable the Shareholder to approve it prior to consultation on the operational cost levy rate.

12.3 The Shareholder will have regard to the responses from the consultation before final approval of the budget. The Company and DECC shall make best efforts to carry out their respective responsibilities to ensure that the consultation and fixing of the operational cost levy rate in regulations is completed in sufficient time to ensure that Company is able to raise the levy at the times anticipated in order to meet its operating costs. This would also apply to any in year adjustment to the budget.

12.4 Any in-year adjustment to the budget will follow the process set out in section 12.2 and 12.3 above.

12.5 Notwithstanding section 12.2 and 12.3 above, the Company’s Accounting Officer is accountable for ensuring that the Budget is prepared and spent in accordance with Managing Public Money as appropriate in accordance with section 3.1 (E) of this document (Low Carbon Contracts Company Operational Parameters). The Principle Accounting Officer of DECC has designated the Chief Executive as the Low Carbon Contracts Company’s Accounting Officer. The Principle Accounting
Officer is responsible for ensuring that arrangements are in place to monitor and maintain effective oversight of the Company.

13. REQUIREMENTS FOR DECC BUDGETING: AME AND CAPEX

13.1 The Company shall provide estimates of the fair value of CFDs in accordance with the methodology set out elsewhere.

13.2 The capital budget for the year ahead and a provisional baseline will be negotiated and agreed annually in accordance with DECC’s business planning process. The capital budget will be set for the 12 months ending 31 March each year. The capital budget will be funded by DECC each financial year and if required will be repaid to DECC in subsequent years through depreciation charged in the operational cost levy.

14. MANAGEMENT OF OPERATIONAL COSTS AND CAPITAL EXPENDITURE

DECC will provide the Company with a working capital loan facility to support the Company in managing its operational costs and Grants in Aid to finance the agreed capital expenditure, the terms of which are set out in a separate letter between DECC and the Company.

15. ANNUAL ACCOUNTS AND AUDIT

Annual Report and Accounts

15.1 The Company must produce an annual report of its activities together with its audited accounts after the end of each year in accordance with the provisions of the Corporate Governance Code. The Company annual report and accounts should be made available on the Company’s website.

15.2 The Company shall provide DECC with audited financial information and supporting narratives by specified dates each year in order for DECC to prepare its consolidated annual report and accounts.

Internal Audit

15.3 The Company will establish an appropriate internal audit function which will report to the Company Board’s Audit and Risk Committee, and provide to the Shareholder all material reports and findings subject to BSC related contractual confidentiality provisions and those set out in the CFDs and Investment Contracts.

External Audit

15.4 The Company will:

(A) appoint suitably qualified auditors to audit its financial statements with regard to the recommendations of the Audit and Risk Committee. It is DECC’s strong presumption that this will be the NAO.
(B) produce its accounts in accordance with statutory requirements, apply the requirements of the Companies Act and IFRS\(^\text{12}\);

(C) provide DECC Finance team when requested with such information as is necessary for DECC to produce its own accounts.

\(^{12}\) International Financial Reporting Standards
F. MISCELLANEOUS

16. CONTINUATION OF THE COMPANY

16.1 Subject to section 16.2 below, the Company will continue in existence and for so long as it is required to carry out the Company’s purpose as set out in section 2 (Low Carbon Contracts Company Purpose).

16.2 It is envisaged that the Company will be wound up upon:

(A) completion of the Company’s purpose or remit as set out in section 2 (Low Carbon Contracts Company Purpose), or

(B) withdrawal by the Secretary of State of the designation of the Company as CFD Counterparty in accordance with EA Legislation.

16.3 DECC shall put in place arrangements to ensure the orderly winding up of the Company.13

17. PUBLICATION

17.1 Copies of this Framework Document, and any amendment to it, will be placed in the libraries of the Houses of Parliament and can be obtained from the Company at Fleetbank House, 2-6 Salisbury Square, London, EC4Y 8JX. The Company shall also make this Framework Document (and any amendments to it) available on its website.

18. STATUS AND REVISION OF FRAMEWORK DOCUMENT

18.1 Subject to section 18.2 below, any amendment, update or replacement of any provision of this Framework Document shall be effected by the Shareholder giving notice in writing to the Company Board.

18.2 If the Shareholder proposes to amend, update or replace any element of the Framework Document, it shall consult, and seek to reach agreement with, the Company Board before effecting the relevant amendment, update or replacement.

18.3 This Framework Document should be interpreted in light of the Articles, EA Legislation and English company law and is without prejudice to the statutory and other rights and obligations of the Shareholder or the Company.

13 See Managing Public Money Annex 7.2
19. REVIEW OF THE COMPANY

19.1 The Shareholder expects to conduct a review of the Company as part of an evaluation of EMR within three years.

19.2 The Shareholder shall review the location of the Company within the first 3 years to decide whether to relocate the Company within 5 years of operation.

Signed by authority of the Secretary of State for Energy and Climate Change

\[\text{Signature}\]

Dated: 1/8/2014

Signed by authority of the Low Carbon Contracts Company

\[\text{Signature}\]

Dated: 1/8/2014
ANNEX

MATTERS REQUIRING SHAREHOLDER CONSENT

1. Whilst the Company has day-to-day operational independence as described in section 5 (Operational Independence and Shareholder Consent Matters) of this Framework Document, the Company may make certain decisions only once it has received the prior written consent of the Shareholder (the "Shareholder Consent Matters").

2. The Shareholder Consent Matters are:

   I. The consent to any proposal by a generator to make a material amendment to a CFD/Investment Contract or the making or pursuit of any proposal to effect a material amendment to a CFD/Investment Contract. For this purpose, a material amendment means:

   a. any amendment to a CFD or Investment Contract which the Company is proposing or required to enter into pursuant to the EA Legislation or which has already been entered into by the Company and which would affect the overall intention of the balance of risks, benefits and liabilities, (any waiver (express or implied, absolute or conditional) provided by the LCC Co shall not constitute an amendment for these purposes) provided for in a CFD or Investment Contract, irrespective of whether or not such amendment is being effected. (i) (a) on a bilateral basis with a single generator or in respect of a single CFD or Investment Contract, or (b) with multiple generators or in respect of more than one CFD/Investment Contract, or (ii) in accordance with the change control procedure provided for in the standard terms and conditions for CFDs/Investment Contracts published by the Secretary of State pursuant to the EA Legislation, and

   b. any amendment to an Investment Contract proposed or made in response to the European Commission issuing a decision that any State Aid arising from the Investment Contract is compatible with the internal market subject to compliance with specified conditions or obligations.

   II. The following commitments with financial or policy impacts for DECC:

   a. any action which is not contemplated or permitted by this Framework Document or which is contrary to the Guiding Principle;

   b. any action which will give rise to obligations or liabilities (including contingent liabilities) which are not in the normal course of the Company’s business or which are not expected to be affordable in terms of expected levy income (present or future);

   c. any action which, notwithstanding the levy arrangements, will or is likely to give rise to an additional funding requirement from DECC (including loans for capital expenditure) or other additional financial support being required from, or liabilities or obligations being assumed by DECC (including in the form of an indemnity).
III  Management of Operations:

a. the approval of or any increase in the Company's Budget in accordance with section 12 (Low Carbon Contracts Company Operational Budget);

b. the approval of financial assistance, subject to section 14 (Management of Operational Costs and Capital Expenditure), which provides for the Company to incur operating costs that are greater than the levy income expected to be received in the same financial year;

c. the approval of or material deviation from, or any revised version of the Company's Business Plan as defined in section 11 (Low Carbon Contracts Company Business Plan);

d. the approval of any board appointments and related remuneration arrangements in accordance with the Framework Document;

e. the approval of any change to the location of the Company;

f. the approval of any change to the name of the Company;

g. the approval of the borrowing of funds from any organisation other than DECC or HM Treasury;

h. the approval of the establishment of subsidiary companies and the acquiring of any other business/company;

i. the approval of the depositing of funds in accounts other than within the Government banking service;

j. the approval of investments not through deposits in interest bearing accounts provided through the Government Banking Service;

k. the approval of the appointment of any auditors as described in section 15.4 (External Audit);

l. the approval of any exceptions to Managing Public Money as referred to in section 3.1(E) (Low Carbon Contracts Company Operational Parameters) or otherwise agreed by HM Treasury.