

Issue 76 'Using the BSC to support Suppliers and the Capacity Market Arrangements'



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Contents

1	Summary	2
2	Background	3
3	Issue Group's Discussions	5
4	Conclusions	10
	Appendix 1: Issue Group Membership	12
	Appendix 2: Glossary & References	14

About This Document

This document is the Issue 76 Group's Report to the Balancing and Settlement Code (BSC) Panel. ELEXON will table this report at the Panel's meeting on 14 February 2019.

There are three parts to this document:

- This is the main document. It provides details of the Issue Group's discussions and proposed solutions to the highlighted Issue, and contains details of the Workgroup's membership.
- Attachment A contains the Issue 76 Proposal Form.
- Attachment B contains an overview of the conclusions of the Issue 76 Workgroup.

287/07

Issue 76
Issue Report

7 February 2019

Version 1.0

Page 1 of 14

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Background

On 15 November 2018 the General Court of the Court of Justice of the European Union annulled the European Commission's (EC) State aid approval for the Great British (GB) Capacity Market (CM). Consequently, the Department for Business, Energy and Industrial Strategy (BEIS) instructed the Electricity Settlement Company (ESC) to stop collecting Supplier charges and making capacity payments to capacity providers.

The UK Government has since confirmed that it intends to work with the EC to reinstate the CM. It has advised capacity providers that they should continue to fulfil their CM obligations during this period.

If, when the standstill is lifted, back payments are authorised, and collections have not been made during the standstill period, then Suppliers will be faced with a substantial bill at that time, and may not have the means to pay it.

[Issue 76](#) was raised by VPI Immingham LLP on 6 December 2018 to consider how the BSC could be used to provide stability and certainty to Market Participants during the CM standstill.

Conclusions

The Workgroup agreed that a BSC Modification should be raised to take forward its recommendations. [P378 'Introduction of a CM Supplier Interim Charge'](#) was subsequently raised by VPI Immingham LLP on 20 December 2018.

The Issue 76 Workgroup concluded that the Modification should mirror the payments Suppliers would have expected to make under the CM, but that credit cover and mutualisation shouldn't be included, in order to keep the solution simple and quick to implement.

The Workgroup preferred an open ended solution as it was unsure how long any appeals process may take and thought that the solution should cover for this period. However the P378 Proposer preferred a time limited approach, as this would emphasise the temporary nature of the solution.

The Workgroup noted that some months' payments were already missing, and concluded that these should be recovered by smearing the amounts across subsequent invoices.

The Workgroup concluded that the funds should either be transferred to ESC if it invoices for payments during the standstill, or returned to Suppliers if there is no change of these payments being required.

The Workgroup concluded that ELEXON should hold the funds, and it should publically report on a monthly basis details of funds invoiced and collected.



CM Standstill

On 15 November 2018 the General Court of the Court of Justice of the European Union found in favour of Tempus Energy, against the EC, annulling the Commission's State Aid approval for the GB CM. All CM cost recovery by Suppliers and payments to capacity providers have been suspended with all credit cover available to be returned.

The UK Government confirmed that it intends to work with the EC to reinstate the CM, believing that it is the most cost effective way of ensuring security of supply in the GB energy market. It has advised capacity providers that they should continue to fulfil their CM obligations during this period.

BEIS communicated to the market that it will look to secure agreement from the Commission that the currently suspended CM payments will be paid to capacity providers, and thus the Suppliers will be asked to fund those payments. It is unclear when such payments will be made, and the potential timing and size of the bill to Suppliers, which ultimately is passed through to consumers. However, it could be substantial as the value of the 2018/19 CM delivery year is circa £1 billion.

BEIS has recommended that obliged parties continue to discharge their obligations during the standstill period. As this is the BEIS minded to position, the Proposer believes that it is prudent that Suppliers also continue to collect CM payments from consumers. However, as ESC is under instruction from BEIS not to collect CM payments from Suppliers, Suppliers currently appear to have no robust legal basis for collecting money from consumers. This impacts Suppliers' ability to plan for future liabilities if back payments are authorised.

Furthermore, ESC has advised Suppliers that they can request the return of the funds already paid to the ESC in respect of the CM in both October and November 2018. The value of the missing payments will escalate further as each month passes. The Proposer therefore believes it is for the industry itself to undertake contingency planning for the orderly reinstatement of the CM. This will help to protect the CM parties and their customers from a potential price shock at some point in the future.

Justification for raising

While the legislative framework around the CM stands alone from the BSC, the Suppliers charged with collecting CM payments from consumers are all BSC signatories and it is BSC Metered data which is used to calculate CM payments. The BSC therefore offers a means of allowing for pragmatic contingency planning, without replicating the CM arrangements.

The Proposer does not believe that all Suppliers will continue to collect CM payments from consumers when they are not being billed by ESC, and is concerned that not all will be accruing charges they collected. There is therefore a substantial risk to all consumers, Suppliers, capacity providers and all BSC Parties that reinstatement of the CM creates a default risk due to Suppliers being faced with substantial CM payments. A future large CM payment will put further Suppliers at risk of failure with the consequential negative impact upon consumers, unless sensible planning is achieved.

Suppliers going out of business will have implications across the market place, for example:

- Renewable generators with Power Purchase Agreements (PPAs) will be concerned about Supplier defaults;

What is the Capacity Market?

The [Capacity Market](#) is designed to ensure sufficient reliable capacity is available by providing payments to encourage investment in new capacity or for existing capacity to remain open. The CM is given effect through secondary legislation and is operated by the Electricity Settlements Company. Monthly payments for the provision of capacity are made to capacity providers in line with their Capacity Agreements. Monthly payments are received from Suppliers based on forecast demands, which is reconciled once actual data is available.

287/07

Issue 76
Issue Report

7 February 2019

Version 1.0

Page 3 of 14

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- Electricity System Operator (ESO) security of supply concerns will increase if Generators or Demand Side Response (DSR) providers cannot fund their activities for the longer term;
- Consumers may be faced with substantial bills at a later point in time due to the smearing of additional costs; and
- Knock on impacts to central industry bodies both in regards to their funding, along with potential operational impacts.

All of these issues have an impact on BSC Parties and the efficient operation of the BSC. We therefore believe that the BSC is an appropriate vehicle to help manage this market wide risk.

Issue Group considerations

[Issue 76](#) was raised by VPI Immingham on 6 December 2018.

The Workgroup was asked to consider what solution would best protect Suppliers (and their customers) from future 'price shocks' if collections for payments that would fall due during the standstill period are authorised. This was compared against the simplicity of any solution to make it quick and cost effective to implement.

Further details of questions the Workgroup were asked to consider are given in Appendix 1.

287/07

Issue 76
Issue Report

7 February 2019

Version 1.0

Page 4 of 14

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3 Issue Group's Discussions

The Issue 76 Workgroup met on [17 December 2018](#). The discussions of the Workgroup are summarised below.

Collection period

The Workgroup discussed whether any prospective Modification would collect funds within future invoices in respect of months from October 2018, or whether it would just be forward looking. The group noted the advice from BEIS that it intended for payments to be collected retrospectively and was seeking ways this could be achieved. The Workgroup noted that CM providers were expected to continue fulfilling their obligations and so would expect to be fully reimbursed.

The Workgroup noted that payments for October and November 2018 had been collected by ESC, but that these were available to be returned to Suppliers upon request. The Workgroup considered whether any BSC solution should include invoices for these months to create a fund equivalent to the annual CM payments.

The Workgroup noted that Suppliers wanted certainty so that they could collect money from their customers to protect against a future price shock, but also noted that legal considerations needed to be clear.

The Workgroup questioned whether a solution would be consistent with Ofgem's price cap. Ofgem responded that it would like certainty to ensure that its price cap is representative and noted that this was due to be reviewed in February 2019.

Legal advice

ELEXON sought legal advice from Dentons, and noted that this was a preliminary view intended to help guide the Workgroup discussions. Dentons advised that it saw no restrictions in the Transmission License that would prevent a BSC solution being implemented. It added that there were a number of factors that could influence the risk of a solution contravening State Aid laws. It believed that this risk would be lowered by having less involvement from the Secretary of State or Ofgem in administering or enforcing the scheme. The external lawyers also noted that the CM suspension related to payments being made to providers rather than the collection of money.

The Workgroup believed that the risk of being seen as State Aid would be lowered if the solution was presented as an industry insurance scheme against future liabilities rather than a replication of CM collections. A Workgroup member questioned whether such a scheme could distort competition, regardless of State Aid considerations. The Proposer believed that the scheme would protect competition by requiring Suppliers to continue making payments, thus removing the possibility that a Supplier could use the funds to gain a competitive advantage.

The Workgroup questioned whether a Modification would be legitimate as BSC Modifications are approved based on the Applicable BSC Objectives, noting that the CM is outside the BSC framework. The Proposer responded that they believed a Modification would better facilitate the Applicable BSC Objectives as it would ensure a level playing field is maintained throughout the standstill period, thus protecting competition. The Proposer also believed that collecting payments under the BSC would reduce the risk of a future

287/07

Issue 76
Issue Report

7 February 2019

Version 1.0

Page 5 of 14

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'price shock' thus reducing the risk of defaulting Parties in the future, which they believed would promote efficiency in the arrangements. For these reasons the Proposer believed that a Modification would better facilitate Applicable BSC Objectives (b), (c), (d), and (f).

The Workgroup noted that a Modification also requires a defect or issue, which the Workgroup considered could be to provide Suppliers with confidence that they will be protected from price spikes in the event that the CM suspension is lifted and in doing so, promote competition. ELEXON noted that while 'defect' implies a defect in the BSC, the term 'issue' has a wider meaning which encompasses the issue identified by Issue 76.

A Workgroup member expressed concern over replicating the CM regulations in the BSC, given the legal advice that this could be seen as contravening the State Aid ruling, and questioned whether the BSC had provisions for making payment at the end of the scheme (either to Suppliers or to the ESC). ELEXON saw no reason that it would be unable to make payments to ESC or Suppliers. The Workgroup considered that it would be cleaner to make the payment direct to ESC rather than returning the money to Suppliers for them to pay ESC. This would protect the paid money from being claimed by administrators or liquidators of Suppliers or used by Suppliers for other purposes.

The Workgroup wanted to protect against money being collected twice in the situation that the CM suspension was lifted and Suppliers were back billed by ESC for the money which had already been collected by ELEXON. ELEXON noted that this proposal was effectively for ELEXON to hold the money and release it at such a time as Suppliers were required to pay CM invoices for the same period, noting that payments to ESC wouldn't happen until the suspension was lifted.

A Workgroup member noted that it was payments to capacity providers that fell afoul of State Aid laws, but questioned whether collections under the BSC could be seen as a hypothecated levy, noting that the Transmission License allowed ELEXON to collect payments for the CM, which was suspended. The Workgroup considered that it would be pragmatic to present the solution as an industry lead planning scheme to help protect it against liabilities which it sees in the future.

The Workgroup agreed that in order to minimise the risk of being seen as State Aid, it was preferable to limit the involvement of BEIS, but questioned what an alternative trigger for releasing funds could be if not a direction from BEIS. An alternative would be to clearly define a trigger for funds to be transferred to ESC based on any decision by the EC to support the CM, with the money being returned to Suppliers in all other cases. Such a supportive decision of the EC would also need to be accompanied by a decision that payments in respect of the suspension period be made. A Workgroup member suggested that the ESC beginning to invoice Suppliers could be a trigger for releasing funds to ESC. The Workgroup agreed this could be a clear and appropriate trigger for releasing funds where CM payments are backdated. Further, the Workgroup agreed the money should be paid to the ESC under this scenario.

The Workgroup considered whether the payments would be considered a tax or not. One member commented that it was easier to pass through the cost to consumers if it was presented as a tax rather than a saving scheme, but that a saving scheme was less likely to be contested as State Aid. The Workgroup concluded that it was not for the BSC to prescribe how Suppliers account for the costs they incur.

How closely should the existing CM regulations be replicated?

The Workgroup considered potential BSC solutions that could be implemented and how closely these should mirror the current CM arrangements. The Workgroup noted that the forecast demand on which CM invoices are based was not done by the BSC, and so questioned whether a new flow would be required to provide this information to the BSC. The Workgroup concluded that a provision in the BSC should be included to provide consent by Suppliers to provide the calculated CM Supplier Charge levy amounts for each Supplier and month from ESC to BSCCo.

The Workgroup considered whether a simple solution could be implemented to start, with layers being subsequently phased in. ELEXON noted that this would be complicated and may require multiple Modifications and so was not advised on grounds of efficiency. The Proposer also commented that it did not intend to include reconciliation as part of the BSC solution as this would require new systems to be implemented, adding to the complexity.

A Workgroup member questioned what would happen with the credit cover currently lodged by Suppliers for their CM payments, noting that this burden shouldn't be duplicated in any cross over period. ELEXON responded that Credit Cover was still being held by ESC, but Suppliers could request to have it returned and so it believed there was little risk of this causing cash flow problems.

A Workgroup member questioned whether Supplier payments could be based on their Megawatt-hour (MWh) share as this information was already available to ELEXON and would simplify the solution. Another member commented that, while this would collect the total amount required, it would be differently apportioned and so would not fully protect against price shocks. The member commented that it was unlikely any solution would completely remove the risk of price shocks and that the solution was seeking to minimise these.

A Workgroup member commented that in order to be able to implement a quick solution to provide the confidence to industry and investors, the solution should be kept as simple as possible. They believed that mutualisation shouldn't form part of the solution and noted that if the CM suspension was lifted, ESC could reconcile payments and mutualise any shortfall, noting that this would likely result in a decreased price shock. Another member believed that credit cover was not required for the solution either. They commented that if a default process was robust and quick enough the solution could omit credit cover to alleviate cash flow concerns. It was suggested that the existing BSC Default provisions could be used for events of non-payment. The Workgroup noted concerns around Ofgem enforcement being too close to state involvement, but concluded that BSC Defaults was at the lower end of the risk spectrum of being seen as state involvement as it was an existing BSC process. The Workgroup noted that anecdotally, BSC remedies are seen as a strong incentive for compliance.

A Workgroup member questioned what would happen in the event that the CM suspension was upheld, commenting that if a Supplier had gone into liquidation, money paid by its customers would be unable to be returned. They questioned whether money paid should move with the consumer in the event of a Supplier of Last Resort (SoLR) event. ELEXON noted that this would complicate the solution and as the ESC was holding two months' of payments, a similar solution would be needed for this. A member commented that most Workgroup discussions were based on the assumption that the CM suspension would be lifted, but that it also needed to consider the event where the suspension was upheld. A member commented that the solution would be a pay off between protecting against a price shock if the CM suspension is lifted, and ensuring that money is correctly returned if

payments for the standstill period were not authorised. A Workgroup member commented that returning the money to customers was an Ofgem issue, as the issue sat under their vires and not the BSC.

The Workgroup considered escalation routes for non-payment. It commented that any enforcement methods would need to be backed by Ofgem in order to carry weight. The Workgroup considered that stronger enforcement methods were preferable to requiring credit cover to be lodged. The Workgroup suggested adding a new criterion to [Section H](#) for invoking default procedures, but noted that it would need to be clear and robust against loopholes. The Workgroup considered that a quick default process would mitigate against the risk to other Suppliers. It noted that if an urgent Panel meeting was required, then quoracy rules may need to be relaxed in this case.

Length of solution

The Workgroup considered how long any solution should endure for. One member believed that it should just last for one year, as under the suspension, the scheduled capacity auctions could not be held. They believed that a subsequent Modification could be raised to extend this if required. The Workgroup noted that if we were to use the existing payment schedule for billing, then this would need to be recalculated for any solution that endured beyond the current delivery year. ELEXON noted that while payments under the CM had been suspended, the other processes remained, so ESC should be able to produce new payment schedules for future delivery years. The Workgroup preferred using the payment schedule as opposed to some other calculation as it provides simplicity, certainty, and accuracy.

The Workgroup considered how uncollected months before a solution is implemented could be handled. One Workgroup member suggested smearing past months over future months to avoid the need for a lump invoice. The Workgroup noted that if the suspension was lifted before the end of the smear this would result in a shortfall, but considered that ESC could address this in its reconciliation. A Workgroup member suggested announcing a commencement date from which payments would accrue. They noted that this would need to be in the future when it was announced, but could be before implementation. They believed that this would warn industry that payments would include amounts for earlier months and so limit the possibility of Suppliers having cash flow issues. One Workgroup member suggested the first invoice should include amounts for months since 1 January 2019, and smearing any previous months' amounts over the rest of the year. The Workgroup expressed a preference for an enduring rather than time limited solution, feeling that this provided the greatest certainty to Suppliers.

Release of funds

The Workgroup considered what should initiate the release of funds collected under the BSC solution. If the suspension is lifted then this could be when ESC starts invoicing in respect of the same period, but there would need to be a clear trigger for releasing funds back to Suppliers if the suspension is upheld. The Workgroup agreed that if the suspension was lifted and 2018/19 payments required, ELEXON should transfer the funds it was holding to ESC with details of what Suppliers have paid in, so that ESC can reconcile these payments. The trigger for this would be ESC invoicing Suppliers for the equivalent months. A Workgroup member noted that any ESC invoices would need to be clear that the invoice is for CM payments covering the period for which the BSC was collecting funds.

A Workgroup member suggested that if the suspension were upheld, a Supplier should apply to the Panel for the funds to be released. Another member was unsure what benefit requiring Suppliers to take an active step added.

Accounting and governance

The Workgroup agreed to mirror the existing BSC accounting governance for any funds to be held under the solution. The Workgroup noted that under the CM regulations, funds were held in a non-interest bearing account. The Workgroup considered that the most suitable beneficiary of interest from funds accrued under the BSC solution would be ELEXON, as it would use this to defray its BSC costs, thus passing through the benefit to the whole of industry, and ultimately consumers. A Workgroup member questioned what cost would be associated with ELEXON running the scheme, and commented that the interest could be used to fund this. ELEXON responded that depending on the complexity of the solution, it did not believe that operating a solution would require a change to its budget.

The Workgroup considered where funds should be held. The Workgroup expressed a preference to keep it in an ELEXON account provided there were no legal issues with this. ELEXON has not received any legal advice that would suggest it could not hold the collected funds in this way.

Reporting

The Workgroup considered what reporting should be required to provide assurance to industry that the scheme was functioning as intended. The Workgroup considered ELEXON should publish the amount collected and the amount invoiced for on a monthly basis on the BSC Website.

Applicable BSC Objectives

Due to time constraints, the Issue 76 Workgroup was not asked to provide comments on the Proposer's views against the Applicable BSC Objectives. Although comments were not explicitly requested from the Workgroup, the Proposer's rationale was made available to Workgroup members and we received no comments. The Proposer's views against the Applicable BSC Objectives were:

- b) As CM providers are more likely to go on operating as usual this winter if they believe CM payments will be back dated in the future. Repayment is more likely to be in a timely manner if the CM payments have been collected over the intervening period. As such the Proposer believes this will be a positive impact.
- c) As competition in both generation and supply will be damaged if the CM is not reinstated in a timely and, importantly, orderly manner. Likewise a prudent Supplier will want to protect their customers from a price shock and plan for future payments, which we believe the BSC can facilitate via a future Modification. As such the Proposer believes this will be a positive impact.
- d) There is a risk that BSC Parties may have to pick up the work and costs associated with Supplier defaults in the event that the reinstatement of the CM, with associated bills, puts Suppliers out of business. As such the Proposer believes this will be a positive impact.

Recommendation

The Issue 76 Workgroup recommended that a Modification be raised to carry forward its discussions. It believed that this should be done quickly so that industry could be provided with certainty during the CM standstill. [P378 'Introduction of a CM Supplier Interim Charge'](#) was raised by VPI Immingham on 20 December 2018.

Recommended solution

The Issue Group recommended that the Modification includes the following features:

Collection of funds

- The amount collected under the P378 solution should be based on the existing CM forecast schedule. This would promote simplicity and reduce uncertainty for Suppliers.
- Credit cover should not be part of the solution. This would ease cash flow concerns for Suppliers.
- Mutualisation should not be included. This would ensure simplicity for the solution. The Issue Group noted that ESC would likely mutualise any shortfall once CM payments resumed.
- Existing BSC Default sanctions should be used for non-payment. This would ensure Suppliers pay their invoices.

Duration

- The solution should be open ended rather than time limited to the 2018/19 CM delivery year. The P378 Proposer preferred the time limited approach and noted that a Modification could be raised to extend the duration of any solution.
- The solution should consider a long stop date (e.g. September 2020) for returning funds to Suppliers if no other release trigger has been invoked.

Collection of historic/missing payments

- The solution should start collecting payments from 1 January 2019 in the first invoice following implementation of the Modification. This should be notified to industry in advance.
- Payments would be collected on a monthly basis.
- Payments covering the months of October to December 2018 would be smeared equally across the remaining invoices. This would help protect against a price shock upon implementation. The P378 solution smears the missing payments equally over the second and third invoice.

Trigger for releasing funds

- If ESC invoices for the relevant period, then collected funds would be transferred to ESC.
- If CM standstill is not lifted after all appeal routes are exhausted, then payments would be returned to Suppliers.
- If a long stop date is included in the solution, then this would also be a trigger for returning payments to Suppliers.

Account Management

- The funds should be held in an ELEXON bank account.
- The account governance used by ELEXON when handling other industry funds is adequate for the new fund.
- Any interest earned in the funds should be used by ELEXON to cover any costs it incurs delivering the solution and further used to defray BSC costs. The Issue Group considered that this would remove the need for complex calculations and would ultimately benefit all market participants.

Reporting

- ELEXON would publish details of the amount invoiced for and collected on a monthly basis.

Issue Group membership and attendance

Issue 76 Workgroup Attendance		
Name	Organisation	17 December 2018
Lawrence Jones	ELEXON (<i>Chair</i>)	✓
Matthew Woolliscroft	ELEXON (<i>Lead Analyst</i>)	✓
Nick Brown	ELEXON (<i>Lead Lawyer</i>)	✓
Peter Frampton	ELEXON (<i>Design Authority</i>)	✓
Matt Johnson	ELEXON (<i>EMRS</i>)	✓
Darren Draper	ELEXON (<i>EMRS</i>)	✓
Mark Bygraves	ELEXON (<i>CEO</i>)	✓
Iwan Hughes	VPI Immingham (<i>Proposer</i>)	✓
Bill Reed	RWE	✓
Chris Harris	Npower	✓
Chris Thackeray	Ofgem	✓
Colin Prestwich	Smartest	☎
Gareth Evans	Waters-Wye	✓
Josh Logan	Drax	✓
Keith Munday	Bryt Energy	☎
Konstantina Maniki	National Grid	✓
Lisa Waters	Waters-Wye	✓
Mark Bellman	SP Retail Energy	✓
Matt Dietz	Energy UK	☎
Natasha Ranatunga	EDF	✓
Paul Jones	Uniper	✓
Phil Broom	Engie	✓
Phil Russell	Self Employed	✓
Pooja Darbar	Ofgem	✓
Robert Smith	National Grid	✓
Ross Haigh	ESC	✓
Rowan Hazel	Cornwall Insight	✓
Ruth Herbert	ESC	✓
Saskia Barker	Flexitricity	☎
Scott Keen	Triton Power	✓
Terry Carr	E.ON	✓

287/07

Issue 76
Issue Report

7 February 2019

Version 1.0

Page 12 of 14

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Items for consideration by the Workgroup

The Issue Proposer asked the Workgroup to consider these areas.
CM elements to include
What period should the solution cover (assumed payments will be backdated to last payment month)?
What CM elements and payments should the solution include?
What Credit Cover elements should the solution include?
Should mutualisation be included?
Consider interest on funds held
CM elements to include
What payment default options should be included?
How can the solution be enforced?
What BSC sanctions should apply for non-payment?
Legal considerations
Whether a prospective BSC solution risked being contrary to state aid rules
Whether there were any steps we could take in designing a solution that might lower that risk
Nature of account holding funds
Escrow, on trust, 'normal'
Release of funds
On lifting of suspension:
What will be the trigger for releasing funds?
Should these be released to the ESC or Suppliers?
On upholding of suspension:
What will be the trigger for releasing funds?
Should these be released to Suppliers?
What if not one of the above?
Longstop date
Reporting and monitoring
What reporting should be made public?
What other reporting and monitoring should be required?
Other
ELEXON costs
Price cap

287/07

Issue 76
Issue Report

7 February 2019

Version 1.0

Page 13 of 14

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Appendix 2: Glossary & References

Acronyms

Acronyms used in this document are listed in the table below.

Acronyms	
Acronym	Definition
BEIS	Department for Business, Energy and Industrial Strategy
BSC	Balancing and Settlement Code
BSCCo	Balancing and Settlement Code Company (ELEXON)
CM	Capacity Market
DSR	Demand Side Response
EC	European Commission
ESC	Electricity Settlements Company
ESO	Electricity System Operator
GB	Great Britain
MWh	Megawatthour
PPA	Power Purchase Agreement
SoLR	Supplier of Last Resort

External links

A summary of all hyperlinks used in this document are listed in the table below.

All external documents and URL links listed are correct as of the date of this document.

External Links		
Page(s)	Description	URL
2, 10	P378 page of the BSC Website	https://www.elexon.co.uk/mod-proposal/p378
2, 4	Issue 76 page of the BSC Website	https://www.elexon.co.uk/smg-issue/issue-76/
3	Capacity Market page of the EMRS Website	https://www.emrsettlement.co.uk/about-emr/capacity-market/
5	Issue 76 meeting page of the BSC Website	https://www.elexon.co.uk/meeting/issue-76/
8	BSC Section H	https://www.elexon.co.uk/the-bsc/bsc-section-h-general/

287/07

Issue 76
Issue Report

7 February 2019

Version 1.0

Page 14 of 14

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