

Issue 76

Using the BSC to support Suppliers
and the Capacity Market
Arrangements

17 December 2018

ELEXON

Health & Safety

In case of an emergency

An alarm will sound to alert you. The alarm is tested for fifteen seconds every Wednesday at 9.20am

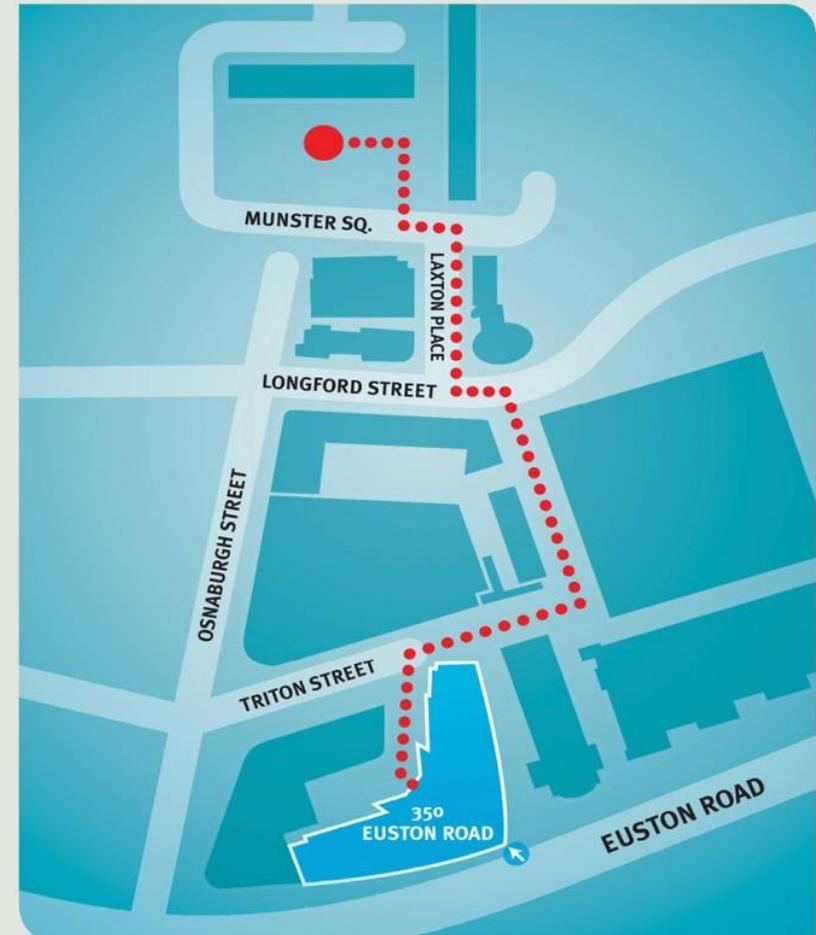
Evacuating 350 Euston Road

- If you discover a fire, operate one of the fire alarms next to the four emergency exits.
- Please do not tackle a fire yourself.
- If you hear the alarm, please leave the building immediately.
- Evacuate by the nearest signposted fire exit and walk to the assembly point.
- Please remain with a member of ELEXON staff and await further instructions from a Fire Warden.
- For visitors unable to use stairs, a Fire Warden will guide you to a refuge point and let the fire brigade know where you are.

When evacuating please remember

- Do not use the lifts.
- Do not re-enter the building until the all clear has been given by the Fire Warden or ground floor security.

Our team on reception is here to help you, if you have any questions, please do ask them.



Agenda

- Welcome and Introductions
- Background to Issue 76 and understanding the defect
- Legal considerations
- CM elements to include
- Escalation routes for non payment
- Nature of holding funds
- Release of funds
- Reporting
- Applicable BSC Objectives
- Other
- Next steps

Purpose and objectives

Purpose is to:

- Discuss the Issue, the areas to consider and agree the optimal solution that could be taken forward

Objectives are to:

- Agree the optimal solution
- Recommend whether a Modification should be progressed



BSC Issue Group 76

Using the BSC to support Suppliers and the Capacity Market Arrangements

BSC Issue Group 76

Using the BSC to support Suppliers and the Capacity Market Arrangements

- One month since ECJ ruling which annulled 2014 GB Capacity Market State aid decision
 - Continued uncertainty for Capacity Market providers, Suppliers and **end consumers (!)**
 - Issue Group 76 set up to develop an industry led solution as an alternative to collecting CM payments via ESC
 - Objective to minimise impact on Supplier business models, reduce risk of “payment shock” for end consumers, increase certainty for Capacity Market agreement holders.
 - Issue Group to act as a precursor to any subsequent BSC urgent modification
- BEIS reiterated its commitment to GB Capacity Market
 - BEIS confirmed a positive outcome results in existing agreements being paid
 - Focused on securing T-1 2019/20 capacity via a summer 2019 auction
 - National Grid reviewing impact on capacity margins for next winter
 - VPI supports BEIS approach
 - Strongly against SBR2 or any additional ESO market intervention in 2019/20
- BEIS reviewing whether Capacity Market Supplier Levy can be reinstated (announcement before Xmas?)
 - Ofgem position that consumers should not be charged – also reviewing implications for next price cap period (increase/decrease?)
 - BEIS taking legal guidance around compatibility of ESC collection process without State aid
 - Perceived risk around Supplier business models and shocks to end consumers
- 2018/19 Capacity Market providers not received payments from the 1st October 2018
 - Significant damage to investor confidence – on top of general impression there is lack of understanding around combined impact of all policy and regulatory outcomes
 - Risk to business models and ongoing operations – unplanned cash-flow reductions, likely breaches of debt covenants, possible credit metrics downgrades, reduced availability/ increase in cost of debt
 - Unknown financial cost of interim measures - as well time required to rebuild balance sheets



BSC Issue Group 76

Justification

- BEIS has signalled to Capacity Market providers and Suppliers that a positive outcome will result in back payments for existing agreements
- The longer payments are suspended, the greater risk to financials of Capacity Market providers
- The longer payments are not collected the greater uncertainty around Supplier business models and future energy costs for end consumers

BSC objectives

- (a) the efficient discharge by the Transmission Company of its Transmission Licence obligations;
 - Supports Transmission system security standard and quality of service specifically 1(b) co-ordinate and direct the flow of electricity onto and over the NETS in accordance with the SQSS (Condition C17)
- (b) the efficient, economic and co-ordinated operation of the GB Transmission System;
 - *Reinstatement of the Supplier Levy will give Capacity Market agreement holders more confidence to operate business as usual – as well as greater certainty around the timing of reimbursement if State aid is approved*
- (c) promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting competition in the sale and purchase of electricity;
 - *A timely and orderly reintroduction of the Capacity Market is critical to ensure any damage to generation and supply is minimised. There is a substantial risk to both Supplier and generation/ capacity business models – as well as to end consumers*
- (d) promoting efficiency in the implementation and administration of the balancing and settlement arrangements;
 - *Relevant if the BSC has to pick costs associated with defaults in the event that the reintroduction of the CM puts some Suppliers out of business*
- (e) compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency [for the co-operation of Energy Regulators]; and
 - *Commission/ BEIS have stated that the successful Tempus State aid legal challenge was based on process*
- (f) implementing and administering the arrangements for the operation of contracts for difference and arrangements that facilitate the operation of a capacity market pursuant to EMR legislation.
 - *A BSC approach would help preserve the GB Capacity Market during the standstill period*





Legal Considerations

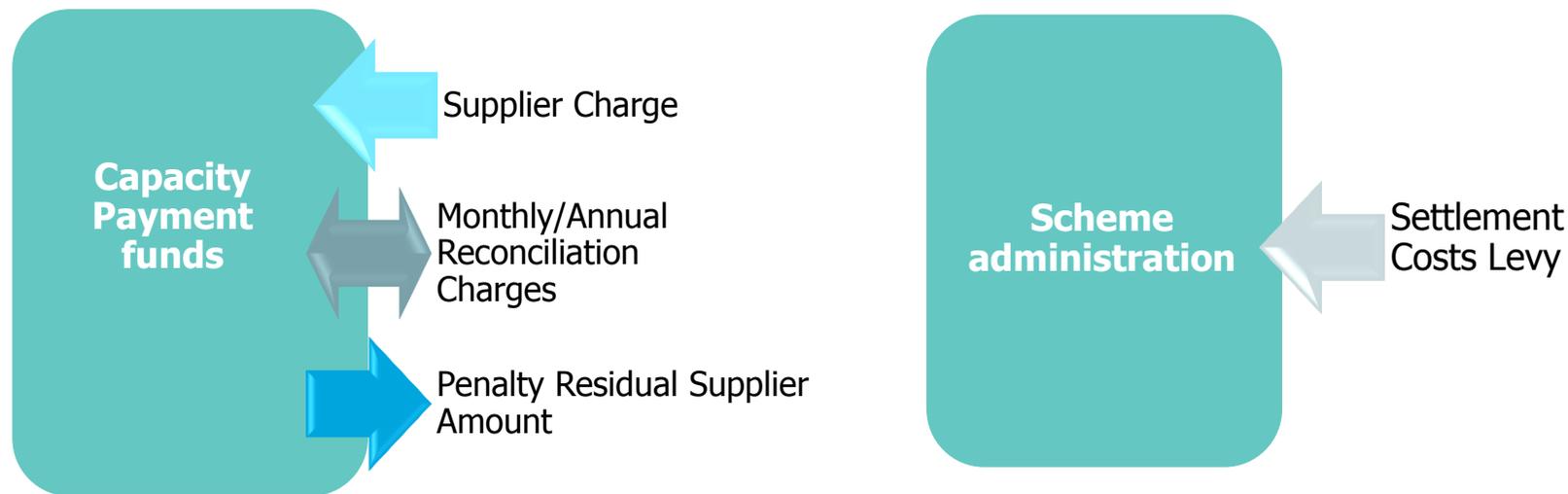
Legal Considerations

- ELEXON has procured external legal advice from Dentons on state aid rules, specifically:
 - 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
- Advice is expected prior to Issue Group 76 meeting on 17 December and will be presented at that meeting
- ELEXON is also taking legal advice on whether the Transmission Licence would allow the BSC to include arrangements for the collection of payments from Suppliers as an interim member pending the outcome of the Commission's further investigation into the Capacity Market



CM elements to include

How CM is currently funded by Suppliers



- Capacity Payment funds are protected by Credit Cover and Mutualisation
- Supplier Charges & Credit Cover held in non interest bearing ESC/government account
- Capacity Payment funds are initially invoiced via a billing schedule issued to Suppliers. The schedules are calculated using forecasted winter demand volumes provided by each Supplier
- November and December 2018 CM funds have been invoiced and collected by ESC
- Now we will explore some options to determine the appropriate balance of simplicity, CM funding robustness and implementation requirements to address the issue raised

Option 1 (easiest)

Manual invoice to current schedule of invoicing

What we would do:

- Set up an invoice template to manually populate based on current schedule

Risks:

- Scheme may not be fully funded in the event of non-payment by one party
- Final Supplier cost would be based on forecast data provided mid 2018 and not the actual position

Option 2 (second easiest)

Credit cover collected at 110% as per CM regs

Manual invoice to current schedule of invoicing

What we would do:

- Manual invoice to current schedule of invoicing
- Manual credit cover monitoring

Risks:

- Scheme may not be fully funded in the event of non payment by one party - *possibly lowered by credit cover - minimal risk reduction*
- Final Supplier cost would be based on forecast and not the actual position
- Credit cover not that effective without mutualisation - more like a one month "payment on account"

Option 3 (becoming complicated)

Manual invoice to current schedule of invoicing

Credit cover collected at 110% as per CM regs

Mutualise when insufficient credit cover lodged/non payment of charges

What we would do:

Manual invoice to current schedule of invoicing

Manual credit cover monitoring

Manual mutualisation based on current schedule of invoicing

Risks:

- ~~— Scheme may not be fully funded in the event of non payment by one party - *removed due to mutualisation*~~
- Final Supplier cost would be based on forecast and not the actual position
- Mutualisation difficult to operate manually especially when compounds or needs to be reversed (in total or partial)

Option 4 (more complicated)

Manual invoice to current schedule of invoicing

Credit cover collected at 110% as per CM regs

Mutualise when insufficient credit cover lodged

Reconcile charges when winter period completes

What we would do:

Manual invoice to current schedule of invoicing

Manual credit cover monitoring

Manual mutualisation based on current schedule of invoicing

When winter completes manually recalculate market share and adjust charges

Risks:

~~Scheme may not be fully funded in the event of non payment by one party - removed due to mutualisation~~

~~Final Supplier cost would be based on forecast and not the actual position - removed due to reconciliation~~

- Mutualisation difficult to operate manually when compounds or needs to be reversed (in total or partial)
- Reconciliation is very difficult to perform manually - risk of human error and mutualisation impacts

Option 5 (could the EMR systems being used?)

An automated solution using ICE (the current Invoicing & Calculation Engine as used by EMRS) – AS IS

What we would do:

- Split SCL and Supplier Charge invoices in ICE - development work (file uploads)
- SCL invoicing sent out as ESC
- "Copy & paste" Supplier Charge invoice into ELEXON format - shadow invoicing
- Administer all in EMR systems, payments & collections will be fed into ICE from ELEXON system.
- ESC Direct Debit can be used for SCL invoices
- Supplier Charge paid to ELEXON bank account - no direct debit set up
- ELEXON Charges would need recording in ICE - development work (file upload)
- ICE would reflect the correct combined position of both ESC and ELEXON bank accounts
- Smooth transfer at a later date

Risks:

- Long implementation timescales
- Increased development costs and testing time.

Option 6

Alternative Option 3

What we would do:

- As per option 3 with the following deviations;
 - a. Simple mutualisation (on Credit Cover), i.e. no demutualisation (repayment of mutualised funds)
- or
- b. Mutualise on non-payment only - say after 10 working days? - this removes the need for credit cover and reduces the likelihood of demutualisation

Option recommendation

- **Option 6.b:**
- **Perform manual invoicing, no credit cover requirements, and mutualisation based on non payment only**

Reasoning

- Shorter implementation timescales
- Simpler operation
- Reduced cashflow burden on Suppliers
- Scheme remains fully funded
- Revised market share would be calculated post State Aid approval

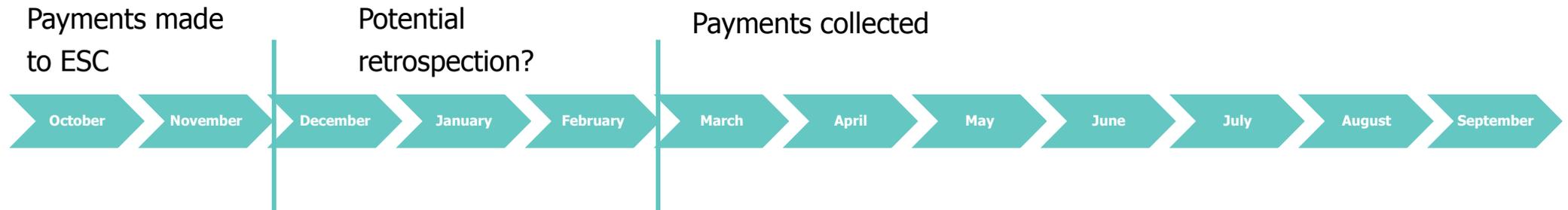
This option offers the best balance of a quick set up , simple operation and ensures that the CM scheme remains fully funded.

Options Matrix

Below is a recap of the various options and the processes included

Task	Option 1	Option 2	Option 3	Option 4	Option 5	Option 6a	Option 6b
Manual invoicing	*	*	*	*		*	*
Credit Cover		*	*	*	*		
Full Mutualisation			*	*	*		
Part Mutualisation						*	*
Reconciliation				*	*		
Automated Solution					*		

Payment timeline



- October and November payments have been made
 - If paid back to suppliers, should they be re-paid to BSC solution?
- December & January (perhaps February) payments could be collected retrospectively
 - Lump sum in March payment, or;
 - Additional payment over rest of term
 - Scheme would be under-funded if ends early
- Payment schedule ends 01 September – extension requires further Modification



Escalation routes for non payment

Escalation Routes for non-payment (1 of 2)

- Options for enforcement of non-payment:
 - Mirror capacity market arrangements:
 - BSCCo to have authority to publically name non-payers
 - Ultimate enforcement by Ofgem (on the basis that compliance with the BSC is a licence condition)
 - Utilise BSC Section H Default:
 - Defaults arise from non-payment of charges or if credit cover is insufficient to cover potential liabilities
 - Escalation steps determined by the BSC Panel
 - Panel's options for BSC defaults include:
 - expulsion from BSC, subject to Ofgem consent
 - suspension of right to submit ECVNs and MVRNs (prevents a Party from trading)

Escalation Routes for non-payment (2 of 2)

- cancellation of existing ECVNs and MVRNs (prevents a Party from trading)
 - suspension of right to register Metering Systems and BM Units, subject to Ofgem consent (prevents a Party from taking on new customers)
 - suspension of right to submit bids and offers, subject to system operator consent (prevents a party from taking part in the balancing mechanism)
 - suspension of right to receive BSC payments
 - suspension of right to receive reports and data
 - suspension of right to vote in Panel elections
 - name and shame
- ELEXON also has the right to pursue non-payments through the courts, subject to Panel consent

Escalation Routes for non-payment

Questions for Issue Group:

- Should payment default cover only non-payment of supplier CM charges?
- Should (i) non-payment of credit and (ii) shortfall in levels of credit (if these form part of the solution) be a default?
- Should escalation steps mirror current capacity market or adopt BSC default (noting that the latter could involve Suppliers incurring some quite severe penalties under the balancing and settlement arrangements for a breach that has no impact on BSC settlement)?
- What payment default options should be included?
- How can the solution be enforced?
- What BSC sanctions should apply for non-payment?



Nature of account holding funds

Nature of account holding funds

- Issue Group to discuss most appropriate legal framework in which ELEXON could hold the funds
 - Escrow / on trust / 'normal'
- External legal advice is pending on this and will be available for the Issue Group meeting on 17 December
- Governance and controls
 - Existing BSC controls explained. Sufficient?



Release of funds

Trigger for Release needs to be clear, unambiguous

The potential scenarios for a release of funds from ELEXON are:

- a) The Capacity Market suspension is lifted
- b) The Capacity Market suspension is upheld
- c) The Capacity Market suspension lifted subject to other conditions being fulfilled

- The potential triggers for release of funds from ELEXON are:
 - One of the above – caution over precise definition; or
 - Clear direction by BEIS/ESC to release
 - Long stop date (release funds to Suppliers)

The options for funds transfer to ESC would be:

- Issue credit notes to all Suppliers and repay monies back, ESC invoice Suppliers, Suppliers pay ESC – higher risk as there is no guarantee that the Suppliers will actually pay once the money is returned to them
- Issue credit notes to all Suppliers, pay monies to ESC, ESC invoice Suppliers but offset using funds received from ELEXON – Optimal, reduces administrative burden on Suppliers whilst guaranteeing the money is passed to ESC

The options for funds transfer to Suppliers would be:

- Issue credit notes to Suppliers and repay all funds within 10WDs from decision date
- Issue credit notes to Suppliers and repay all funds within 10WDs of a direction from BEIS/Secretary of State, or within 10 WDs of the end of the delivery year
- Issue credit notes to Suppliers and repay all funds within 10WDs of a request from the Supplier after a decision

Mechanism for payment of fund – recommendation

Payment to ESC

- Issue credit notes to all Suppliers, pay monies to ESC, ESC invoice Suppliers but offset using funds received from ELEXON

Payment to Suppliers

- Issue credit notes to Suppliers and repay all funds within 10WDs of a direction from BEIS/Secretary of State, or within 10 WDs of the end of the delivery year

Payment Processing

Release of Funds

- Access to banking systems controlled by smart cards for select users
- Payment release will be subject to strict internal controls
- Due to the expected value of charges, all payments will be made via CHAPS payment and subject to the following controls
- Payment requests will be digitally signed off before input into banking system, checking all bank account details, match information provided
- A minimum of 3 to create/approve all payments, 1 inputter, 2 authorisers. Segregation of duties means you cannot input & authorise, this is controlled within the Barclays banking system. Authorisers will be checking payment request matches entered details

Collection of Funds

- BACS/CHAPS by Suppliers, Direct Debit is unavailable



Reporting

Reporting requirements

What reporting should be made public?

- How much we have collected in total?
- Compare this with how much we have invoiced for? This includes invoices to failed Suppliers
- Where should this be reported?
- What other reporting and monitoring should be required?



Applicable BSC Objectives

Proposer's views on Applicable BSC Objectives

Impact of the Modification on the Relevant Objectives:

Relevant Objective	Identified impact
(a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence	<i>Neutral</i>
(b) The efficient, economic and co-ordinated operation of the National Electricity Transmission System	<i>Positive</i>
(c) Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity	<i>Positive</i>
(d) Promoting efficiency in the implementation of the balancing and settlement arrangements	<i>Positive</i>
(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency [for the Co-operation of Energy Regulators]	<i>Neutral</i>
(f) Implementing and administering the arrangements for the operation of contracts for difference and arrangements that facilitate the operation of a capacity market pursuant to EMR legislation	<i>Neutral</i>
(g) Compliance with the Transmission Losses Principle	<i>Neutral</i>

Applicable Objectives rationale - discuss

Objective (b)

- CM providers are more likely to continue operating as usual over winter if they believe that CM payments will be backdated and funds are available for this

Objective (c)

- Having funds available for the restarting the CM will reassure investors to continue operating as normal. The continued collection will also help Suppliers protect their customers from a price shock upon restarting the CM.

Objective (d)

- Limits the risk of BSC Parties paying Default Funding Shares on defaulting Parties resulting from significant costs in restarting the Capacity Market.



Other

Interest

- **Current Position under CM**

- The current CM scheme funds (Supplier Charge funds & Credit Cover) are held in a non interest bearing account

- **Current position under BSC**

- Funds collected in a non interest bearing account, and a portion moved to an interest bearing account, with interest earned defraying BSC costs.

- **New arrangements under the BSC**

- Should scheme funds be held in an interest bearing account?
- Should credit cover (if applicable) be held in an interest bearing account?
- If yes to either, who should be the beneficiary of the interest?

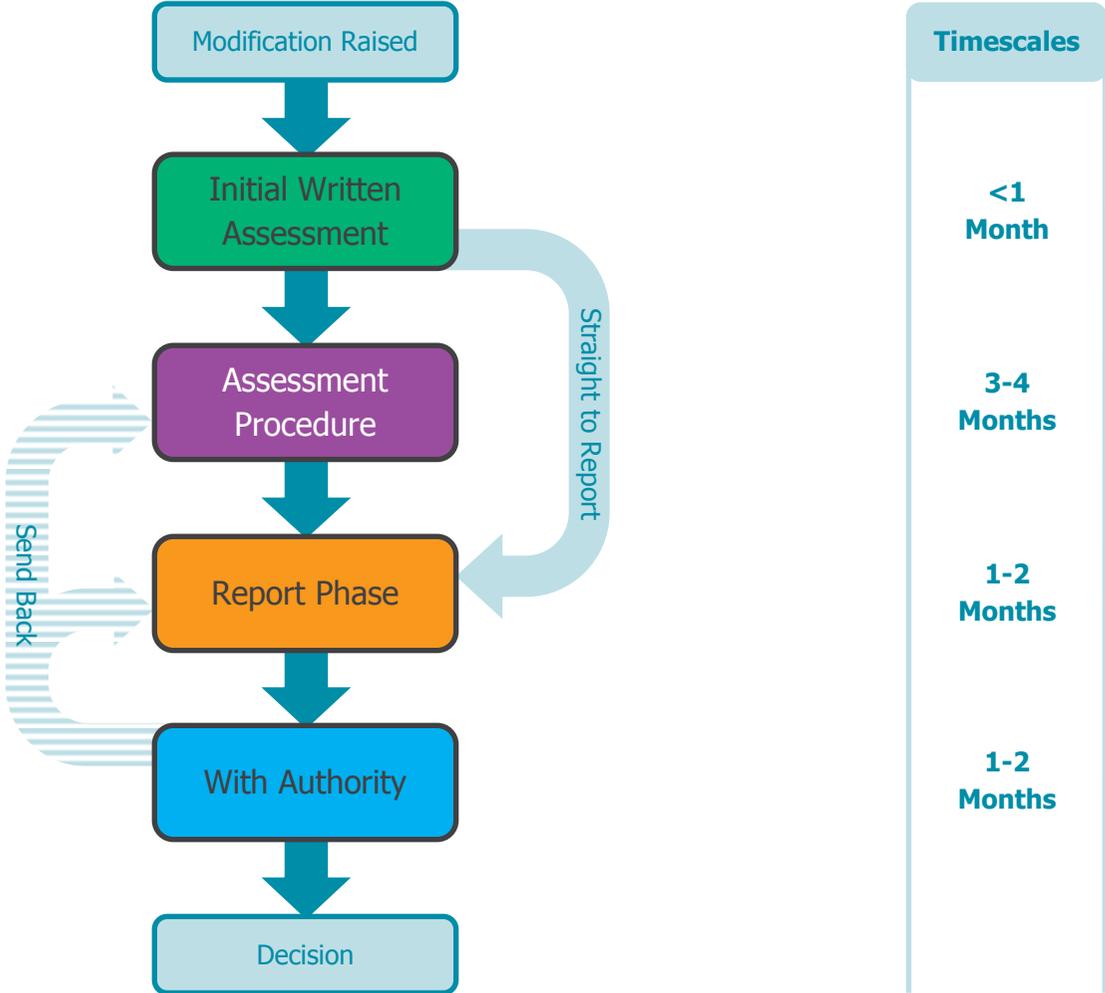
Options

- a) Suppliers to receive interest based on their share of funds held
 - b) Capacity Providers to receive interest based on their share of capacity agreements
 - c) ELEXON to receive all interest to defray costs
 - d) ESC to receive all interest less ELEXON costs
 - e) Suppliers to receive interest on credit cover held (if applicable), Capacity Providers to receive interest on Supplier Charge equivalent funds held.
-
- **Areas to note**
 - If ELEXON receive interest, Industry will benefit in accordance with their market share due to defrayed BSC costs
 - Interest apportionments will increase complexity of the solution, and increase operational effort



Next steps

Progression of a Modification

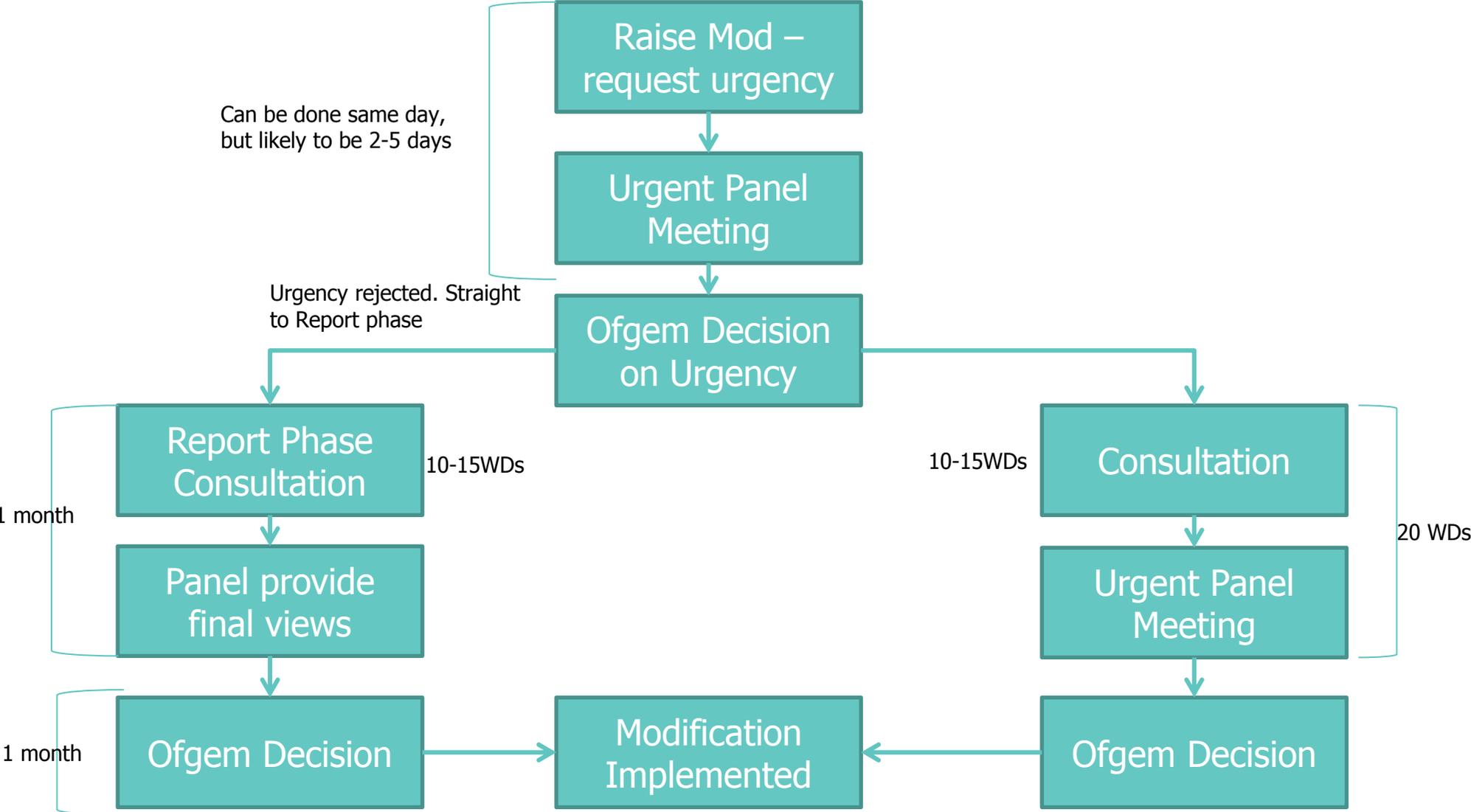


Raising an Urgent Modification

Ofgem guidance is that an urgent Modification should:

- Be linked to an imminent issue or a current issue that if not urgently addressed may cause:
 - A significant commercial impact on parties, consumers or other stakeholder(s); or
 - A significant impact on the safety and security of the electricity and/or gas systems; or
 - A party to be in breach of any relevant legal requirements

Progression Routes for Urgent Modification



Can be done same day,
but likely to be 2-5 days

Urgency rejected. Straight
to Report phase

10-15WDs

10-15WDs

20 WDs

1 month

1 month

Potential timeline (fastest)

Activity	Date
Raise Modification and request Urgent status	Day+0WD
Urgent Panel Meeting	Day+1WD (could be January Panel?)
Ofgem decide on Urgent Status	Day+5WD (requested response date only)
Report Phase Consultation	Day+6WD for 10 WD (subject to legal text being ready)
Ah-hoc Panel meeting	Day+19WD (3WD following consultation)
Submit Final Modification Report to Ofgem	Day+21WD

