ELEXON

30 July 2004

David Halldearn
Ofgem
9 Millbank
London
SW1P 3GE

Dear Mr Halldearn

"Response to licence conditions in electricity generation, transmission, distribution and supply licences relating to Security Arrangements".

This is the response from ELEXON Limited to the DTI open letter entitled, 'Licence conditions in electricity generation, transmission, distribution and supply licences relating to the Fuel Security Code in England and Wales and directions issued under sections 34 and 35 of the Electricity Act 1989 – Ofgem/DTI revised proposals under BETTA', dated 9 July 2004.

We note that Ofgem/DTI propose to retain the existing separate fuel security obligations that apply in Scotland and in England and Wales for the time being, in view of the timetable for the introduction of BETTA and the fact that DTI's review of the Fuel Security Code (FSC) arrangements is ongoing.

The effect of the proposed licence conditions set out in your document is that:

- the existing FSC provisions shall remain in place in relation to England and Wales; and

- in relation to Scotland, Licensees shall be obliged to enter into an agreement designated by the Secretary of State in relation to compliance with directions issued under section 34 and/or section 35 of the Act.

ELEXON currently has procedures in place to allow us to respond should the existing FSC arrangements ever be invoked, and we will, of course, put in place similar provisions in respect of any revised arrangements that may be introduced in the future. However, we are concerned that the proposed interim approach will potentially give rise to a number of issues upon extension of the scope of the Balancing & Settlement Code (BSC) to apply fully on a GB basis from BETTA Go-live. It is also not clear that ELEXON would have the capacity under the BSC to make the necessary drafting changes that might be required to address such issues, even if such changes can be identified.

Registered Office 350 Euston Road London NW1 3AW
Reg Co No 3782949 Registered in England and Wales

ELEXON Limited 4th Floor 350 Euston Road London NW1 3AW
T 020 7380 4100 **F** 020 7380 0407 **W** www.elexon.co.uk

Given these concerns, we would urge that consideration be given to harmonising the arrangements in Scotland and E&W from BETTA Go-live, regardless of the timescale for the introduction of a revised FSC. For example, in the event that the agreement designated by the Secretary of State to apply to Licensees in Scotland was such that the E&W fuel security arrangements effectively operated in Scotland in the same way as in E&W, then we do not see the problems described below arising. Another option would simply be to extend the application of the existing FSC to Scottish parties via the same licence condition that it is proposed to apply to parties in E&W.

The potential issues that we foresee arising if such a solution is not adopted are described in the following paragraphs.

At BETTA Go-live, Scotland will be fully integrated within the BSC arrangements. Should the arrangements in the agreement(s) designated by the Secretary of State in relation to security directions in Scotland differ from the arrangements set out in the FSC then a number of consequences could result for the implementation of the related contingency arrangements in the BSC. The operation of two separate arrangements would be contrary to the physical reality presented by the elimination of the Scottish interconnector. There could be difficulties in separating any consequences presented by two separate sets of security period arrangements.

It would be necessary to address the application of BSC arrangements for pricing during a security period. Under BSC Section G4.2, the BSC Panel (upon a direction from the Secretary of State) is obliged to apply a single imbalance cash out price for a specified period of time. This single imbalance price would then have to be paid to or by all GB BSC Parties if they trade long or short. If separate arrangements prevail, this would be very complicated to split between Scotland and E&W as we would essentially need to operate two separate Settlement Systems. While it may be possible to develop some form of workaround, it is not presently clear whether the BSC Systems could handle such a split given that the software will be amended and fully integrated at BETTA Go-live. Similarly, we cannot separate out energy contracts between E&W and Scotland so imbalances under which different prices apply would be a problem.

Another issue that requires consideration is the provision in BSC Section G4.4 for the revision of the Credit Assessment Price (CAP) during security periods. Once again, given the automated nature of the contract aggregation (ECVAA) and settlement (SAA) processes under the BSC, it is not clear that it would be feasible to operate with two different CAP values.

There is also a question as to who could operate the arrangements set out under the designated agreement with which the Scottish licensees would be obliged to comply. ELEXON as BSCCo only has capacity to operate the arrangements provided in the BSC and could not operate any other arrangements. At the same time SESL (the Settlement Agreement for Scotland operator), may have ceased to exist or to operate in such a way that it could administer security arrangements.

There are likely to be other issues that would arise if any contingency provisions are applied independently to either E&W or Scotland and, given that most Trading Parties will have interests in both geographical areas, questions about whether the intentions of those arrangements will actually be met. In many cases the purpose of Section G of the BSC is to secure or control the market. If restrictions apply to one territory only, Parties may be able to use unrestricted assets in the other to either deliberately or accidentally jeopardise the market. This area needs to be considered in more detail.

Another issue concerns reconciliation and compensation issues. If separate restrictions were applied in Scotland, would affected Parties in E&W be able to claim compensation and would relevant data be included in reconciliation calculations even though the FSC and BSC provisions do not directly apply to them?

We hope you find these comments useful and we would be happy to discuss these issues further with you if that would be helpful.

Yours sincerely

Brian Saunders
Chief Executive