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15th October 2007

Dear Ysanne,

Introduction

Thank you for your letter of 11th July 2007 to Michael Gilbert. Michael has now left the Department and I have taken over responsibility for the Fuel Security Code (the "Code") aspects of his work.

The Department appreciates the work that Elexon and the Issue 20 Group has done with respect to the Code. As I'm sure you will understand the Code and the associated Guidance Note are intended to be enduring documents and as such we feel it is not appropriate to incorporate all your comments (in your 11th July and 18th May 2007 communications) into these two documents.

However, we do appreciate that the substantive matters you raised in your communications to us need to be addressed and we propose to do so via this letter. In this regard we are mindful of the need for the BSC Panel to incorporate the Code into the Balancing & Settlement Code ("BSC") in order to ensure the BSC is in line with the underlying intention of the Code.

In view of the enduring nature of the code I should stress that the further guidance provided in this letter is applicable whilst the BSC is adapted to meet the requirements of the Code. It should not be assumed that the further guidance will apply during the lifetime of the Code and associated Guidance Note.

Purpose of Guidance

The purpose of the Guidance Note is to assist readers in understanding the reasons for, and background to, the Code. The Department (BERR) would therefore intend that the BSC Panel should use the Guidance Note as a framework for reflecting the Code into the BSC.

For example, the Guidance Note describes in greater detail than the Code itself the arrangements for exceptional cost recovery. This is to assist the BSC Panel in understanding our intention with respect to their implementing the Code (as it relates to the BSC) and we would expect this to be reflected into the BSC.

For the avoidance of doubt, we would expect the details and principles within the Code and the Guidance Note to be incorporated into the BSC. Any alternative solutions which deviate from these details or principles would not, in our view, be compatible with incorporating the Code into the BSC.

Cost Recovery Process

In the earlier drafting of the Code a possible route explicitly involving recovery (of exceptional costs by generators from suppliers) via the BSC was explored.

However, the Department has noted your observation that this is not consistent with the wider intention for the cost recovery mechanism to be determined by Ofgem and has removed these explicit references from the Code. Instead, as stated in paragraph 5.08 of Part 5 (B) of the Code "the mechanism for cost recovery [of exceptional costs by generators from supplier] shall be determined by the Authority".

It is not the intention of the Department to prescribe which route the Authority should adopt and, therefore, we cannot rule out a BSC route being adopted by the Authority.

However, we note that your communication of 17th May 2007 was copied to the Authority and are mindful that if the Authority were minded to go down a BSC route that they are likely to discuss this further with yourselves and the BSC Panel (at which time your concerns would no doubt be taken into account). In this regard we also note that your advice is that changes could be required to your internal Finance system (and probably to Section D of the BSC) to introduce the capability for any new charges (if a BSC route were taken) and that for this system functionality to be put in place prior to a Fuel Security Period, the specific BSC cost-recovery arrangements would need to be codified in advance.

Emergency Powers

I can confirm that the Department wishes that the provisions (in Section G part 4) remain in place (in the BSC) for both civil emergencies and Fuel Security Periods, as there may be Fuel Security Periods which do not also constitute civil emergencies. This is to reflect the fact these two situations

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may (a) occur separately, (b) at the same time and/or (c) 'flow' into each other as the situation unfolds.

For example, an event may occur which requires (FSC) directions to be issued to five power stations. However, the wider ramifications from the event also means that a Single Imbalance Price and/or Historic limit of balancing mechanism prices (as outlined in paragraphs 4.2 and 4.3 of Section G of the BSC) may be required.

In this example this would mean that the five power stations issued with (FSC) directions would be able to claim for Exceptional Costs. All other generators would be subject to the Single Imbalance Price and/or Historic limit of balancing mechanism prices, as appropriate. As these other generators had not been in receipt of an (FSC) direction they would be unable to make a claim for Exceptional Costs under the provisions of the Code.

Furthermore, as noted in section 16 of the Guidance Note, nothing in the Code will permit the double recovery of costs by Generators.

For the avoidance of doubt the provisions of the Code should apply when a Fuel Security Period is invoked, whether or not this coincides with a Civil Emergency

Interim Claims Process

Section 20 of the Guidance states that Generators should receive payment of their valid claims as expeditiously as practicable, and the purpose of any interim claims process should be to further this intention. In the example cited in Section 4 of your letter of 18 May, rule b) would appear to be closer to the intention than rule a).

For the avoidance of doubt, if Interim Payments are allowed then the opportunity to claim (from Interim Payment) should, in principle, be available to all those generators able to make an Exceptional Cost claim; i.e. they have been in receipt of a direction.

Communication of Fuel Security Period

As indicated in paragraph 11 of the Guidance Note, unless requested by the Department to treat the information about a security period being declared in a confidential manner, National Grid will, without delay, take steps to inform all DNOs, Generators and other stakeholders that a Fuel Security Period is in effect. The Department would envisage Elexon being one of the "other stakeholders" whom National Grid would seek to inform that a Fuel Security Period is in effect.

"In anticipation of"

As noted in paragraph 5.02 (a) of Part 5 (B) of the Code a Generator may only incur Exceptional Costs in carrying on its Generation Business as a

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result of a direction or directions given by the Secretary of State. The only person who can anticipate a Security Period is the Secretary of State who may as a result issue a direction (or directions) to the Generator.

Therefore the Generator (or for that matter National Grid or the DNOs) cannot incur any Exceptional Costs "in anticipation of" a Security Period in the absence of a direction or directions given by the Secretary of State. If, in complying with the direction, a Generator incurs any Exceptional Costs then a claim may be made (to the BSC Panel) in accordance with the arrangements set out in the Code and Guidance Note.

Once a Direction has been issued, it is recognised that if there is a delay before the Fuel Security Period comes in to force Generators may incur Exceptional Costs if these are necessary to prepare for the Fuel Security Period.

For the avoidance of doubt it is not the intention of the Department that advance payments will be made under the Code, therefore Exceptional Costs have to be incurred before they can be claimed.

Part 5 Recovery of Costs

2.02- The Code (Section 5.03, first paragraph) refers to the 60 day period commencing after the end of each time period. The 60 days would therefore commence on the day after each time period.

2.02 (b)-It is intended that an application for an Interim Payment would be made before the end of the Fuel Security Period, therefore the scenario described in paragraph 2.4 of your letter should not arise.

I hope this letter covers the main points of concern raised in your letters of 18 May 2007 and 11 July 2007, but please contact me on 0207 215 3054 if you would like to discuss any of the points raised.

Yours sincerely

Andy Stevenson
Energy Resilience