



Direct Dial: 020 7901 7355

10 May 2002

The National Grid Company, BSC Signatories and  
Other Interested Parties

Our Ref : MP No: P44

Dear Colleague,

**Modification to the Balancing and Settlement Code (“BSC”) - Decision and Notice in relation to Modification Proposal P44: “Correction of Notification Errors where Parties are able to satisfy a Reasonable and Prudent Operator test”**

1. The Gas and Electricity Markets Authority (the “Authority”)<sup>1</sup> has carefully considered the issues raised in the Modification Report in respect of Modification Proposal P44, “Correction of Notification Errors where Parties are able to satisfy a Reasonable and Prudent Operator test”.
2. The Balancing and Settlement Code Panel (the “Panel”) recommended to the Authority that:
  - the original Modification Proposal be rejected; and
  - the Alternative Modification be approved with an implementation date of 5 Business Days after the Authority Determination.

The Authority has decided not to direct a Modification to the BSC.

3. This letter explains the background and sets out the Authority’s reasons for its decision.

**Background**

4. Modification Proposal P44 is the fourth Modification Proposal to have been submitted related to allowing for the correction of errors in Energy Contract Volume Notifications (ECVNs) and in Metered Volume Reallocation Notifications (MVRNs) after Gate Closure. Such errors are called “notification errors” hereafter in this decision letter. These Modification Proposals

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<sup>1</sup> Ofgem is the office of the Authority. The terms “Ofgem” and “the Authority” are used interchangeably in this letter.

followed a number of notification errors that participants made during the first few weeks of NETA. Ofgem decided not to direct that the first two Modifications Proposals should be implemented:- P9: "Correction of Technical Error In Respect of ECVNs and Adjustment of Settlement Data" (proposed by ScottishPower plc) and P19: "To provide for the remedy of errors in Energy Contract Volume Notifications and in Metered Volume Reallocation Notifications" (proposed by London Electricity plc). The Authority has today decided to direct NGC that Modification Proposal P37 (alternative): "To provide for the remedy of past errors in Energy Contract Volume Notifications and in Metered Volume Reallocation Notifications" should be made and implemented.

5. P44 was raised by PowerGen on 8 October 2001. It sought to modify the BSC so that Parties would be able to apply to the Panel requesting the ex post creation of new ECVNs/MVRNs or amendment of previously submitted ECVNs/MVRNs under limited circumstances. The Modification Proposal sought to address the increased risks that the proposer considered were faced by Parties that had no alternative but to notify their ECVNs/MVRNs close to Gate Closure.

### **The Modification Proposal**

6. The Modification Proposal, and the subsequent Alternative Modification Proposal, were progressed by the Error Processing Modification Group (the Group), which met three times to discuss the Proposal. Two Detailed Level Impact Assessments were carried out by the NETA Central Service Agent.
7. Modification Proposal P44 would enable Parties to submit claims for consideration by the Panel (or a Panel Committee) relating to ECVNs and MVRNs that were submitted incorrectly or were not submitted by Gate Closure. It seeks to address the increased risks faced by Parties who have no alternative but to submit their ECVNs close to Gate Closure, and requires that the process by which a claim can be submitted and determined is defined under the Code. Modification Proposal P44 would not apply to Settlement Periods that occur before the Implementation Date. The Proposal also states that a non-refundable administration fee of £5,000 would be payable by the claimant.
8. Under Modification Proposal P44, in order to pursue a claim for compensation, the claimant would be required to demonstrate to the Panel (or a Panel Committee) that a notification error had occurred in either of two circumstances:-
  - the ECVN/MVRN could not have reasonably been submitted in time to be included in the last Volume Notification Report which includes the relevant Settlement Period; or
  - the last Volume Notification Report which includes the relevant Settlement Period, was not in fact sent to the claimant.

and also to demonstrate, to the Panel's reasonable satisfaction, that it took all reasonable and prudent steps to:

- prevent the occurrences of errors;

- minimise the risk that errors were not noticed in a reasonable time;
  - minimise the impact of such errors;
  - avoid repetition of subsequent errors; and
  - mitigate the effects of the error, once discovered.
9. The other relevant Contract Trading Party, the Volume Notification Agent and the ECVAA would need to provide the necessary evidence in support of the claim. The Panel (or a Panel Committee) would then take into account all information and evidence provided to it, including the report of an investigation by ELEXON, and make a determination. If a claim were upheld, Settlement calculations (excluding those associated with credit checking) would be amended accordingly.
10. As part of the process, any Contract Trading Party would be able to appeal to the Authority, on limited grounds, following the Panel determination, in which case a non-refundable administration fee of £5,000 would be payable by the Contract Trading Party. The status and progress of claims would be published on the BSC Website.
11. In considering the original Modification Proposal, the Group noted that there was no provision to include an Error Correction Payment (ECP) mechanism. ECPs reduce the total refundable amount that Parties can recover in respect of notification errors, in addition to the non-refundable administration fee for consideration of the claim. The Group considered that the Authority's decision letter on Modification Proposal P19<sup>2</sup>, which suggested that it would be appropriate for a material charge to be levied on any party seeking to correct a notification error, was relevant to this Modification Proposal and accordingly decided that an ECP mechanism should be included in the Modification Proposal. On the basis that including such a mechanism introduced a significant change to the Modification Proposed, the Group agreed that an Alternative Modification Proposal should be progressed and a further industry consultation was carried out in particular to establish views on the appropriate level for an ECP and whether there should be a cap.
12. The only difference between the original Modification Proposal and the Alternative Modification Proposal was that, under the Alternative Modification Proposal, an ECP would be levied against those benefiting from the correction and the resultant cash flow would be disbursed to all other Parties, pro rata on credited energy. In its consultations, the Group agreed that an ECP level of 10% was appropriate, on the basis that it would ensure that there was an increased incentive on Parties to provide correct and timely notifications to the ECVAA.

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<sup>2</sup> Modification Proposal 19, "To provide for the remedy of errors in Energy Contract Volume Notifications and in Metered Volume Reallocation Notifications"

13. After consultation, the Group felt that the addition of an ECP mechanism would act as an additional incentive on Parties to ensure that they correctly submitted Volume Notifications. Following further consultation, the Group agreed that it was appropriate that an ECP be introduced and that there should be no associated cap.
14. ELEXON published a Draft Modification Report on 21 January 2002 that invited respondents' views by 4 February 2002.

### **Respondents' views**

15. The respondents' views are summarised in the Final Modification Report<sup>3</sup> for Modification Proposal P44, which also includes the complete text of their responses.
16. In total, ELEXON received 8 responses (representing 43 parties) to the final consultation on Modification Proposal P44. Of the responses, 6 (representing 31 parties) expressed support for the implementation of the Alternative Modification Proposal. The remaining two responses (representing 12 parties) provided a caveated support to the implementation of the Alternative Modification Proposal. Of these two responses, one respondent reluctantly agreed to the implementation of the modification despite its disappointment that the addition of an increased administration fee as a deterrent to frivolous claims had not been accepted in the Modification Proposal. The other respondent reiterated that although its primary stance was to support the Modification Proposal, it believed that the Alternative Modification Proposal, in absolute terms, better met achievement of the Applicable BSC Objectives<sup>4</sup>. This respondent also noted that the criteria for a claim to succeed are extremely rigorous.
17. 9 respondents to the consultation commented on an appropriate level for the ECP, of which 5 (representing 13 Parties) agreed that the level of the ECP should be set at 10%. Of the remaining four responses, one respondent (representing 3 Parties) suggested 20%. One response (representing 4 Parties) stated that the level of ECP should be a proportion of 10%. The third response (representing 6 Parties) stated that the level of ECP should be that which covers the cost of investigating and correcting the consequences of a notification error and the final respondent (representing 2 Parties) stated that an administration fee of £20,000 should be set rather than a fixed percentage ECP being introduced.

### **Panel's Recommendation**

18. The Panel met on 14 February 2002 and considered the Modification Proposal P44, the draft Modification Report, the views of the Modification Group and the consultation responses received.

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<sup>3</sup> ELEXON document reference 010MMU, Version 1.0, dated 21 February 2002

<sup>4</sup> The Applicable BSC Objectives, as contained in Condition C3 (3) of National Grid Company's Transmission Licence, are:

- (a) the efficient discharge by the licensee of the obligations imposed upon it by this licence;
- (b) the efficient, economic and co-ordinated operation by the licensee of the licensee's transmission system;
- (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;
- (d) promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

19. The Panel recommended that the Authority should approve the Alternative Modification with an implementation date of 5 Business Days after the Authority's determination. Moreover, the Panel recommended that the Proposed Modification should be rejected.
20. The rationale for the Panel's recommendation was that implementing the Alternative Modification Proposal would maintain the incentive on Parties to ensure they have robust systems in place to prevent notification errors and that claims would only be considered if they met the stringent criteria. In addition, within-day market liquidity would potentially increase as Parties may choose to submit notifications near to gate closure.
21. The Panel agreed that in light of these considerations, Alternative Modification Proposal P44 would better achieve the Applicable BSC Objectives, defined in condition C3 (3) of NGC's licence, particularly condition C3 (3) (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'.

#### **Ofgem's view**

22. When Ofgem initially considered this Modification Proposal we were concerned that it would be inappropriate for us to take any decision pending the outcome of the litigation between ScottishPower and ELEXON. However, having now intervened in those proceedings and having had the opportunity to consider the relevant matters further and in more detail, Ofgem has decided that, notwithstanding the litigation, it is appropriate for us to issue a decision in relation to Modification Proposal P44.
23. Having assessed the relevant issues and reviewed the consultation responses, Ofgem has considered the Modification Report pursuant to our duty under condition C3 5(a) of NGC's licence and in the light of our statutory duties. Ofgem does not agree that Alternative Modification Proposal P44 would better facilitate achievement of the Applicable BSC Objectives for the reasons set out below.
24. Ofgem has previously stated, and continues to believe, that:-
  - It is essential that there should be strong incentives on BSC Parties to deliver correct notifications. If the incentives to have robust contract notification systems in place are inadequate, it is likely that participant would wish to adjust or correct their notifications more frequently due to errors and this could adversely affect the efficient administration of the BSC.
  - A correction mechanism for notification errors might also effectively allow ex post trading to take place since participants might seek to make intentional post-Gate Closure adjustments to their traded quantities. As Ofgem made clear in our various NETA consultations, we have concerns that ex post trading might increase the opportunities for players with generation assets, even in a generally competitive market, to drive up the prices that participants with short positions have to pay to reduce their imbalance exposure after real time and before contract notification.

25. Ofgem considers that accepting the Modification Proposal would reduce the incentives on BSC Parties to have in place robust risk management systems, although we accept that the circumstances under which P44 would allow notification errors to be corrected are limited. However, Parties who choose to continue trading close to real time (for whatever reason) i.e. in circumstances under which P44 would apply, need to trade-off the benefits that they believe will accrue from such trading against the risks attached to such trading. Parties can choose to offset these risks by using the services of a third party ECVNA (normally in return for the payment of a fee). To the extent that Parties require third party ECVNAs to provide enhanced levels of service, this is a commercial decision between the ECVNA and its customers. In addition, Parties can insure themselves against the risks of notification errors and it is our understanding that some third party ECVNAs already do this. Given that these possibilities exist, we do not consider that accepting P44 would better promote effective competition.
26. Ofgem is also mindful of the fact that there is an approved change proposal awaiting implementation that will change the frequency and coverage of Forward Contract Reports, so that contracts relating to the current day will be included in Forward Contract Reports. Clearly, once Forward Contract Reports capture contracts that are traded closer to real time, the rationale for the proposals included in this Modification Proposal will be further reduced. There is, moreover, a question as to whether a failure to deliver Forward Contract Reports should more properly be considered to be a failure of the central systems.

#### **The Authority's decision**

27. The Authority has therefore decided that it does not intend to direct that either the original Modification Proposal P44 or the Alternative Modification Proposal P44, as set out in the Modification Report, should be made and implemented.
28. Having regard to the above, the Authority, in accordance with Section F1.1.4 of the BSC, hereby notifies NGC that it does not intend to direct NGC to modify the BSC as set out in the Modification Report.

**Contact point**

29. If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'A. Simpson', written over a horizontal line.

**Nick Simpson**

**Director of Industry Code Development**

Signed on behalf of the Authority and authorised for that purpose by the Authority