Memorandum

To	SSMG (P147)	**cc.**	
From	ELEXON Trading Arrangements Design		
Date	15 January 2004		

Modification Proposal P147 'Introduction of a Notified Contract Capacity to limit Party liability in the event of erroneous contract notifications'

The following document sets out some initial thinking on a possible alternative modification for P147, in response to a request from the SSMG. It should be noted that this is intended to provide a 'straw man' for consideration by the SSMG, and is not intended to be a definitive set of requirements or to represent the thinking of the SSMG at this point.

Furthermore, the summaries in this document are an interpretation of the relevant determinations and therefore not intended to be definitive, and do not replace the Authority determinations.

DISCUSSION OF AN ALTERNATIVE OPTION FOR P147 – EX POST ERROR RECTIFICATION

1. EX POST RECTIFICATION PROCESS: A VIABLE ALTERNATIVE TO P147

During discussions at the P147 Modification Group meeting on 18 December 2003, the SSMG identified a possible alternative to Proposed Modification P147 where a manual ex post error correction process could be utilised.

The proposed process would be to allow, within a tightly defined timescale, errors or malicious notifications to be identified by the BSC Party. The BSC Party can then apply to the BSC Panel for rectification. Where the Panel agrees the rectification, then the rectification will be made via manual input into ECVAA (using a process similar to the ECVAA System Failure recovery).

The initial consideration was whether, if adopted, this approach would constitute a valid Alternative to P147. The ELEXON Legal Department were requested to provide a view in respect of this matter. The ELEXON Legal Department indicated that a manual process for error rectification could be considered to be addressing the same defect as the Proposed Modification, since the Modification Proposal asserts that P147 is seeking to "limit liability associated with contract notifications identified in Modification Proposal P98 and enable these risks to be effectively managed by BSC Parties at much lower cost [*than P98*]", and therefore is considered to be a valid Alternative Modification.

2. PRECEDENTS TO CONSIDER WHEN DEVELOPING THE PROCESS

A number of past Modifications have sought to introduce an ex post error correction process for contract notifications. All but one of these Modifications has been rejected by the Authority. Therefore it is appropriate to review the Authority determinations in respect of these Modifications to understand the rationale for the determinations made, and to develop a process that addresses any issues raised by the Authority in previous determinations.

The Modification Proposals to be considered are:

1. P9 'Correction of Technical Error in Respect of the ECVNs under Section P2.3 and Adjustment of Settlement Data under Section U 2.5' - **REJECTED**;
2. P19 'To Provide for the Remedy of Errors in ECVNs and in MVRNs' – **REJECTED**;
3. P35 'Qualified ECVNAs' – **REJECTED**;
4. P37 'To Provide for the Remedy of Past Errors in Energy Contract Volume Notifications and in Metered Volume Reallocation Notifications' – **APPROVED**;
5. P44 'Correction of Notification Errors where Parties are able to satisfy a Reasonable and Prudent Operator test – **REJECTED**; and
6. P128 'Correction of Erroneous ECVN Errors in Specifically Defined Circumstances' – **REJECTED**.

There are two other Modifications that, whilst not directly addressing contract notification error correction, should also be considered as relevant, and these are:

1. P98 'Dual Notification of Contract Positions' – **APPROVED**; and
2. P110 'Nullification of Volume Allocations' – **APPROVED**.

Section 5 summarises each of these Modification Proposals and the Authority determination in respect of the Modification.

3 IMPLICATIONS FOR P147 SOLUTION / MECHANISM

The following summarises the key points of the relevant Authority determinations that should be taken into consideration when defining the solution for P147.

1. The Modification should be prospective, not retrospective;
2. Incentives to maintain robust notification systems and checking processes should be maintained;
3. Strictly defined circumstances for error and rectification, such that the mechanism is not used for frequent adjustments to correct errors, or as a mechanism that can be used to intentionally adjust, post Gate Closure, traded quantities;
4. Recognition in any solution to the effect that Parties can choose to notify in such a way which leaves them sufficient time to identify and correct errors in their notifications prior to Gate Closure, and which recognises the availability of trading system test environments and trading expertise to new and existing Parties;
5. A short timescale for notifying errors for rectification, in recognition of Parties abilities to check, via Rejection and Acceptance Feedback Reports and the Forward Contract Report notifications within short timescales;
6. In recognition that some losses may be disproportionate to the incentives necessary to achieve the incentive to notify correctly, the Authority indicate that a Modification for error rectification could / should contain the following attributes:

a. An appropriate material charge for the correction, but not set to such a level that it is prohibitive for small Parties. Potentially the Authority could approve any change to the fee to ensure this aspect;

b. A fixed percentage limit on the claim in addition to the claim fee; and

c. Responsibility for establishing the nature of the error should be placed on the claimant, and the claimant should be required to show that it had acted prudently in checking its notifications and that it had promptly put in place steps to avoid a repetition of the error.

7. Approved Modification P37 had the following attributes, which may be appropriate for consideration as part of the solution for a prospective error correction mechanism:

a. Determination on the notification errors may have regard for the extent to which the notification error was attributable to a failure of the BSC Systems, an inaccuracy or non availability of the Forward Contract Report, a combination of circumstances which could not have reasonably been foreseen, or the extent to which the loss caused by the error was of a magnitude which is wholly disproportionate, with due weight given to incentivising correct notifications;

b. A £5000 claim fee;

c. A 20% error correction payment, such that only 80% of the loss of the error would be recovered; and

d. An impartial claims process (recognised as being impartial).

4 STRAWMAN FOR THE MECHANISM / SOLUTION

4.1 RATIONALE FOR HAVING AN ERROR CORRECTION MECHANISM

The Authority noted in its determination on P98 that dual notification is a way of mitigating notification risk, and the potential for exposure to unlimited liability as a consequence of an erroneous or malicious notification. However, the Authority acknowledged that the decision as to whether to implement dual notification was a commercial one, and one which would fall on individual Parties, to be made on the basis of the trade off of the development and implementation costs of dual notification versus the risk management tools under the current single notification mechanism.

The implication from this is that choosing not to implement dual notification should not be considered to be an indication of risk taking, nor should it be considered to be an indication of a lack of prudency in the approach to managing the risks associated with notifying.

Furthermore, leaving the commercial decision for implementing dual notification down to individual Parties means that those that develop and implement the dual notification system amendments as a means of mitigating notification risk have to find willing partners to trade and thus dual notify with. Where this is not the case, then single notification will be the necessary medium for notifying, carrying with the risk of exposure to imbalance from a malicious or erroneous notification, since "it may be impossible to eliminate completely the element of human error or software error".

Furthermore, there are circumstances where use of dual notification may actually increase notification risk, for example intra – Party trading, where energy is transferred from one of the Party's Energy Accounts to the other. If dual notification is used under this circumstance, then two identical

notifications have to be generated by the same BSC Party, increasing the notification risk. Therefore it could be argued that single notification would be the most robust notification mechanism under these, and similar, circumstances.

Therefore in order to deliver the risk mitigation benefits associated with dual notification to all, it seems appropriate to develop an error rectification process to allow non dual notifiers to mitigate their risk of the exposure to potentially unlimited settlement liability. However, this is not to say that dual notifiers cannot use this process, it is just difficult to see why they would need to[1].

It should be noted that this notification error rectification process is aimed at the rectification of notification errors where an error has occurred despite all efforts having been made to avoid and mitigate the risk of notification errors, by implementation of robust, reasonable and prudent systems and processes, i.e. an error resulting from it being "impossible to eliminate completely the element of human error or software error".

Furthermore, some have argued that the presence of a notification error rectification process may decrease the vigilance of Parties in respect of avoiding and / or mitigating notification risk, and the process defined has, as far as possible, tried to ensure that Parties are still incentivised strongly to notify correctly, by seeking to allow notification error rectification only where all reasonable efforts have been made to avoid and mitigate the risk of notification errors, by implementation of robust, reasonable and prudent systems and processes.

4.2 ERROR CORRECTION MECHANISM

Taking all factors set out in this document into account, and thus attempting to draw them all together into a mechanism / solution that addresses the issues raised and builds on the precedents set, whilst attempting to avoid the resource intensive and costly process associated with the P37 claims process. The proposed error correction mechanism could be as follows:

Note: The reference to 'committee' throughout this section should be interpreted to mean the Panel or other committee with delegated authority from the Panel.

1. only notification errors occurring on or after the Implementation Date of this Modification would be eligible for rectification under this process, i.e. this is a prospective Modification only;
2. A notification error could be defined as a mistake in giving effect to a settled and shared commitment due to a combination of circumstances that could not have reasonably have been foreseen and / or was attributable to an inaccuracy or non-availability of the Forward Contract Report, Rejection Feedback Report and / or Acceptance Feedback Report;
3. The essence of the notification error (i.e. the numbers involved, not what caused the mistake) should be agreed by both counterparties and the notification agent (for each impacted notification);

[1] An error correction process would allow mistakes in giving effect to a shared and settlement commitment to be rectified (under certain circumstances); under dual notification, both Parties notify the shared and settled intent, and therefore where one makes a mistake, then it is expected that a prudent dual notifier would alert its counterparty to the error in order to get it corrected in time for inclusion in settlement.

4. A notification error should be an error in one notification regardless of the circumstances causing the error, unless the circumstances set out at (2) above gave rise to a number of notifications all exhibiting or resulting from the same mistake, in which case the notification error can encompass all such notifications;

5. A notification error should have led to a loss for at least one of the counterparties which was disproportionate, due weight being given to the desirability of incentivising Parties[2] to avoid mistakes in the submission of notifications. Therefore the materiality threshold of the claim should represent a loss of in excess of £33,000[3], or could be determined on a case by case basis, taking into consideration the size of the Party, and therefore the materiality of the loss to them.

   Given the stringent timescales for the submission of a claim, the loss may not be known definitively at the time of making the claim, however, it is expected that a relative materiality will be able to be derived using the Indicative Energy Imbalance Prices published close to real time on the Balancing Mechanism Reporting Agent (BMRA) applied to the difference between the intended notification and the actual notification submitted. Parties will be expected to provide the details of this calculation on submitting the claim to allow BSCCo / the relevant committee to verify that the claim is likely to exceed the materiality threshold.

   Where the evidence submitted verifies that the materiality threshold is exceeded, and BSCCo / the relevant committee agrees with that evidence, then the claim will be processed, even where changes to the Energy Imbalance Price post event mean the loss incurred is lower than that expected and the materiality falls below the threshold.

   It should be noted that the materiality of Past Notification Error claims made under Section P6 of the Code used a comparison of the Energy Imbalance charges with and without the Past Notification Error in order to derive the materiality of the claim, i.e. taking into account the overall imbalance position of the Party. However, where an immediate judgement of materiality is required, as would be the case where there is a short deadline for claim submission, the materiality would not be known, and nor could it be reliably quantified, as it relies on the availability of metered data in order to derive the overall imbalance position of a Party.

6. A notification error must be raised by the end of the Business Day following submission of the notification or notifications giving rise to the claim[4]. However, where the Party can prove that there was inaccuracy or non-availability of the Forward Contract Report, Rejection Feedback Report and / or Acceptance Feedback Reports, then the claim should be raised within one Business Day of the receipt of the relevant reports;

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[2] The reference to Parties in this section should be interpreted as including notification agents.

[3] The determinations made in respect of P37 indicate that a loss of £31,788 is proportionate and could be seen as an incentive to notify correctly, whereas a loss of £33,815 was considered (albeit at the bottom end of the scale) to be disproportionate. Therefore £33,000 represents a threshold between these two figures, noting that the determination of proportionality did take into account other factors, such as the size of the Party.

[4] Given the generation of Acceptance Feedback Reports on notification submission and the relative frequency of the Forward Contract Reports, it is considered that there is little excuse for a prudent operator not to identify an error within one Business Day of the error occurring, except in the absence of the relevant reports.

7. A notification error will incur a non refundable £5000 claim fee (where the claim is accepted for processing, (see 4 above)), with any amendment to the claim fee set by the Panel (or delegated committee) and approved by the Authority;

8. The claimant would be expected to provide evidential proof (section 6 covers some of the evidence that could be provided) as to the following:

    a. That there was a shared and settled commitment;

    b. That a mistake was made when giving effect to that shared and settled commitment;

    c. That the systems and processes in place at the time of the mistake were reasonable and prudent; and

    d. That prompt rectification occurred; and

    e. That (relatively) immediate steps were taken to prevent a re-occurrence of the mistake.

9. The committee would determine on the claim as soon as possible after the claim was raised, in order that where the claim is upheld, the rectification can occur in the next possible Settlement Run, in order to minimise the uncertainty of Parties in relation to their trading charges. The process should be designed such that the rectification is aimed at the Initial Settlement Run in as many cases as possible for this purpose, noting that this may not be possible;

10. Rectification of the notification error would be subject to a cap. This cap could take the form of a percentage cap on the actual volumes, or to a percentage cap on the recovery of the loss associated with the claim, for example, an 80% recovery cap, allowing Parties to recoup a maximum of 80% of the losses from the claim;

11. The committee should have a set of guidelines to assist in making the determination on the claim, building on the precedents set by the claims made under section P6 of the Code, and added to where other circumstances arise when considering new claims, in order that the process for making the determinations is as transparent, and thus seen to be as impartial, as possible;

12. Where the Party does not agree with the determination made by the committee, the Party should have a limited scope for appeal, where the appeal is made to the Panel / Authority for final determination.

Some relevant criteria for consideration by the relevant committee when considering the claim and making a determination:

1. A notification error should be for as limited a number of Settlement Periods as possible. It is expected that where a Party is a 24-7 operation that the number of Settlement Periods requiring rectification would be minimal, to reflect that the error should be noticed almost immediately through the Acceptance Feedback Report, and prompt action should be taken to rectify it. However, it is acknowledged that a non 24-7 player may require rectification over significantly longer periods where the notification was made by a counterparty[5] outside of working hours;

[5] It would be expected that a prudent non 24-7 player would check all known notifications, especially notifications submitted by themselves, prior to close of business,

2. Consideration should be given to the risk management strategy of the Party in relation to trading close to Gate Closure. Where a Party notified close to Gate Closure and a notification error occurred, then an assessment as to whether the Party did sufficient to mitigate that risk should be made[6] when making the determination;

3. Evidence is expected to be provided in support of claims made to prove that systems and processes were prudent at the time of the error, specifically in relation to the error. The sort of evidence that could be provided (and considered as reasonable proof) is documentation detailing the approach taken to manage the risks associated with notifying, and how these are identified and mitigated. Some examples provided as to how the risks of notifying are dealt with are:

   - Implementation and use of a robust, and potentially integrated, trade capture and notification system;
   - Use of back up systems and third party notification agents in the event of system failures;
   - Management and reconciliation (against trading systems) of ACK's, NACK's, Rejections, Acceptances, Forward Contract Reports and daily notification reports; and
   - Building access controls, secure system access, automated system back up and full audit trail and archiving (mostly in respect of malicious notifications, where the Party would be expected to demonstrate that controls were in place to prevent, as far as possible, unauthorised access to notification systems).

   For example, prudency in a non 24-7 operation could be considered to be in evidence by the Party checking all notifications made on the last Business Day before leaving the office and ensuring that all the expected notifications made have been submitted and the submissions checked as correct (and any corrections made) before going home for the weekend. Furthermore, a check would be made first thing on the first Business Day following the weekend to ensure no unexpected notifications were made over the weekend, and to address any issues immediately;

4. When making the assessment as to whether systems and processes are considered to be reasonable and prudent, it should be recognised that Parties should, at all times, have systems and processes (in relation to notifying) that have a sufficient degree of robustness to be able to carry out the basic functions to transfer trade data to the notification system, submit the data as a notification and check that the notification has been submitted correctly.

   In terms of the circumstances prevailing, it would be expected that systems and processes would be working in the manner intended and would be robust. If changes were made to the systems and processes, these should generally be planned and tested in advance so that they would be fully robust when first activated. Human errors or software defects would be an exception.

[6] This arises from a number of decision letters, specifically P44, where the Authority noted that Parties know when Gate Closure is, and should take care to manage the risk of trading close to Gate Closure to avoid errors that cannot be corrected, as Gate Closure has passed. However, even where due care has been taken when trading close to Gate Closure, errors may occur, and therefore these Parties should be allowed to seek rectification via this process.

Examples of non prudent systems and processes can be derived from the (relevant) determinations in respect of the claims considered by the Past Notification Error Committee, available on the BSC Website:

http://www.elexon.co.uk/ta/panel/pne_individual_claims_docs.html

4.3 CORRECTION MECHANISM FOR MALICIOUS NOTIFICATIONS

Effectively there is no reason why the claims process set out above could not cover malicious notifications, as the process would more than adequately cope with claims raised as a result of a malicious notification. However, consideration should be given as to whether (and why) it is appropriate to:

1. Drop the materiality threshold for claims made in respect of a malicious notification;
2. Reduce the claims fee; and / or
3. Remove the error rectification cap.

On the basis that even the most robust notifier cannot prevent a malicious notification being made against them.

5. PREVIOUS MODIFICATIONS

5.1 REJECTED MODIFICATION P9

P9 sought to permit Parties to correct the submission of ECVNs (retrospectively or otherwise) which are manifestly incorrect due to no fault technical error.

The Authority determined that P9 should not be made on 8 June 2001.

The Authority determination to reject P9 was broadly based on the premise that the pre NETA agreement, via consultation, was that there should not be a manifest error provision for notifications. Furthermore, the Authority noted that Parties can choose to notify in a way which leaves them sufficient time to identify and correct errors in their notifications prior to Gate Closure.

The Authority set out the principle that "losses resulting from errors will lie where they fall", but noted that there may be very limited circumstances where the rules of the market permit corrective action. The Authority expressed the opinion that corrective action must be initiated within a very short period of the error occurring, for example notification of manifest errors is limited to 4 hours.

The Authority asserted that this principle should be adhered to in order to retain appropriate incentives on Parties to carry out proper checks, but acknowledged that "it would not necessarily be incompatible with the BSC Objectives or its [the Authority's] statutory duties for a Modification to be made which would add to the categories of error addressed by the BSC or their consequences in a clearly defined manner and which properly delineates the nature of errors to which, and the circumstances in which, it would apply." The Authority determination also indicated that the period within which remedial action must be initiated would need to be appropriately defined in a manner reflecting the BSC Objectives and taking account of the effect on the market of any such provision.

5.2 REJECTED MODIFICATION P19

P19 sought to enable errors in ECVNs and MVRNs to be remedied on an ex post basis, allowing at the most 72 hours for identification of the error, and noting that there would be a 72 hour window following approval of P19 for Parties to raise errors made since NETA Go – live and the implementation of P19. Furthermore, to ensure the veracity of claims, a claim fee of £5,000 would be levied for each claim, and the Panel would be required to consider and adjudicate on each claim.

The Authority determined that P19 should not be made on 2 August 2001.

The Authority determination to reject P19 was broadly based on the principle that "in a commercial setting, one of the strongest incentives to efficient trading is the knowledge that insufficiently robust risk management systems and procedures can result in trading errors and that losses are a likely consequence of such errors." Thus, the Authority asserts that:

- "It is essential that there should be strong incentives on BSC Parties to deliver correct notifications. If the incentives to have robust risk management systems in place are inadequate, it is likely that notifications would need to be frequently adjusted for errors that could adversely affect the efficient administration of the BSC."
- Furthermore "a correction mechanism for erroneous notifications may also create a possibility of intentional post Gate Closure adjustments to traded quantities. There could be the risk of undermining the strong commercial incentives on participants to balance their own positions ahead of real time."

The Authority asserted that:

1. "While understanding that it may be impossible to eliminate completely the element of human error or software error, Ofgem observes that BSC Parties have a clear knowledge of the timing of Gate Closure and can, in conjunction with the reporting systems available, take a view on how close to that time they wish to notify and to what extent they wish to check and correct such notifications in the light of the known risk they would be facing. We also note that those Parties who wish to reduce the risk of notification errors can provide additional opportunity for checks by contracting these services elsewhere, for example with independent dual notification agents."
2. "Ofgem considers that a key feature [of NETA] underpinning the incentives on Parties to balance their positions is that Parties take active responsibility for the accurate notification of the energy transfer quantities. In the foreknowledge of the risks, many Parties will take care in their notifying arrangements and systems to avoid such errors and the consequences of such errors. Others will choose to use independent agents to notify on their behalf or use the power exchanges to trade close to Gate Closure." … "On this basis, it could be argued that any losses incurred (and associated windfalls gained) as a result of notification errors are the results of the commercial operation of NETA".

The Authority indicated that it recognised that some losses may be disproportionate to the incentives necessary to achieve accurate notifications, and expresses the opinion that it would not necessarily be incompatible with the BSC Objectives or its [the Authority's] statutory duties for a notification error correction Modification to be made which would, in the interest of preserving incentives include:

1. An appropriate and material charge for any party seeking to correct a notification error. A fee of a fixed amount, …, should not be set at such a level as would be prohibitive to small players (this may argue for any change to the fee to be subject to Authority approval);
2. A fixed percentage limit on the recovery of the claim, in addition to the fee, may better achieve the relevant objectives by providing an incentive to accurate notification. The effectiveness of such provisions in providing appropriate incentives would need to be kept under review;
3. A short claim period. Ofgem considers that a claim period of less than two Business Days would be appropriate; and
4. The responsibility for establishing the nature of the error should be placed on the claimant. In addition the claimant would be expected to show that it had acted prudently in checking its notifications and that it had promptly put in place steps to avoid a repetition of the error.

Furthermore, specifically in terms of the retrospective element of P19, the Authority asserts that there is a "general principle of law that rules ought not change the character of past transactions completed on the basis of the existing rules."

5.3 REJECTED MODIFICATION P35

P35 sought to enable errors in ECVNs and MVRNs, made by ECVNAs and MVRNAs to be remedied on an ex post basis, only where the notification agent has been 'qualified' (a sort of accreditation) by the Performance Assurance Board. 'Qualified' ECVNAs and MVRNAs would then be limited to a defined number of claims in any year. Furthermore, to ensure the materiality of claims, a claim fee of £5,000 would be levied for each claim.

The Authority determined that P35 should not be made on 14 May 2002.

The Authority determination to reject P35 asserted that notification agent failure was considered prior to NETA Go-live, where it was concluded that:

- It would not be appropriate to include provisions for ECVNA accreditation in the Code;
- It would dilute the incentives on ECVNAs to develop robust systems; and
- Any exposure to the costs of such failures is likely to be very small if notification agents regularly update their submissions to the ECVAA and develop systems with the appropriate degree of redundancy and diversification.

The Authority asserted that P35 effectively implements accreditation for notification agents, and as the above points still stood [*at the point of the determination*], it would not be appropriate to introduce notification agent accreditation, on the basis that "to the extent that participants require third Party ECVNAs to provide enhanced levels of service, this should be a commercial decision between the ECVNA and its customers".

Therefore the Authority determined to reject P35 on the basis that it would be likely to increase the uncertainty in the market, which would not promote competition, and it would increase the need to re-run settlement calculations and therefore increase the burden on the central systems and processes which would not promote efficiency in the implementation of balancing and settlement arrangements.

5.4 APPROVED MODIFICATION P37

P37 sought to enable errors made in ECVNs and MVRNs in a defined period following NETA Go-live (Past Notification Errors) to be remedied on an ex post basis, incurring a non refundable £5,000 claim fee. Parties would be expected to provide evidence in respect of the Past Notification Error to the effect that they had in place prudent systems and processes, and that they had promptly taken all appropriate steps to rectify, reverse, or otherwise mitigate the effect of the error, and avoid a repetition of the error following its discovery. A body, such as the Panel, would determine on the Past Notification Error having regard to the extent to which the Past Notification Error:

- Was directly attributable to a failure of the BSC Systems;
- Was attributable to an inaccuracy in, or the non availability of the Forward Contract Report;
- Caused a loss suffered by the relevant Trading Parties, which was attributable to a combination of circumstances which cannot have been reasonably foreseen; and / or
- Caused a loss suffered by one or both of the Trading Parties, the magnitude of which was wholly disproportionate, due weight being given to the desirability of incentivising Parties to avoid mistakes in the submission of notifications.

Where the Panel / body agreed that all or part of the Past Notification Error should be rectified, then the rectification would be subject to a 20% Error Correction Payment, such that only 80% of the loss would be recovered.

The Authority determined that P37 should be made on 20 May 2002.

The Authority noted in its determination that it continues to believe that:

1. It is essential that there should be strong incentives on Parties to deliver correct notifications. If the incentives to have robust contract notification systems in place are inadequate, it is likely that Parties would wish to correct or adjust their notifications more frequently due to errors and this could adversely affect the efficient administration of the Code; and
2. A correction mechanism for notification errors might effectively allow ex post trading to take place since Parties may seek to make intentional post Gate Closure adjustments to their traded quantities, raising 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 will have to pay to reduce their imbalance exposure after real time and before contract notification.

The Authority noted that it would expect that the test for a reasonable and prudent Party would effectively become progressively more stringent in relation to notification errors occurring later in time. Furthermore, the Authority noted that there will always be the risk of high imbalance prices and in these circumstances it would be reasonable to expect all Parties to ensure that they have in place appropriate systems to deliver accurate notifications. Therefore the risk of high imbalance charges alone is not a sufficient reason for allowing the correction of notification errors. The Authority further noted that it continues to believe that it is not generally appropriate to expect that a Party should recover its losses in full nor should it expect to do so. The Authority also indicated that it is important that the process for considering claims is, and is recognised as being, impartial.

The key point to note in respect of the approval of P37 is the time constraint on rectification of notification errors. Notification errors were only to be corrected where they occurred within a strictly defined period following NETA Go-live, i.e. "in the early stages of NETA when participants were still getting to grips with the new arrangements, it is possible that even prudent operators may have made material errors as a consequence of their inexperience in dealing with the new systems. Although it was only to be expected that imbalance prices would be particularly volatile initially, this volatility coincided with the period during which participants were becoming accustomed to the operation of NETA". However, it should be noted that the Code (Section P6) did not differentiate between the treatment of claims made at different points of time during the 'claims window'.

5.5 REJECTED MODIFICATION P44

P44 sought to allow Parties to apply to the Panel request ex post creation of new ECVNs / MVRNs or amendment of previously submitted notifications under limited circumstances. P44 sought to address the increased risks that were faced by Parties where they had no alternative but to notify close to Gate Closure. Application for such error corrections would incur a non refundable £5,000 administration fee.

Errors would be rectified only where they had occurred under the following circumstances:

1. the ECVN / MVRN could not reasonably have been submitted in time to have been included in the last Volume Notification report which includes the relevant Settlement Period; and / or
2. The last Volume Notification report which includes the relevant Settlement Period was not sent to the claimant.

The claimant would also be required to demonstrate, to the Panel's reasonable satisfaction, that it took all reasonable and prudent steps to:

- Prevent the occurrence of errors;
- Minimise the risk that errors were not noticed in a reasonable time;
- Minimise the impact of such errors;
- Avoid repetition of such subsequent errors; and
- Mitigate the effect of the error(s) once discovered.

Where the Panel agrees that the error should be rectified, the rectification would be subject to a 10% Error Correction Payment level (i.e. a cap of 90% on the recovery).

The Authority determined that P44 should not be made on 10 May 2002.

The Authority noted in its determination that it continues to believe that:

1. It is essential that there should be strong incentives on Parties to deliver correct notifications. If the incentives to have robust contract notification systems in place are inadequate, it is likely that Parties would wish to correct or adjust their notifications more frequently due to errors and this could adversely affect the efficient administration of the Code; and
2. A correction mechanism for notification errors might effectively allow ex post trading to take place since Parties may seek to make intentional post Gate Closure adjustments to their traded quantities, raising 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 will have to pay to reduce their imbalance exposure after real time and before contract notification.

The Authority asserts that although the correction potential is limited under P44, it decreases the incentives to have robust notification / risk management systems and "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 feel 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 payment of a fee). The Authority further noted that the frequency and coverage of the Forward Contract Report was to change [*at the time of the determination*] and that this, in its opinion, reduced further the rationale for the Modification.

5.6 REJECTED MODIFICATION P128

P128 sought to allow new entrant Parties to have a period of grace following new entry, where a new entrant is defined as a Party that trades between its own Energy Accounts for the first time, where mistakes in such trades could be rectified.

The Authority determined that P128 should not be made on 1 September 2003.

The Authority noted in its determination that P128 would introduce uncertainty that would not engender confidence in the electricity retail market. The Authority stated that "bearing in mind the level of care Parties should take with regards to their notification systems and the accessibility of both trading system test facilities and trading expertise to new and existing Parties alike" P128 would not better facilitate the Applicable BSC Objectives.

Furthermore, the Authority noted that "in considering the limited circumstances under which the Modification Proposal would operate, Ofgem notes that only 'new internal transactors' can make a claim under P128 … Ofgem considers that whilst it could be argued that experience and facilities for testing were limited at the start of NETA, this is not the case after two years of operation." Therefore the Authority considered that P128 did not better facilitate the Applicable BSC Objectives.

5.7 APPROVED MODIFICATION P98

P98 implements dual notification with web based reporting and notification submission.

The Authority determined that P98 should be made, with an Implementation Date of 8 November 2004.

The Authority noted in its determination that "in order to promote effective competition in generation and supply of electricity it is important that all artificial barriers to entry within the wholesale trading arrangements are removed".

In considering the Proposed Modification the Authority noted the conclusion of the Modification Group that although the number of erroneous or malicious notifications that have resulted in significant settlement liabilities have been relatively few, the potential exists for unlimited settlement liability. The Authority additionally noted that the Modification Group concluded that erroneous or malicious notifications could be potentially catastrophic for the Party that has been notified against, with detrimental implications for other Parties.

The Authority further noted that the Modification Group concluded that there are means of mitigating the risk of erroneous or malicious notifications through robust single notification processes combined with monitoring of ECVAA reports, with additional legal recourse through the Grid Trade Master

Agreement (GTMA). However, the Authority expressed the opinion that "although these measures can mitigate the risk of erroneous or malicious notifications, the potential for unlimited liability still exists … and that legal recourse through the GTMA does not address the circumstances where the ECVNA cannot meet their obligations under the commercial contract, for example where either they are insolvent or where they are in administration".

The Authority noted that "after two years operational experience of the wholesale electricity trading arrangements and no commercial means identified to reduce the unlimited settlement liability, Ofgem considers that the potential for this unlimited liability represents a barrier to entry within the wholesale trading arrangements. It is Ofgem's view that the introduction of a voluntary dual notification facility will give Parties the scope to remove the risk of unlimited settlement liability due to erroneous or malicious notifications and that the removal of this barrier will promote effective competition. … The option for these Parties to dual notify contracts will remove this barrier to entry whilst giving Parties the option of continuing to trade using single contract notification".

In respect of the web based functionality being implemented by P98, the Authority expressed the belief that "the reduced risk and increased efficiency in contract notification associated with the web based facility should further facilitate competition and potentially encourage liquidity closer to Gate Closure".

5.8 APPROVED MODIFICATION P110

P110 implements dual functionality that enables nullification of contract positions remaining after all Authorisations between the two Parties have been terminated and no agreement can be reached between the Parties to Authorise and overwrite existing contract notifications.

The Authority determined that P110 should be made, with an Implementation Date of 5 November 2003.

The Authority indicated in its determination that P110 would increase market participants confidence in the robustness of the contract notification process which could potentially encourage new entrants which could further promote competition.

6 PAST NOTIFICATION ERROR DETERMINATIONS

The claims made under Section P6 of the Code, (implemented by Approved Modification P37) have been determined on, and the determinations offer useful pointers for criteria to be considered when developing the solution for P147, specifically the rationale for not rectifying claims made, as it sets a precedent where determinations are to be made on claims made under P147. The following summarises the determinations:

1. Claims were allowed for Past Notification Errors made in the period from NETA Go-live to 20 May 2002. Where two or more claims result from a single cause, then these would be treated as a single claim (for the purposes of calculating the claims fee). Furthermore, both Parties and the relevant notification agent (if different) needed to confirm that a Past Notification Error had occurred;

2. An error in the submission of a Volume Notification was considered to have occurred only where the Relevant Contract Trading Parties had, at the time of such submission, a demonstrably settled and shared commitment to notify particular ascertained volume data for the Settlement Period in question and it is clear that a mistake occurred giving effect to that commitment;

3. Parties were required to provide evidence, information and comments for BSCCo to investigate and provide a report on its findings;

4. Past Notification Errors were not to be rectified where the Volume Notification would have been invalid, rejected or refused at the point of the original submission, or where the Past Notification Error was a failure to submit, immediately prior to Gate Closure for the Settlement Period. Furthermore, rectification should have been declined where it was considered that the Party or notification agent failed to demonstrate that, at the time the Past Notification Error occurred, prudent systems and processes for notifying were in place (judged in light of the prevailing circumstances), and / or failed to take all appropriate steps to rectify, reverse or otherwise mitigate the effect of the error in respect of Settlement Periods for which Gate Closure had not yet occurred after becoming aware of the error and to avoid repetition of the error;

5. The committee were recommended to consider, when determining on the Past Notification Error, the extent to which:

    a. The Past Notification Error was directly attributable to a failure of BSC Systems;

    b. The Past Notification Error was directly attributable to an inaccuracy or non availability of the Forward Notification Summary (Forward Contract Report);

    c. The Past Notification Error and / or the magnitude of the loss suffered by the Parties in respect of Trading Charges as a result of the error was attributable to a combination of circumstances which could not have been reasonably foreseen; and

    d. The magnitude of the loss suffered by one or both of the Parties in respect of the Past Notification Error was wholly disproportionate, due weight being given to the desirability of incentivising Parties to avoid mistakes in the submission of notifications.

6. The considerations in respect of the claim were detailed;

    a. The considerations of the committee were based on the evidence and submissions provided during investigations;

    b. The standard of proof should be the civil standard of the balance of probabilities;

    c. Whilst the definition of a Past Notification Error is defined by reference to a Settlement Period, and therefore can apply to a single Settlement Period, most of the claims were based on a number of Settlement Periods (and Settlement Days). Therefore it was generally unnecessary to consider each factor individually for each Settlement Period;

    d. The committee had regard to the industry survey summary and synopsis which set out the approach of respondent Parties to the systems and processes in connection with notifying, and took this into account when making determinations;

    e. The special advisors main report set out three scenarios – vertically integrated, single site generator and trade; in seeking to describe the general approach to NETA, in respect of business requirements, implementation and systems and processes;

    f. Three other reports (E1, E2 and E3) set out additional matters raised during the assessment of the claims; dealing with the timing of notifications and implications for controls and checking reports (E1), a discussion of the 'circumstances then prevailing' (E2), and difference

in risks of intra-company notifications compared to inter-company notifications and the impact on the method of notifying (E3);

7. ELEXON was involved in the investigation of claims and in facilitating the process, however, it was not involved in making the determinations in respect of the claims;

8. The assessment as to whether systems and processes were considered to be reasonable and prudent was made in light of the circumstances prevailing at the time of the error. It was considered that Parties should, at all times, have systems and processes (in relation to notifying) that have a sufficient degree of robustness to be able to carry out the basic functions to transfer trade data to the notification system, submit the data as a notification and check that the notification has been submitted correctly.

   In terms of the circumstances prevailing, (with reference to the more relevant latter end of the P37 claims window), it would be expected that systems and processes would be working in the manner intended and would be robust. If changes were made to the systems and processes, these should generally be planned and tested in advance so that they would be fully robust when first activated. Human errors or software defects would be an exception;

9. Evidence was expected to be provided in support of claims made under P37 to prove that systems and processes were prudent at the time of the error. The sort of evidence provided (and considered as reasonable proof) was documentation detailing the approach taken to manage the risks associated with notifying, and how these are identified and mitigated. Some examples provided as to how the risks of notifying are dealt with are:

   - Implementation and use of a robust, and potentially integrated, trade capture and notification system;
   - Use of back up systems and third party notification agents in the event of system failures;
   - Management and reconciliation (against trading systems) of ACK's, NACK's, Rejections, Acceptances, Forward Contract Reports and daily notification reports[7]; and
   - Building access controls, secure system access, automated system back up and full audit trail and archiving.

10. In terms of proving that a Past Notification Error was made, claimants were expected to provide evidence of the error. In respect of inter - Party notifications, the evidence would be required to prove that there was a 'shared and settled commitment' between the two counterparties, and thus to prove the mistake. Types of evidence provided were:

    - Copies of the deal confirmations;
    - Sound files of the telephone conversations, or other evidence of the agreement to the transaction; and

[7] It should be noted that non 24-7 notification operations were deemed to have prudent processes in place where reconciliation of notification reports (specifically the Forward Contract Report) occurred on the Friday for the approaching weekend (including bank holidays). Therefore the precedent set by the Past Notification Error determinations is that Parties are not expected to be 24-7 to be deemed to be prudent.

- Activity level audit reports for the deals.

In terms of the evidence for mistakes in notifying intra – Party trades (i.e. trades between the Production and Consumption Energy Accounts of the same BSC Party), the evidence would be required to prove, as far as possible, that there was a legitimate requirement to intra-trade, and thus to prove the mistake. Types of evidence provided were:

- Evidence of the requirement for a periodic reconciliation resulting in an intra-Party notification, for example operational procedural documents;
- Demonstration of an ongoing requirement to intra-trade (for example, previous intra-Party trades made); and
- Trade entry screen shots showing trades for the relevant period (and longer).

11. A number of claims / part claims made under the P37 process were not rectified. Rationale for non rectification in each case is provided in detail in the relevant determinations, available on the BSC Website:

    http://www.elexon.co.uk/ta/panel/pne_individual_claims_docs.html