Modification Proposal – F76/01	MP Number: P19

Title of Modification Proposal

To provide for the remedy of errors in Energy Contract Volume Notifications and in Metered Volume Reallocation Notifications.

Submission Date

11 June 2001

Date Logged

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Description of Proposed Modification

London Electricity ('London') proposes a modification which would amend Section P of the Code to enable errors in Energy Contract Volume Notifications and Metered Volume Reallocation Notifications to be remedied on an ex-post basis.

Where such a notification failed to reflect the true trading positions of one or more Parties, the Party/Parties concerned would be entitled, once it/they had recognised the error, to submit a claim for the Notification Error to be rectified, with a longstop for the claim of 72 hours. (The Proposed Modification would, however, also allow Parties to claim rectification of Notification Errors in respect of Settlement Periods which have closed before the publication or adoption of the Modification, even where the 72 hour limit has been passed.)

To ensure that claims for rectification of a Notification Error are restricted to errors of genuine significance, a fee of £5,000 would be payable in respect of each claim.

It would be for the parties to prove to the satisfaction of the Panel that there had, in fact, been a Notification Error.

Where the Panel was so satisfied, it would be required to determine that appropriate adjustments be made to the erroneous notification, in order to bring it into line with the true trading position.

The adjusted notifications would then be used for the purposes of settlement.

Description of Issue or Defect that the Modification Proposal Seeks to Address

Condition 7A.1 of NGC's transmission licence requires NGC to have in force a document (the BSC) setting out the terms of the balancing and settlement arrangements. Those arrangements are defined in condition 7A.2(b)(ii) to include arrangements for the settlement of obligations between the BSC parties**:**

'*arising by reference to the [physical quantities of electricity allocated to BSC parties], including the imbalances … between such quantities and the quantities of electricity* <u>*contracted*</u> [our emphasis] *for sale and purchase between BSC Parties'*.

The Modification Proposal is designed to ensure that the BSC fulfils the requirements of condition 7A.2(b)(ii) of NGC's licence, by providing for each Party's imbalance position to be settled by reference to its true contract position, rather than by reference to a notified position which turns out to have been erroneous.

The BSC places on contracting Parties the onus of notifying to the Energy Contract Volume Aggregation Agent details of its contractual position in respect of each Settlement Period. Once Gate Closure has been reached for any given Settlement Period, there is no facility for Parties to correct any errors in their contract notifications. This means that, in cases where an erroneous notification has been made, and has not been corrected before Gate Closure, the settlement of imbalances will be effected by reference to the difference between the Party's physical production (or consumption) and the notified amount, rather than by reference to the difference between the Party's physical production (or consumption) and the contract amount.

This means that the objects described in Condition 7A.2 are not achieved, and that the affected Party may consequently suffer substantially higher imbalance charges than would apply if the correct contract volumes had been used to calculate settlement liabilities.

In order to achieve final settlement, the BSC must provide an effective mechanism for the Settlement Administration Agent to collate information as to each Party's contract position for each Settlement Period, and to calculate settlement liabilities accordingly. In practice, the contracting Parties are best placed to provide information as to their contract position, and it is appropriate that they should be required and incentivised to provide accurate information. In particular, in order to achieve finality of settlement, it is desirable that there should come a point, in respect of each Settlement Period, at which Parties' notified contract volumes must be treated as definitive of their contractual position.

However, there is no good reason why Parties should be denied the opportunity to correct erroneous notifications, provided that**:**

(i) the Parties do so sufficiently soon to avoid any delay in final settlement;

(ii) the opportunity for Parties to rectify erroneous notifications does not unduly diminish incentives to provide accurate notifications in the first place; and

(iii) the opportunity to rectify erroneous notifications is used for its proper purpose – namely, to rectify erroneous notifications of Parties' true trading positions, and not to effect and notify changes in a Party's contract position which occur after Gate Closure.

The Proposed Modification is designed to introduce into the BSC a provision enabling Parties to rectify notification errors within these limits.

Given that there has been a greater risk of notification errors during the early period of the operation of the BSC, the Proposed Modification is designed to allow the rectification of all past notification errors, including those in respect of Settlement Periods for which initial settlement has been completed prior to the publication or adoption of the Proposed Modification.

The Proposed Modification also embodies a similar modification to deal with erroneous notifications of Metered Volume Reallocation Notifications.

Impact on Code

Section P should be amended by the insertion of a new paragraph 2.3.6A as follows**:**

2.3.6A

*(1) For the purposes of this Section P, a **Notification Error** occurs where and only where**:***

(a) the information contained in an Energy Contract Volume Notification (taken together with any prior Energy Contract Volume Notification that remains in force pursuant to paragraph 2.3.5(b)) does not, at Gate Closure for any Settlement Period to which that notification relates, accurately reflect a trade of Active Energy; or

(b) a trade of Active Energy is not, at Gate Closure for any Settlement Period to which that trade of Active Energy relates, reflected in an Energy Contract Volume Notification.

*(2) In relation to a claim under paragraph (3) for rectification of a Notification Error, a **trade of Active Energy** is**:***

(a) an agreement between two Trading Parties for the sale and purchase of a quantity (or quantities) of Active Energy in relation to one or more Settlement Periods; or

(b) a resolution on the part of a single Trading Party to transfer Energy Contract Volume(s) from one of its Energy Accounts to the other which has been implemented within the Trading Party's own books or other records of account.

(3) Where a Party considers that there has been a Notification Error in relation to any trade of Active Energy to which it is Party, it may, subject to paragraph (4), as soon as reasonably practicable after becoming aware of the Notification Error and, in any event, no later than 72 hours after the end of the Settlement Period(s) to which the trade of Active Energy relates, make a claim for rectification of the Notification Error by giving notice of such claim to the Energy Contract Volume Aggregation Agent, together with details of the other Party (if any) to the relevant trade of Active Energy;

(4) Where a Party makes a claim for rectification of a Notification Error, it shall pay a fee to BSCCo, the amount of which (for each such claim) shall be £5,000, or such other amount as the Panel may from time to time, after Consultation with Parties, determine upon not less than 30 days' notice to Parties – which fee shall not be reimbursed in any circumstances.

(5) Where a Party gives notice of a claim for rectification of a Notification Error to the Energy Contract Volume Aggregation Agent, that agent shall within 24 hours of receiving such notice forward the notice to BSCCo, and to all Contract Trading Parties and Volume Notification Agents.

*(6) The Panel shall consider claims for rectification of Notification Errors in accordance with this paragraph (6)**:***

(a) For the avoidance of doubt, the Panel may establish or appoint a Panel Committee to discharge its functions under this paragraph 2.3.6A; and (notwithstanding Section W2.2) the Panel may appoint the Trading Disputes Committee, and (if so appointed) that Committee shall have the ability and competence, to do so.

(b) Where a claim for rectification of a Notification Error is made:

(i) the Panel Secretary shall arrange for the claim to be placed on the agenda of the Panel (consistently with paragraph (6)(b)(iii)), and shall request:

- *the Party claiming rectification of the Notification Error to provide such evidence and information supporting its claim as it may consider appropriate to resolve the claim; and*
- *the Energy Contract Volume Aggregation Agent to provide comments in relation to the claim;*

(ii) the Panel shall determine in its opinion whether there was a Notification Error and (if so) shall also determine what adjustments are to be made to the relevant Energy Contract Volume Notification or (in the case of a Notification Error under paragraph (1)(b)) what Energy Contract Volume Notification should be treated as having been submitted in respect of the relevant Settlement Period(s);

(iii) the Panel shall wherever practicable consider and determine the claim in time for any such adjustments to be taken into account in the Initial Settlement Run;

(iv) the Panel Secretary shall notify the Panel's determinations to the Energy Contract Volume Aggregation Agent and to all Contract Trading Parties and Volume Notification Agents;

(v) the fee under paragraph (4) shall be invoiced as and included in determining BSCCo Charges for the relevant Party for the next month for which BSCCo Charges are invoiced following the notification of the Panel's determination under paragraph (6)(b)(iv), and shall be paid accordingly.

(c) The determination of the Panel (or any Panel Committee established or appointed under paragraph (6)(a)) as to whether there was a Notification Error, and (if so) what adjustments are to be made under paragraph (6)(b)(ii), shall be final and binding on all Parties.

(7) Where the Panel has determined pursuant to paragraph (6)(b)(ii) that adjustments are to be made to the relevant Energy Contract Volume Notification or that an Energy Contract Volume Notification should be submitted, a notification in such terms shall be treated as having been submitted by the relevant Energy Contract Volume Notification Agent in respect of the relevant Settlement Period(s) in accordance with paragraph (8) below.

(8) An Energy Contract Volume Notification submitted in accordance with para (7):

(a) shall be deemed (for the purposes of the Code) to have been received:

(i) in the case of a Notification Error under paragraph (1)(a), at the time at which the original such notification was received; or

(ii) in the case of a Notification Error under paragraph (1)(b), in the period immediately before Gate Closure for the first Settlement Period to which the relevant trade of Active Energy relates; and

(b) if valid in accordance with paragraph 2.3.4, shall, notwithstanding that it may be submitted after Gate Closure for any Settlement Period, be in force and (subject to paragraph 2.4) effective for Settlement Periods for which:

(i) in the case of a Notification Error under paragraph (1)(a), the original Energy Contract Volume Notification would (consistent with paragraph 1.2.4) have been in force; or

(ii) in the case of a Notification Error under paragraph (1)(b), the trade of Active Energy relates.

A similar, but separate, provision will need to be included under Section P (as a new paragraph 3.3.6A, after 3.3.6) for Metered Volume Reallocation Notifications.

A supplemental provision will be needed to deal with the making of claims for Notification Errors in respect of Settlement Periods which have closed before the publication or adoption of this Proposed Modification. London proposes that claims in respect of such Notification Errors should require to be made within five days of the adoption of the Proposed Modification.

A number of consequential and supplementary amendments may also need to be made as a result of the addition of new paragraphs 2.3.6A and 3.3.6A.

Impact on Core Industry Documents

None

Impact on BSC Systems and other Relevant Systems and Processes used by Parties

None

Justification for Proposed Modification with Reference to Applicable BSC Objectives

The Proposed Modification is justified on the following grounds**:**

(i) It will ensure that, in principle, settlement will be conducted by reference to Parties' true contract positions, rather than by reference to erroneously notified positions. This requires that Parties should be allowed to correct erroneous notifications. However, they should not be entitled to do so if, by doing so, they would undermine the finality of settlement, or introduce inefficiency into the settlement process, to such an extent (in either case) as to prevent the BSC from operating efficiently or to introduce doubts into the market.

London submits that the Proposed Modification strikes an appropriate balance between (1) securing that settlement is effected by reference to accurate data, while ensuring that parties are incentivised to provide accurate data at the outset, and (2) securing that settlement is effected efficiently.

It is reasonable to require Parties to adopt effective measures to ensure that they make accurate notifications under the BSC. However, if Parties were to be confident of *never* making a notification error, then they would have to spend disproportionate amounts on the design and operation of their notification systems and procedures. Moreover, if there is no facility to correct notification errors, Parties are likely to manage their trading operations in such a way as to minimise the risk of notification errors, in preference to optimising their trading position: for example, they might aim to complete their trading and notify (and check) their contract position well before Gate Closure, instead of trading up to Gate Closure. This would unnecessarily curtail available trading time. (In fact, there is some evidence that this is what is happening now.)

Overall, it is likely to be less costly, and therefore more efficient, to allow Parties to correct notification errors.

However, there are costs to other parties in dealing with notification errors. These fall into two main categories:

(a) the cost of processing/determining a Party's claim that there has been a notification error and correcting settlement information if the claim is made out; and

(b) the cost to other Parties which might arise if there were an open-ended possibility of having settlement of previous Settlement Periods re-opened, by virtue of notification errors discovered long after the event.

The first of these costs can be addressed by requiring a Party claiming rectification of a notification error to pay a fee, to cover the costs of processing the claim. The obligation to pay a fee to have errors rectified will also serve to incentivise Parties to avoid making errors at the outset.

The second of these costs can be substantially avoided, or mitigated, by imposing a longstop date for claims for rectification of notification errors (being a longstop date consistent with the present timetable for final settlement) and/or by ensuring that, as soon as a claim for rectification of an alleged notification error is made, all Parties are notified of the claim (and can therefore factor it into their forecasts of their settlement liabilities).

It is proposed that, for claims in respect of notification errors made after the adoption of the Proposed Modification, a longstop for making a claim be adopted of 72 hours after the Settlement Period(s) to which the claim relates. This will provide Parties with an incentive to check their notifications promptly. There is no justification for an even shorter longstop, since Parties to the BSC do not rely on the notified contract position of other Parties for the purposes of their own trading decisions. (Parties will only be concerned that the figures used for the Initial Settlement Run are as accurate as possible.) This position can be contrasted with that of claims of Manifest Error in the submission and/or acceptance of Bids and Offers in the Balancing Mechanism (paragraph 7 of Section Q). In those specific circumstances, a longstop for making claims of four hours is appropriate since Parties will be making important trading decisions on the basis of Bids and Offers being made by other Parties and accepted by NGC. Any errors in the submission and/or acceptance of Bids and Offers must be corrected at the earliest opportunity to avoid misleading the market.

London submits that, in the light of all the above considerations, the Proposed Modification would:

(a) provide for settlement of imbalance obligations to be undertaken by reference to Parties' true contract positions, as required by Condition 7A.2(b)(ii) of NGC's transmission licence. It would therefore promote the attainment of the objective specified in Condition 7A.3(a) of that licence (the efficient discharge by NGC of its licence obligations); and

(b) promote efficiency in the implementation and administration of the balancing and settlement arrangements (Condition 7A.3(d)).

(ii) The Proposed Modification is also intended to allow Parties who have already made notification errors in respect of past Settlement Periods to submit claims for correction of those errors. To this extent, the 72-hour longstop in relation to making claims for Notification Error should be relaxed, and a different longstop time applied (for example, as we have proposed above, five days after adoption of the Proposed Modification).

London proposes that the Proposed Modification should apply retrospectively to take account of the fact that, in the period immediately following the introduction of NETA, Parties have found it unusually difficult to validate notification data in a timely manner. In particular, problems arising from the operation of systems employed by central parties have frequently led to inaccurate data being fed back to the Parties for validation. (This is clear from Elexon circulars issued at or around that time, notably numbers 11 to 13, 15 to 17, 19 to 21, 24, 27, 28, 33, and 41, and the Logica bulletin dated 11 April relating to settlements for 3 April.) In consequence, it was often unusually difficult for Parties to distinguish errors arising from central systems from errors in Parties' own notifications. This meant that Parties were often unable to identify and correct errors before Gate Closure, with errors becoming apparent only on the provision of data in respect of the initial settlement run.

By way of example, initial validation reports received by London on 3 and 4 April 2001 both indicated substantial imbalances but were accompanied by a warning from Elexon that a malfunction in its systems might have led to errors, and that apparent imbalances would be corrected automatically, without intervention by London. In the event, however, only the figures for 4 April resolved themselves. The figures for 3 April represented a significant imbalance resulting from a Notification Error which, by the time it became apparent, it was then too late for London to correct.

The plethora of data errors was compounded by the Parties' initial lack of familiarity with the reports in the early days of trading. These factors have resulted, in some cases, in the use of erroneous notification data to calculate settlement imbalances. This has, in turn, led to substantial imbalance liabilities. The adoption of the Proposed Modification, allowing these past errors to be corrected, would serve the general purpose of ensuring that settlement liabilities in respect of past Settlement Periods are calculated by reference to Parties' true contract positions.

The Proposed Modification is therefore justified on the basis that it contributes to the better attainment of the objectives of the BSC, as detailed above. It is also consistent with the approach taken in recent Trading Disputes, where difficulties encountered by Parties immediately following Go-Live have led to a temporary (three-month) relaxation of the requirements for the timely notification of disputes.

A question may arise as to whether retrospective application of the Proposed Modification is

appropriate. In some cases, the retrospective application of new rules may be regarded as inappropriate. This may be the case where, for example:

(a) the retrospective application of new rules may be unfair to parties who would have acted differently, if they had known that the new rules would apply;

(b) the retrospective application of new rules on one occasion may create a perception among present and future participants that there will be other occasions where new rules are adopted and applied retrospectively to the detriment of parties, thereby causing them to regard participation in the arrangements as carrying additional risk, which will feed through into higher prices; or

(c) the retrospective application of rules may re-open settled financial transactions.

Taking these three issues in turn:

The first of these issues does not arise in this case: no Party would have conducted itself differently in the balancing market if it had known that erroneous contract notifications could be rectified, since balancing trades are based on notifications of physical positions, and not contract positions. (This also means that, where some Parties have benefited from errors in others' notifications, that benefit has been a windfall.)

The second issue is of a more general nature, and is based on a common concern that *all* retrospective application of new rules creates increased risk. This is a misconception. It may equally be argued that a refusal to implement retrospective changes to address unfairnesses is a risk factor which participants must factor into their decision-making. Indeed, London submits that, in this case, the BSC has caused unnecessary unfairness by exposing Parties to substantial imbalance settlement liabilities, which were not foreseen at the time when the BSC was concluded. If the BSC is now amended to provide for retrospective correction of such unfairnesses, then that would send a signal to participants that Parties are protected from unforeseen unfairnesses in the operation of the BSC. Parties can therefore be expected to regard a retrospective application of the Proposed Modification as in fact decreasing, rather than increasing, the risks associated with participation in the BSC.

The third of these issues need not be of concern in the present case because:

(a) the retrospective application of the Proposed Modification will not interfere with transactions which have been finally settled, since final settlement in respect of any given Settlement Period is not completed until 14 months after its close;

(b) there is no absolute rule of law prohibiting the re-opening of transactions which have been fully settled: see, for example, *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All ER 513 (HL);

(c) the retrospective application of the Proposed Modification should therefore be permitted if the benefits of retrospective application (as outlined above) are likely to outweigh any detriments.

London submits that, in this case, retrospective application of the Proposed Modification will be beneficial overall. Any detriments can be avoided by ensuring that the rationale for the retrospective application of the Proposed Modification is fully explained in any report or decision document, to allay concerns that new rules might be applied retrospectively in other, materially different, cases.

The retrospective application of the Proposed Modification can therefore be expected to**:**

(a) provide for Parties' imbalances in respect of past Settlement Periods to be settled by reference to their true contract positions, as required by Condition 7A.2(b)(ii). This will contribute to the efficient discharge by NGC of the obligations imposed on it by its licence (Condition 7A.3(a));

(a) promote effective competition in the generation and supply of electricity, by allowing Parties, and new entrants in particular, to place reliance on the effectiveness of the BSC in addressing unfairnesses (Condition 7A.3(c)). To the extent that new entrants to the market may be more likely to make Notification Errors, then the Proposed Modification may further serve to promote competition from new entrants, by protecting them from the disproportionate consequences of such Errors; and

(b) promote efficiency in the implementation of balancing and settlement arrangements (Condition 7A.3(d)), by reducing the risk to Parties of participating in the BSC, and thereby reducing the risk-related costs of balancing and settlement activity.

(iii) It may be argued (as it was recently in the context of Modification Proposal P9) that the balance of fairness lies in favour of making no Code modification (or no retrospective modification) because Parties had an opportunity to address these considerations before the BSC was signed. London submits that such an argument would be incorrect because**:**

(a) discussions of the proposed terms of the BSC prior to its signature expressly contemplated that the question of notifications post-Gate Closure would be reconsidered in the light of the operation of the BSC, and also that Parties would be free to make a modification proposal post Go-Live to address errors in Energy Contract Volumes or in Metered Volume Reallocation (see, respectively, page 48 of the Ofgem/DTI 'conclusions document'on NETA dated October 1999, and pages 2 and 3 of the joint NETA Programme/Elexon working group paper dated October 2000 on Manifest Errors in Balancing Mechanism Transactions);

(b) discussions before signature of the BSC focused on whether Parties should be allowed to notify trades conducted after Gate Closure, whereas the Proposed Modification relates only to the notification after Gate Closure of trades effected (but not correctly notified) before Gate Closure;

(c) experience of the operation of the BSC shows that, in the weeks immediately after the commencement of the BSC, it has been more difficult than might previously have been expected for Parties to validate contract notification data, because of the large numbers of unrelated errors in the data put to them for validation, so that any conclusion on these issues reached through discussions conducted prior to the start date of the BSC could properly be re-opened in the light of experience; and

(d) discussions as to the terms on which the BSC should be adopted focused on the adoption of terms which would be appropriate to cater for the normal functioning of the market, and were not addressed to the exceptional circumstances which would apply in the period immediately following the introduction of NETA. There should therefore be no objection to adopting a retrospective modification to cater for the exceptional difficulties arising from the exceptional circumstances of the period immediately following Go-Live.

Details of Proposer

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Attachments

For completeness, London details in its letter covering this application a recent instance of contract notification error in respect of which it will wish to make a retrospective claim for rectification, if the Proposed Modification is adopted.

London asks that that letter be treated as an integral part of this Modification Proposal.