Modification Proposal

MP No: 98
(mandatory by BSCCo)

Title of Modification Proposal *(mandatory by proposer)***:**

Dual Notification Of Contract Positions.

Submission Date *(mandatory by proposer)***:** 02 September 2002

Description of Proposed Modification *(mandatory by proposer)***:**

Introduce a voluntary dual notication system for contract positions between BSC parties. The new process would be based on the specification drawn up under modificaiton P4.

Description of Issue or Defect that Modification Proposal Seeks to Address *(mandatory by proposer)***:**

Dynegy has always maintained that the single contract notification system under the BSC adds to the trading risks for all parties and adds additional costs to trading under NETA. This modification would put a dual notification system in front of the existing ECVNA function. The system would be screen based, with each party submiting their contract volumes to a centralised matching process, similar to the gas market, and only matched trades then going into central settlement systems. The systems would be built in line with the specification already drafted under modification P4, raised by Dynegy in March 2001. Copies of the specification are available on the Elexon web-site and no significant changes should be required to that specification.

At the currrent time all market participants are picking up balancing costs due to notification errors, with the single notification system having only one party submitting volumes into the central services. While parties can claim monies back from errors, under their GTMA contracts, the industry is unnecessarily paying for errors that would be impossible under a dual notification system. Under the dual system, each party notifies the contract volume against their counter-party, with only agreed trades going though, so by each gate closure each party knows exactly what their contract notification position is (even if they have outstanding disputes). Any remaining disputes will be related to whether a deal ocurred, and at what price, but with dual notification that dispute will not involve the additional cost of imbalance charges.

Dual notification also stops parties having positions notified against them that they do not know about. This is a risk for anyone not operating a 24 hour desk, 7 days a week. Again, while the party maybe able to claim costs back, in the meantime the party unaware of the notification against him could have been pushed into paying vast charges and may possibly have to increase their credit cover to catch a position that the party did not trade. Dynegy is aware of several instances where parties have been put in this position, coming in on Monday to find a set of reports that show an imbalance they knew nothing about. Enhanced reporting will do nothing to stop this continuing to ocurr under a single notificaiton system.

Any party facing imbalance charges because of notification errors will be facing charges that NGC as the system operator probably did not incur. The industry are already agreed that the imbalance prices are penal, so it would be more efficient to have a notification system that protects all parties from unnecessary penal charges.

Where parties are in agreement about whose mistake lead to the imbalance charge, both parties still have to employ valuable resources to bill each other, chase payments, transfer money etc. For Dynegy the "ageed" level of errors for the first year of NETA has been around £250,000, with errors ocurring between many of our trading parties for a variety of reasons. This indicates that there are not specific issues with any one party, but that all are impacted and all are facing additional costs as a result. Assuming Dynegy's experiences are typical, the industry is moving millions of pounds a year around because the contract notification system is not robust.

The problem of notification errors became acute with the failure of Enron. No trading parties knew what Enron was nominating against them when Enron went into administration (and it was the notification agent in most of its GTMAs). The enhanced reporting that will be implemented as the alternative to P4 would have made no difference to the exposure companies faced as they would not have been able to undo their positions close to real time. The liquidity in the power market is very limited closer to gate closure and notably for small quantities in the short term. We believe that parties would agree with us that they felt more exposed under the NETA systems than in the gas market when Enron collapsed. The attached graphical representation of the

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imbalance costs that were associated with the Enron collapse were derived from the system opertor I14 report and highlight the size of the costs that parties were exposed to. Dynegy believe that a dual notification system would have reduced these costs significantly.

Where parties do not agree with a notification under a dual notifcation system they have the benefit of time to call their counter parties and agree their positions, then correct their contract notifications, or in some cases positions will not be agreed and then contracts remian unnotified. With single notification parties do not have the same degree of control, with the result that many do not trade up to real time. The liquidity in the market is being impacted by the trading arrangements. Dual notification reduces the risk associated with trading close to real time and should therefore increase liquidity. Notably this would help the smaller less predictable generators to trade closer to real time and therefore better balance their positions, reducing their costs. We understand that the alternative P4, as accepted by Ofgem, aims to overcome this same defect, but we continue to believe that enhanced reporting does not address all the risks that single notifcaiton raises, such as the need for 24 hour cover.

Given the costs of a new system (Logica quotes less them £1 million for a dual notification system) are relatively low they would be significantly outweighed by the benefits. In Ofgem's decision letter on P4 they acknowledge that of the 10 respondents, 6 supported a dual notificaiton system, all siting their reason for support as the reduced commercial risks that it offers. In light of industry developments, Dynegy believe that many participants will support this change being made. Much of the ground work is already done, with a detailed specification already drafted, so the industry should be able to move quickly to a workable solution.

In its decision on P4, Ofgem wanted to maintain pressure on participants to operate robust systems. Dynegy can state catergorically that we have far fewer systems problem than the central service provider, suggesting our systems are robust. However, that aside, the spread of the costs associated with incorrect notifications across so many parties implies this has nothing to do with systems, but human error. A sensible business will always try to design systems that are robust against human error and dual notification is exactly that, robust with built in double checking by all parties. Dual notification provides a check and balance on all notified trades for all parties so each of us knows where our positions are and what our exposure is.

Ofgem also points out in its original decision letter that parties must take responsibility for their contract notifications. Dynegy agrees, but dual notification allows parties to work together rather than placing risk on a party to a trade who cannot necessarily manage that risk. More importantly, we can all be responsible parties, but that will not stop erroneous notifications against us that then cost us all money and will ultimately see customers pay more for their power than they should.

Impact on Code *(optional by proposer)***:**

Section P: 2.3-2.38 of the BSC - significant impact

Section V: Reporting - possible impact

Impact on Core Industry Documents *(optional by proposer)***:**

BSCP 71

BSCP533 - PARMS possibly

BSCP534 - PARMS Techniques - possibly

BSCP535 - Technical assurance of suppliers and supplier agents - possibly

Reporting Catalogue - possibly

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Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties *(optional by proposer)***:**

Energy contract notification systems

Reporting systems

Possibly on disputes ressolution

Impact on other Configurable Items *(optional by proposer)***:**

Justification for Proposed Modification with Reference to Applicable BSC Objectives *(mandatory by proposer)***:**

This modification will increase the efficiency of the market by reducing the risks associated with trading, particularly close to real time, reducing players costs to the benefit of the final customers. The imbalance risks faced by parties will be simpler for them to manage, again improving efficiency and reducing the barriers to market entry, which will enhance competition.

Dual notification will also increase the liquidity in the market, again improving efficiency, but also adding to competitive pressures in the market, as it provides a more robust trading mechanism. The ability of smaller players to leave trading closer to real time should improve their efficiency and thus the overall efficiency of the electricity market.

This modification better fulfils the relevant objectives by improving the efficiency of the market, promoting effective competition in the generation and supply of power, by encouraging and facillitating trading. Ultimately the more efficient the market the easier it is for NGC to discharge its own licence obligations in an efficient and cost reflective manner.

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Attachments: YES

If Yes, Title and No. of Pages of Each Attachment:

Graphical representation of the imbalance costs from the Enron collapse - from the I14 reports.

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