

Modification Proposal P98 'Dual Notification of Contract Positions' – Second Assessment Consultation

Overview

Modification Proposal P98 'Dual Notification of Contract Positions' (P98) was raised by Dynegy UK Limited on 2 September 2002. P98 seeks to introduce a (voluntary) dual notification system within the BSC systems. It should be noted that P98 seeks to address the issues that were identified under Modification Proposal P4 'Dual Energy Contract Notification' (P4) (raised in March 2001). P98 also seeks to utilise the definition and assessment work undertaken under P4, to provide a solution based upon the P4 Requirements Specification (014AAR V1.0).

The Panel, at their meeting of 12 September 2002, agreed to submit Modification Proposal P98 to the Assessment Procedure, with the Assessment Report to be submitted for consideration at the Panel meeting of 12 December 2002.

The Panel also agreed that an initial consultation should be undertaken to determine the likely take up of the voluntary dual notification system, with an interim report to be submitted for consideration at the Panel meeting of 17 October 2002 (Panel Paper 51/020). The Initial Assessment Consultation was duly undertaken and it was determined, from the responses to that consultation (twenty-two responses on behalf of 68 Parties) that there was sufficient interest in dual notification to warrant completion of the assessment. The initial Assessment Consultation also contained a number of questions set by the Settlement Standing Modification Group (SSMG) in order to assist in the assessment of P98.

Dual Notification of Contract Positions

The SSMG defined the requirements for the dual notification process, building on the requirements set out in the 'P4 Requirements Specification' (014AAR V1.0). In defining the solution, the SSMG also took into consideration the consultation responses made in respect of the Initial Assessment Consultation on P98, which indicate that there is a requirement for there to be minimal change to Parties systems and processes, in order to minimise impact. Therefore the SSMG defined a dual notification process designed to run seamlessly alongside the single notification process.

The SSMG also identified a number of enhancements in the dual notification process which could be equally applicable to the single notification process, and as such could be implemented at the same time as any dual notification functionality, as a 'bi-product' of dual notification. These are covered in more detail in the Requirements Specification, but can be summarised as follows:

- Functionality to specify who wishes to receive Acceptance Feedback Reports and Rejection Feedback Reports for each Authorisation.
- ECVAA business validation at Settlement Period level.
- Web Based View of Contract Positions.
- Web Based Entry of Contract Positions.

The 'Modification Proposal P98 'Dual Notification of Contract Positions' Requirements Specification' (P098AR, V1.0, 1 November 2002) was issued to industry and the BSC Central Service Agent for Detailed Level Impact Assessment.

The Requirements Specification is attached for information and is intended to provide supporting information for consideration when responding to this consultation.

Assessment of Dual Notification

The SSMG, during its assessment of Modification Proposal P98, have identified a number of issues relevant in the consideration of P98, which the SSMG believe should be highlighted in this consultation.

1. Unlimited Liability (to Imbalance Exposure)

The Proposer of P98 asserts that the Modification was raised primarily to address the issue of the potential for exposure to unlimited liability as a consequence of an erroneous or malicious notification under single notification. The Balancing and Settlement Code (the Code) contains no concept of limitation of exposure to Energy Imbalance charges, and therefore Settlement liability, in the event of an erroneous or malicious notification made against a Party by their counterparty.

The SSMG noted that there are commercial arrangements in place (outside of the Code) to deal with these circumstances, for example the Grid Trade Master Agreement (GTMA), however, it was noted that these commercial arrangements will not address the circumstance where the notifier can not meet their obligations under the commercial contract, for example, where either they are insolvent, potentially as a consequence of the settlement liability (perhaps resulting from the erroneous notification), or where they are in administration (and the administrators are enforcing a certain course of action).

The SSMG noted that although the probability of such extreme circumstances is relatively low, the materiality could be high and potentially catastrophic for the Party on the receiving end of the erroneous / malicious notification.

The SSMG also noted that, although dual notification would not allow cancellation of notifications previously submitted and still in force, as a consequence of the requirement for matching from both counterparties, the ability to determine the contract position at all times (from the Acceptance Feedback Reports and from the web based view) would enable Parties to trade out the position. Dual notification would also prevent further notifications being submitted to Settlement against an 'unwilling' Party.

It should further be noted, in respect of this point, that a number of the SSMG believe that the potential risk of unlimited (settlement) liability under the current single notification process could be considered to be a barrier to entry for new participants. It was proposed that there are a number of potential new entrants who are not currently entering the market, directly as a consequence of this notification risk.

2. Notification (Commercial) Disputes Resolution

The SSMG noted that the use of a dual notification system could clarify the identification of the culpability of erroneous notifiers. It is proposed that adoption of a dual notification system would improve the ability of Parties to identify where the culpability for an erroneous notification lies, as it is clear which of the counterparties made the error. This may improve the efficiency of the (commercial) disputes resolution process where there have been erroneous notifications made.

It was also proposed that this may increase the incentives on Parties (and their notification agents) to maintain robust notification systems to avoid making notification errors and thus being deemed culpable for the error.

3. Cost Benefits

The SSMG noted that Modification Proposal P98 is a cost-benefit driven Modification Proposal. A number of the SSMG believe that the costs of implementation of dual notification are far outweighed by the benefits that the dual notification process offers, namely the reduction in notification risk from erroneous or malicious notifications, the mitigation of the potential for unlimited (settlement) liability resulting from such erroneous or malicious notifications, and in the increased ability to identify culpability for errors in notifications, and the associated reduction in the cost of recovering commercial compensation for such errors.

Impact Assessment

BSC Parties and the BSC Central Service Agent were requested to provide an impact assessment of the changes required to support the implementation of Modification Proposal P98, as set out in the Requirements Specification.

The impact assessments received from BSC Parties indicate that there is a relatively material amount of development and implementation required within BSC Party systems and associated processes. Estimates of costs varied from £5000 to £600,000, with timescales of 40 mandays to 15 months quoted.

A number of the impact assessment responses indicate that there is some concern amongst respondents that the implementation of dual notification increases complexity, and therefore risk, in the systems and processes used by parties for notifying, as a consequence of potentially having to use two differing processes. A number of the SSMG agreed with this assertion. However, it should be noted that this was not a specific question in the impact assessment.

The impact assessment received from the BSC Central Service Agent provided indicative costs for implementation of the dual notification within the BSC Systems and it should be noted that it is an interim assessment pending further verification.

The BSC Central Services cost of implementing and developing the full solution (dual notification, web based reporting and web based submission of notifications) is as follows:

- £1,000,000 software development and implementation;
- £600,000 hardware implementation (for infrastructure upgrade, including £200,000 for disaster recovery); and
- £150,000 hardware implementation (for web based aspects, including £25,000 for disaster recovery).

In total, development and implementation of dual notification within the BSC Systems would incur BSC Central Service Agent costs in the region of £1,750,000.

It should be noted that development and implementation of the enhancements to the single notification process, highlighted earlier in this consultation document, do not incur any additional BSC Central Service Agent costs over those set out above.

With regards to the potential implementation of P98 dual notification, it is expected that the implementation would be part of the November 2003 BSC Systems release, at the earliest, with a more probable implementation in the February 2004 BSC Systems release.

This impact assessment summary is attached for information and is intended to provide supporting information for consideration when responding to this consultation.

Consultation

The SSMG have identified a set of questions aimed at obtaining information from BSC Parties relevant to the continued consideration and assessment of Modification Proposal P98. BSC Parties are requested to provide as much detail in the responses as is possible, as the SSMG believe that these questions address the key issues associated with Modification Proposal P98, and therefore comprehensive responses will be valuable for concluding the assessment of P98.

BSC Party Consultation Questions

Please provide responses to these consultation questions using the proforma provided.

Please provide responses to modifications@elexon.co.uk by 17:00 on **Wednesday 27 November 2002**.

BSC Parties responding on behalf of (please list all Parties):

Question	Response
<p>Q1. What significance do you attach to the risk of unlimited (settlement) liability from erroneous or malicious notifications made against you?</p>	<p>Rationale:</p>
<p>Q2. In your opinion, will the implementation of dual notification make it easier under contracts to clarify, legally, responsibility for incorrect notifications?</p> <p>What effect do you think this will have on incentives for notifiers and on the robustness of Party notification systems?</p>	<p>YES / NO</p> <p>Rationale:</p> <p>Rationale:</p>
<p>Q3. In your opinion, considering the issues set out in this consultation document, do you consider the implementation of dual notification to be cost beneficial?</p> <p>If so why? If not, why not?</p>	<p>YES / NO</p> <p>Rationale:</p>
<p>Q4 (a). In your opinion, will the implementation of dual notification mean the adoption of different approach to trading, for example, trade by trade notifications, or a move away from Parties notifying contracts in a batch at the end of the working day? If so, how?</p> <p>Do you anticipate the changes you describe as being implemented by your own organisation and / or the market as a whole?</p>	<p>YES / NO</p> <p>Rationale:</p> <p>Rationale:</p>
<p>Q4 (b). Will dual notification lead to changes in market liquidity? For example, will the potential reduction in notification risk lead to any change in the liquidity of short-term trading?</p> <p>Please provide rationale for your response.</p>	<p>YES / NO</p> <p>Rationale:</p>

