

Modification Proposal – F76/01

MP Number:37

Title of Modification Proposal

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

Submission Date

11 September 2001

Date Logged

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Description of Proposed Modification

London Electricity ('London') proposes a modification which would amend the BSC to enable past (but not, under this proposal, future) errors in Energy Contract Volume Notifications and Metered Volume Reallocation Notifications to be remedied on an ex-post basis.

This proposal follows Modification Proposal P19, which addressed both past and future notification errors but which was rejected by the Gas and Electricity Markets Authority (the 'Authority') in its decision document dated 1 August 2001. Following a meeting with the Authority to clarify its approach to notification error modifications, London is submitting this proposal in respect of past notification errors in advance of a separate proposal that will address future notification errors. This approach will enable past notification errors to be dealt with on an urgent basis (if that is thought appropriate) and considered separately from the issue of future notification errors.

This Modification Proposal is based upon 'P19 Optimised', that being the version of P19 that was preferred by the BSC Panel in its consideration of that proposal. It additionally incorporates the features which the Authority indicated in its decision on P19 should form part of an acceptable notification error correction modification. In particular, it includes features that Ofgem has said would be applicable to modifications that have retrospective effect.

Under this proposal, where a notification made prior to the adoption of this modification failed to reflect the true trading positions of one or more parties, the party/parties concerned would be entitled to submit a claim for the notification error to be rectified. Parties would have five business days from the adoption of this proposal in which to make such claims.

It would be for the parties to prove to the satisfaction of the Panel that they had a demonstrably settled and (where appropriate) shared commitment to notify accurately the true trading position, and that there had been a mistake in giving effect to that commitment.

The Panel would have discretion to decline to rectify a notification error if it considered that the party or parties concerned did not at the relevant time have prudent systems and processes in place for checking notifications and/or had failed to take appropriate steps to improve such systems and

processes once the error had been discovered. Moreover, the Panel could refuse to rectify a notification error in circumstances other than where:

- the notification error was directly attributable to BSC Systems;
- the notification error or loss suffered as a result of the error arose from a combination of circumstances that could not have been reasonably foreseen; or
- the magnitude of the loss suffered was wholly disproportionate to the fault or error committed.

Where the Panel decided that a notification error should be rectified, it would be required to determine that appropriate adjustments be made to the erroneous notification. These adjustments would bring the notification into line with the true trading position, but would also subject the parties to a financial penalty equivalent to 20 per cent of the value to the parties of having the notification error rectified (the maximum penalty for each claim being capped at £200,000). The adjusted notification would then be used for the purposes of calculating settlement liabilities.

A non-refundable administration fee (initially set at £5,000 but subject to revision by the Panel, with the approval of the Authority) would be payable to BSCCo in respect of each claim.

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

The defect in the Code that this Modification Proposal seeks to address is the same as that which P19 sought to address, although the proposal relates only to notification errors made prior to its adoption: future notification errors will be the subject of a separate modification proposal.

Condition 7A.1 of the NGC transmission licence requires NGC to have in force a document (the Balancing and Settlement Code) 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 contracted [our emphasis] for sale and purchase between BSC Parties’.

The Modification Proposal (together with the separate proposal now envisaged in respect of future notification errors) is designed to ensure that the BSC does, in fact, fulfil 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 the contracting Parties the onus of notifying to the Energy Contract Volume Aggregation Agent details of their 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. The actual requirements described in Condition 7A.2 are therefore not, in fact, achieved, and 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 full and 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.

However, there is no good reason why Parties should be denied the opportunity to correct erroneous notifications, including those which have occurred already, provided that:

- (a) the Parties do so sufficiently soon to avoid any delay in final settlement;
- (b) the opportunity for Parties to rectify erroneous notifications does not unduly diminish incentives to provide accurate notifications in the first place; and
- (c) 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, in this case with retrospective effect. In particular, the proposal incorporates, to the extent relevant, those features which the Authority has indicated (at paragraph 25 of its decision in respect of P19) should form part of any notification error correction modification. Taking the elements of paragraph 25 in turn:

- (a) **Authority's paragraph 25(i): an appropriate and material charge for any party seeking to correct a notification error**

This would initially be set at £5,000, being an estimate of the average administrative cost that the BSCCo would incur in investigating a claim of notification error (it is also the fee charged for investigating claims of manifest error under Section Q of the Code). The Panel would have the discretion to vary this charge, following consultation with the parties and with the approval of the Authority. The need to obtain the Authority's approval would guard against the charge being set at a level that could be prohibitive to smaller players.

- (b) **Authority's paragraph 25(ii): a fixed percentage limit on recovery of a claim**

This is given effect by imposing a 20 per cent financial penalty on parties that make a successful claim of notification error. The maximum size of the financial penalty is capped at £200,000. This is because, notwithstanding that a notification error can result in losses running into many millions of pounds, whether such an error results in a large or a small loss is largely a consequence of chance and bears little, if any, relationship to the scale or nature of the error committed by the party concerned. It would be arbitrary to impose very widely varying financial penalties on such a basis, for example by setting a fixed discount on the total value of the claim at any level. We believe that a cap of £200,000 on the penalty to be incurred addresses these considerations, while providing BSC Parties with sufficient incentive to submit accurate notifications.

- (c) **Authority's paragraph 25(iii): a short claim period**

This element of the Authority's decision is directed more at claims for future notification errors, rather than at claims for notification errors falling within the scope of this Modification Proposal. However, parties will have only five days from the date that this proposal comes into effect in which to make their claims of past notification error.

(d) **First part of Authority's paragraph 25(iv): the responsibility for establishing the nature of the error must rest on the claimant**

It is for the party claiming a notification error to demonstrate to the Panel that it had a settled and (where appropriate) shared commitment to accurately notify the true trading position, and that there had been a mistake in giving effect to that commitment;

(e) **Second part of Authority's paragraph 25(iv): the claimant must show that it had acted prudently in checking its notifications**

The Panel would have discretion to refuse to rectify a notification error if it considered that the party at fault did not, at the time that the error occurred, have in place prudent systems and processes for the checking of notifications. The effect of the drafting is that the Panel would have to judge whether such systems and processes were prudent in the light of the circumstances prevailing at the time, rather than with the benefit of hindsight.

(f) **Third part of Authority's paragraph 25(iv): the claimant must promptly put in place steps to avoid repetition of the error**

The Panel would have discretion to refuse to rectify a notification error if it considered that the party at fault had not, following discovery of the error, promptly taken all appropriate steps to avoid repetition of the error.

In addition, because this Modification Proposal is directed to the rectification of past notification errors, it also incorporates those features which the Authority has indicated are appropriate to modifications which have retrospective effect.

At paragraph 36 of its decision in respect of P19, the Authority outlined a non-exhaustive list of categories of 'particular circumstances' which could give rise to the need for a retrospective rule change. The Modification Proposal incorporates these categories of particular circumstances into the notification error correcting mechanism so that the Panel is bound to have regard to them in deciding whether to allow rectification of a notification error. If a notification error falls outside the specified categories of circumstances, the Panel may decline to rectify that error. Those particular circumstances are:

- where the notification error was directly attributable to BSC Systems;
- where the notification error and/or the magnitude of the loss suffered by the party or parties concerned arose from a combination of circumstances that could not have been reasonably foreseen; or
- where the magnitude of the loss suffered by the party or parties concerned was wholly disproportionate to the fault or error committed by that party.

It can be seen that, where necessary, appropriate changes have been made to the categories of particular circumstances described in paragraph 36 of the P19 decision to reflect the fact that the Modification Proposal is concerned with retrospective notification errors rather than with a more general type of retrospective change. For example, the category comprising the third bullet point under Ofgem's paragraph 36 ('where the possibility of a retrospective action had been clearly flagged to the participants in advance, allowing the detail and process of the change to be finalised with retrospective effect') has not been included, since those particular circumstances are not applicable to notification errors under the BSC.

Moreover, the Modification Proposal includes a category of circumstances (our third bullet point above) that did not appear in paragraph 36 of the Authority's decision. In its broader context, this additional category can best be defined as:

'where the magnitude of the loss suffered by a party is wholly disproportionate to the fault or error committed by that party, provided that the fault or error had no detrimental effect on the efficient operation of the balancing and/or settlement systems'

In the context of notification errors, the reference to 'no detrimental effect on the efficient operation of the balancing and/or settlement systems' can be omitted since notification errors by their nature are incapable of having any such detrimental effect.

In common with the three categories of circumstance identified by the Authority in paragraph 36 of its P19 decision, this 'fourth' category is derived from modifications approved by the regulator in respect of the Gas Network Code, including, in particular, modification reference number 0064.

In that specific case, the Authority's predecessor, the Director General of Gas Supply, approved a retrospective modification which had the effect of redistributing millions of pounds of imbalance charges that had been incurred by certain (but by no means all) shippers of gas. The shippers concerned had incurred significant imbalance charges as a direct result of their failure to provide zero nominations to Transco, the system operator. It was accepted that zero nominations (which were in relation to gas deliveries to sub-terminals) were of no importance or value to Transco in its operation of the system. Nevertheless, those who failed to provide the zero nominations incurred significant imbalance charges, whereas those who provided zero nominations did not (and, indeed, benefited from a redistribution of the imbalance charges incurred by others). Despite opposition from the system operator, the Director General of Gas Supply directed that the Network Code be modified with retrospective effect to reverse the imbalance charges incurred by those of the gas shippers who had omitted to provide zero nominations.

London submits that this precedent from the Gas Network Code justifies the incorporation of a 'fourth' category of particular circumstances into the Proposed Modification.

At paragraph 37 of its decision in respect of P19, the Authority stated that a more stringent cap should apply to the retrospective recovery of monies lost through notification errors. The size of the financial penalty under this Modification Proposal (20 per cent, up to a maximum of £200,000) already incorporates this more stringent cap. A lesser financial penalty would be appropriate in relation to future notification errors (which will be the subject of a separate proposal).

The proposed modification also embodies a similar modification to deal with the correction of past erroneous notifications of Metered Volume Reallocation Notifications.

Impact on Code

The following text shall be inserted in Section P.

6. PAST NOTIFICATION ERRORS

6.1 Meaning of Past Notification Error

6.1.1 For the purposes of this Section P:

- (a) a '**Past Notification Error**' has occurred in relation to the notification of Energy Contract Volume Data or Metered Volume Reallocation Data for a Settlement

Period where and only where there was an error in the submission of a Volume Notification on the part of the Volume Notification Agent and/or the relevant Contract Trading Parties which was not rectified prior to Gate Closure for the relevant Settlement Period and where Gate Closure for such Settlement Period has occurred prior to the date on which this paragraph 6 comes into effect;

(b) references in this paragraph 6 to the submission of a Volume Notification:

- (i) mean the submission of a particular Volume Notification, and
- (ii) include a failure to submit a Volume Notification,

and the provisions of this paragraph 6 shall be construed accordingly;

(c) for the purposes of paragraph (a), an error in the submission of a Volume Notification will be considered to have occurred only where:

- (i) the relevant Contract Trading Parties had, at the time of such submission, a demonstrably settled and (save in the case of paragraph 1.4.1) shared commitment to notify particular ascertained Volume Data for the Settlement Period in question, and
- (ii) it is clear that a mistake occurred in giving effect to that commitment;

(d) in relation to a claim of Past Notification Error:

- (i) the **'relevant'** Volume Notification is the Volume Notification in respect of which the Past Notification Error has occurred,
- (ii) the **'relevant'** Volume Notification Agent is the Volume Notification Agent which submitted or failed to submit (as the case may be) the relevant Volume Notification,
- (iii) the **'relevant'** Settlement Period is the Settlement Period in respect of which the Past Notification Error has occurred,
- (iv) a **'relevant'** Contract Trading Party is a Contract Trading Party in relation to which the Past Notification Error has occurred, and
- (v) the **'rectified Volume Notification'** is the Volume Notification which would have been made had the Past Notification Error not occurred;

(e) in relation to a relevant Contract Trading Party, references to a Past Notification Error are to the Error which has (or is alleged to have) occurred in respect of such Party;

(f) **'Volume Data'** means Energy Contract Volume Data or Metered Volume Reallocation Data, as the case may be.

6.2 Claiming Past Notification Errors

6.2.1 Where a relevant Contract Trading Party considers that there has been a Past Notification Error, such Party may make a claim to that effect by giving notice of such claim to BSCCo, identifying the Past Notification Error(s) and the relevant Settlement Period(s), provided

that no claim of Past Notification Error may be made after the expiry of five days after the date on which this paragraph 6 comes into effect.

6.2.2 Where a relevant Contract Trading Party makes a claim of Past Notification Error, such Party shall pay a fee to BSCCo for each such claim (provided that, for the purposes of this paragraph 6.2.2, and subject to paragraph 6.2.4, a claim may relate to more than one Past Notification Error in respect of the same Volume Notification), the amount of which shall be £5,000, or such other amount as the Panel may from time to time, after consultation with Parties and with the approval of the Authority, determine upon not less than 30 days' notice to Parties, and which shall not be reimbursed in any circumstances.

6.2.3 Where a relevant Contract Trading Party makes a claim of Past Notification Error (other than one to which paragraph 1.4.1 applies), the claim shall be accompanied by a statement in writing from the other relevant Contract Trading Party (addressed to BSCCo for the benefit of all Contract Trading Parties) confirming that it considers that the Past Notification Error has occurred.

6.2.4 A claim of Past Notification Error may not be made in relation to a Volume Notification in respect of which a previous claim has been made (and, accordingly, if a relevant Contract Trading Party wishes to claim Past Notification Errors in relation to more than one Settlement Period, a single claim must be made for all such errors).

6.2.5 A claim of Past Notification Error may be made in relation to a Volume Notification, notwithstanding that the Volume Notification was treated as rejected (in relation to the relevant Settlement Period) or refused, in accordance with paragraph 2.4 or 3.4, where the rectified Volume Notification (if submitted as described in paragraph 6.4.5) would not have been so treated, but without prejudice to paragraph 6.6.2.

6.3 Flagging Past Notification Errors

6.3.1 Where a Party gives notice of a claim of Past Notification Error under paragraph 6.2.1, BSCCo shall within one Business Day after receiving such notice notify the claim to the Energy Contract Volume Aggregation Agent, all Contract Trading Parties, and the relevant Volume Notification Agent.

6.4 Determination of Past Notification Errors

6.4.1 The Panel shall consider claims of Past Notification Error in accordance with this paragraph 6.4.

6.4.2 For the avoidance of doubt, the Panel may establish or appoint a Panel Committee to discharge its functions under this paragraph 6, 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.

6.4.3 Where a claim of Past Notification Error is made:

(a) the Panel Secretary shall arrange for the claim to be placed on the agenda of a meeting of the Panel (consistently with paragraph (c)), and shall request:

(i) the Party claiming the Past Notification Error to provide evidence and information supporting its claim,

(ii) the other relevant Contract Trading Party (if any) to provide evidence and

information supporting the claim, and

- (iii) the relevant Volume Notification Agent and the ECVAA to provide comments in relation to the claim;
- (b) the Panel shall determine in its opinion whether there was a Past Notification Error and, if so, what it was;
- (c) the relevant Contract Trading Parties and the relevant Volume Notification Agent shall:
 - (i) provide the Panel with such further information as it may reasonably request to assist it in making its determination, and
 - (ii) confirm to the Panel that the evidence and information provided to the Panel are complete and not misleading;
- (d) the Panel Secretary shall notify the Panel's determinations to all Contract Trading Parties and the relevant Volume Notification Agent;
- (e) BSCCo shall give such instructions to the ECVAA, SAA, and FAA as are necessary to give effect to any such rectification;
- (f) the fee under paragraph 6.2.2 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 (d), and shall be paid accordingly.

6.4.4 The determination of the Panel (or any Panel Committee established or appointed under paragraph 6.4.2) as to whether there was a Notification Error and, if so, what it was shall be final and binding on all Parties.

6.4.5 Rectification of a Past Notification Error shall not be made if the rectified Volume Notification would have been invalid (pursuant to paragraph 2.3.4 or 3.3.4) or treated as rejected (in relation to the relevant Settlement Period) or refused (pursuant to paragraph 2.4 or 3.4) if such rectified Volume Notification had been submitted:

- (a) at the time at which the relevant Volume Notification was submitted; or
- (b) where the Past Notification Error is a failure to submit, immediately prior to Gate Closure for the relevant Settlement Period.

6.4.6 The Panel may decline to rectify a Past Notification Error:

- (a) where it considers that the Contract Trading Party and/or Energy Contract Volume Notification Agent that made the error in the submission of the relevant Volume Notification did not:
 - (i) at the time that the Past Notification Error occurred, have in place prudent systems and processes for the checking of Volume Notifications (the question of whether such systems and processes were prudent to be judged in the light of the circumstances then prevailing), or
 - (ii) following discovery of the error, promptly take all appropriate steps in

relation to such systems and processes to avoid a repetition of the said error;
and

- (b) in circumstances other than where:
 - (i) the said Past Notification Error was directly attributable to BSC Systems,
 - (ii) the said Past Notification Error and/or the magnitude of the loss suffered by the relevant Contract Trading Parties as a result arose from a combination of circumstances that could not have been reasonably foreseen, or
 - (iii) the magnitude of the loss suffered by one or more of the relevant Contract Trading Parties as a result of the said Past Notification Error was wholly disproportionate to the fault or error committed by that party.

6.5 Rectification of Past Notification Errors

6.5.1 Where the Panel determines that a Past Notification Error has occurred:

- (a) the Panel shall determine what adjustments are required to the relevant Account Bilateral Contract Volumes, Metered Volume Fixed Reallocations, and/or Metered Volume Percentage Reallocations (as the case may be) to achieve the following effects:
 - (i) to put the relevant Contract Trading Parties into the position that they would have been in had the Past Notification Error not occurred (subject to paragraph (ii) below), and
 - (ii) to impose on each of the relevant Contract Trading Parties in respect of each claim an Error Correction Penalty determined in accordance with paragraph 6.5.2; and
- (b) such adjustments shall be made as soon as is practicable, and shall be taken into account in the next Settlement Run for the relevant Settlement Period.

6.5.2 In relation to a claim of Past Notification Error (provided that, for the purposes of this paragraph 6.5, and subject to paragraph 6.2.4, a claim may relate to more than one Past Notification Error in respect of a single Volume Notification covering more than one Settlement Period), an Error Correction Penalty is the lesser of:

- (a) a sum equal to 20 per cent of the cash equivalent of the value (if any) to the relevant Contract Trading Party of being put into the position that it would have been in had the Past Notification Error(s) to which the claim relates not occurred; and
- (b) £200,000.

For the avoidance of doubt, the maximum Error Correction Penalty applicable in respect of any claim shall be the amount provided for in this paragraph 6.5.2, regardless of the number of Past Notification Errors to which any particular claim relates.

6.6 Credit arrangements

6.6.1 Where a Past Notification Error is rectified, the rectification shall be taken into account for the purposes of the determination of the relevant Contract Trading Parties' Credit Cover

Percentages in relation to Settlement Periods for which Gate Closure occurs after, but not earlier than, the time of the rectification.

6.6.2 In accordance with paragraph 6.6.1:

- (a) where, in accordance with Section M, a relevant Contract Trading Party was treated before the time of the rectification as being in Credit Default and would not have been so treated had the rectified Volume Notification been submitted:
 - (i) Section M3.5 shall not apply, and such Party shall not be entitled to any right or remedy in respect of being so treated, and
 - (ii) to the extent that, as a result of such Party being so treated, any other Volume Notification was treated as rejected (in relation to any Settlement Period) or refused in accordance with paragraph 2.4 or 3.4, such refusal or rejection shall not be affected or prejudiced by the rectification of the Past Notification Error and Section M4 shall not apply in relation thereto;
- (b) where, in accordance with Section M, a relevant Contract Trading Party would have been treated before the time of the rectification as being in Level 2 Credit Default had the rectified Volume Notification been submitted, and was not so treated, the rectification of the Past Notification Error shall not affect or prejudice any other Volume Notification which was not treated as refused before, or rejected as to Settlement Periods for which Gate Closure was before, the time of the rectification.

6.6.3 For the purposes of this paragraph 6.6, the time of the rectification of a Past Notification Error is the time with effect from which the ECVAA enters into its BSC Agent System the adjustments determined under paragraph 6.5.1.

Section D

The following text shall be inserted in Section D4.1(a)(v):

‘(v) any amounts paid to BSCCo by way of fee pursuant to Section P6.2.2 or Section Q7.2.3;’

Section G

The following text shall be inserted as a new Section G1.1.2(b) and the existing Section G1.1.2(b) and remaining paragraphs of Section G1.1.2 shall be renumbered accordingly:

‘(b) Section P6, which addresses the possibility of notification errors in the submission of Volume Notifications;’

Section M

The following text shall be inserted as a new Section M3.5.2 and the title of Section M3.5 shall be amended to read ‘Result of Trading Dispute, etc’:

‘3.5.2 This paragraph 3 and paragraph 4 are subject to the provisions of Section P6.’

Annex X–1

The following new definitions shall be inserted in Annex X–1:

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| ‘Past Notification Error’ | has the meaning given to that term in Section P6.1.1(a); |
| ‘Volume Data’ | has the meaning given to that term in Section P6.1.1(f); |
| ‘Error Correction Penalty’ | has the meaning given to that term in Section P6.5.2 |

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 principal grounds:

1. It would ensure that, as regards the period prior to the adoption of the Modification Proposal, settlement of imbalance obligations will be conducted by reference to Parties’ true contract positions, as required by Condition 7A.2(b)(ii) of NGC’s transmission licence, rather than by reference to erroneously notified positions. When taken together with a separate modification in respect of future notification errors, the Proposed Modification 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).
2. The Proposed Modification is intended to allow Parties who have already made notification errors in respect of past Settlement Periods to submit claims for correction of those errors.

At paragraph 36 of its decision in respect of P19, the Authority outlined a non-exhaustive list of categories of ‘particular circumstances’ that could give rise to the need for rule changes having a retrospective effect. These categories (with appropriate amendments) have been incorporated into the notification error correction mechanism so that the Panel is bound to have regard to them in deciding whether to allow rectification of a notification error. If a notification error falls outside the specified circumstances, the Panel may decline to rectify that error.

Such an approach to retrospection is consistent with general principles of law as to when retrospection may be justified. Generally, retrospective changes are presumed to be unfair because:

- (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: there is no evidence that any Party would (and no Party has claimed that it 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 of contract positions. (This also means that, where some BSC 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, and could not reasonably have been, foreseen at the time when the BSC was concluded.

If the BSC is now amended to provide for retrospective correction of such unfairnesses, 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 effect 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 and clearly explained in any report or decision document, so as to allay concerns that new rules might be applied retrospectively in other, materially different, cases.

The retrospective effect of the Proposed Modification can therefore, on this analysis, be expected to:

- (a) promote effective competition in the generation and supply of electricity, by allowing the BSC 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.

3. It may be argued (as it was in the context of Modification Proposal P9) that the balance of fairness lies in favour of making no Code modification with retrospective effect 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 was 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 may 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 modification with retrospective effect to cater for the exceptional difficulties arising from the exceptional circumstances of the period immediately following Go-Live.

Details of Proposer

Name: Roger Barnard
Organisation: London Electricity plc
Telephone: 0207 331 3398
e-mail address: roger_barnard@londonelec.co.uk (note: the link is an underscore)

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.