



Direct Dial: 020-7901 7412

15 May 2002

The National Grid Company, BSC Signatories and
Other Interested Parties

Your Ref:
Our Ref : MP No: P04

Dear Colleague,

Modification to the Balancing and Settlement Code - Decision and Direction in relation to Modification Proposal P04: "Dual Energy Contract Notification"

The Gas and Electricity Markets Authority (the "Authority") has carefully considered the issues raised in the Modification Report dated 21 March 2002 for Modification Proposal P04 "Dual Energy Contract Notification".

The Balancing and Settlement Code ("BSC") Panel (the "Panel") recommended to the Authority that the Alternative Modification be approved with an Implementation Date of the 10 December 2002¹.

The Authority has decided to direct that the Alternative Modification Proposal P04 is made to the BSC. This letter explains the background and sets out the Authority's reasons for its decision. In addition, the letter contains a direction to the National Grid Company plc ("NGC") to modify the BSC in line with Alternative Modification Proposal P04, as set out in the revised Final Modification Report dated 21 March 2002.

This letter constitutes the notice by the Authority under section 49A Electricity Act 1989 in relation to the direction.

¹ See the Revised Modification Report section of this decision letter for an explanation of the revised Implementation Date from the original recommendation.

Background to the proposal

NETA is designed to ensure that there are strong incentives on participants to balance their individual trading positions and minimise the costs to the NGC as System Operator ("SO") of balancing the Transmission System ("System"). Market participants can contract ahead in the forwards, futures and short-term markets to balance their contract position ahead of Gate Closure (3½ hours before real time²). Parties can amend contract notifications³ up until Gate Closure. Gate Closure is the last point at which Parties can make contract notifications to and correct their contract position with NETA Central Systems. For each Settlement Period the metered volumes for each Trading Party are used to determine if the actual volumes taken from, or put onto the System match their notified contractual volumes. Parties with a position of energy imbalance will be exposed to the relevant Energy Imbalance Prices for the relevant Settlement Period. Contract notifications are only registered if they are notified from a participant's system via communications links to the Energy Contract Volume Aggregation Agent (ECVAA⁴) System and acknowledged before Gate Closure.

Prior to NETA Go-Live⁵ consideration was given by market participants and Ofgem on whether to have a system of dual or single contract notification. Ofgem determined that the process for making contract notifications to the ECVAA System would be done via single notification. It was also made clear to Parties that the ECVAA reporting they would receive on contract notifications was in addition to the requirement for Parties to have their own systems and processes for managing their contract notifications. Under the arrangements for single notification the Contract Trading Parties appoint a Notification Agent⁶, which can be one of the two Parties or alternatively a third party. The Notification Agent makes a single notification to the ECVAA on behalf of both of the Contract Trading Parties.

On 28 March 2001 Dynegy UK Limited proposed Modification P04: Dual Energy Contract Notification. The Proposer argues that the existing notification system relies on the Forward Contract Report and cannot confirm notifications of trades close to real time. The Proposer suggested that the process of single notification puts significant risk of imbalance on the contract parties and that it would be more efficient and cost effective to have a central system that only

² On the 2 May 2002 the Authority accepted Modification Proposal P12 "Reduction of Gate Closure From 3.5 Hours To 1 Hour". Modification Proposal P12 will be implemented on the 2 July 2002.

³ Reference to 'contract notifications' includes both Energy Contract Volume Notifications (ECVNs) and Metered Volume Reallocation Notifications (MVRNs).

⁴ The ECVAA provides the NETA central settlement system.

⁵ NETA Go-Live was the 27 March 2001.

⁶ Reference to 'Notification Agent(s)' includes both Energy Contract Volume Notification Agents (ECVNA's) and Metered Volume Reallocation Notification Agents (MVRNAs).

registered agreed trades. The Proposer suggested that the risk associated with single notification is acting as a barrier to trading, reducing liquidity in the market and thereby its efficiency.

The Modification Proposal

Modification Proposal P04 seeks to further the achievement of the applicable BSC Objectives⁷ (b) the efficient, economic and co-ordinated operation by transmission system and (c) promoting effective competition in the generation and supply of electricity. Modification Proposal P04 proposes that each Party would notify their agreed energy contract volumes to the ECVAA Systems and only valid matched notifications would result in a contract being successfully notified for use in settlement. Any non-matched notifications would be rejected automatically by the ECVAA. The ECVAA would notify both Parties of their failure to complete a valid contract notification and of the acceptance of matching notifications. The Parties would be responsible for resolving and correcting any non-matching notifications before re-notifying them. At Gate Closure for any Settlement Period, all matched contract notifications received prior to or at Gate Closure for the Settlement Period would be made available for credit checking. The dual notification functionality referred to as the Central Matching Process (“CMP”) would form part of NETA Central Services and the provisions for ECVAA System Failures would extend to cover the CMP.

After the Initial Assessment, the Panel recommended that this Modification Proposal be progressed through the Assessment Procedure⁸. The Modification Group (“the Group”) considered the issues raised within the proposal and identified two key issues they wanted to address:

- the provision of facilities to ensure that notifications cannot be submitted by one party without the knowledge and approval of the counter party; and
- the provision of facilities to enable Parties to determine their current trading position.

⁷ The applicable BSC Objectives are contained in Condition C3.3 of NGC’s Transmission Licence and are:

- (a) the efficient discharge by the licensee of the obligations imposed upon it by this licence;
- (b) the efficient, economic and co-ordinated operation by the licensee of the licensee’s transmission system;
- (c) promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity;
- (d) promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

⁸ As defined in the BSC, Section F, paragraph 2.6

In the Assessment of the Modification Proposal the Group considered any options that could also address these two key issues. As a result, the Group extended the scope of the Modification Proposal to include: Enhanced ECVAAs reporting; Increased ECVAAs capacity for volume notifications; and associated GTMA changes.

Enhanced ECVAAs reporting

The Group suggested that within-day trading was impeded close to real time due to a lack of real time information and that more timely feedback of successful notifications and reporting of within day notifications is required. Enhancing the ECVAAs reporting service would remove this impediment to within-day trading and would enable Parties to better determine their current trading position. It was considered by some of the Group that improving ECVAAs reporting would deliver most of the benefits of dual notification. The Group also considered developing the provision of a web based application for enhanced reporting where contract positions could be viewed in real time by a Trading Party. It was proposed that enhanced reporting should provide a New Acceptance Feedback dataflow and amend the existing Forward Contract Report.

The new Acceptance Feedback Report would on receipt and successful validation of a contract notification, generate a positive Acceptance Feedback dataflow covering 72 Settlement Periods forward and be sent to the Notification Agent and the counterparties to the contract notification.

In addition to Parties internal systems, the Forward Contract Report enables Parties to determine their contract position and to identify and rectify errors and omissions in contract notifications. Under provisions in the BSC the ECVAAs is required each day to provide Contract Trading Parties with a Forward Contract Report that confirms notified volumes received by the ECVAAs for the subsequent 7 Settlement Days. It was proposed that the Forward Contract Report be changed so as to include: all Settlement Periods which have not yet gate closed on the day the report is generated; reporting on null/zero volumes for Settlement Periods for any relevant Notification Agent Authorisation and Trading Party; and the filename of the original notification last received which has been processed and incorporated in the Forward Contract Report.

Increased ECVAAs capacity for volume notifications

The Group suggested that the Modification Proposal would enable trading parties to trade more effectively within day, which could lead to an increase in the number of contract notifications to the ECVAAs. The ECVAAs can currently process 2000 contract notifications per Settlement Period. The Group deemed the current limit as insufficient and suggested that this service needs to be enhanced to support the Modification Proposal. Given that the ECVAAs service is part of the agreement between the NETA Central Service Agent and ELEXON⁹, it was considered that

⁹ ELEXON is the Balancing and Settlement Code Company (BSCCo).

this enhancement could not be included as part of the Modification Proposal. Instead it was agreed that should the Modification Proposal be approved, ELEXON should manage the procurement of enhancing the ECVAA service to increase the capability for processing contract notifications.

GTMA changes

The Grid Trade Master Agreements (“GTMA”) describe the framework on which counter parties bilaterally trade, confirm, notify and settle energy accounts. The Group assessed the impact of dual notification on the GTMA. The Group identified that there would be some necessary changes to the GTMA framework. After initial analysis the Group decided that GTMA participants could develop the necessary changes and this issue was removed from the scope of this proposal.

On the 28 June 2001 the Panel considered an Interim Assessment Report issued by the Group. In the report the Group recommended that:

- dual energy contract notification should be provided by a BSC Agent in parallel with single energy contract notification subject to costs;
- the provision of enhanced ECVAA reporting should be progressed subject to costs; and
- the ECVAA contract notification capacity should be increased.

All the Group’s recommendations were subject to acceptable costs and timescales. The Panel noted that all respondents supported enhancing ECVAA reporting, but that views were split on dual notification. The Panel instructed the Group to present the enhanced ECVAA reporting option as an Alternative Modification in the revised Assessment Report.

On the 11 July 2001 the Group had a final meeting before the revised Assessment Report was sent to the Panel. The Group noted the Panel’s instruction to consider enhanced ECVAA reporting and dual notification as Alternative Modifications. The Group considered impact assessments provided by the NETA Central Service Agent that outlined the costs and timescales for implementation. The Group recommended that:

- the provision of enhanced ECVAA reporting should be developed as a priority and implemented as an Alternative Modification. However, the Group did not believe that the development of Web based reporting should be progressed because of the high costs;
- the ECVAA should be required to provide an enhancement to the performance of the ECVAA service, to support the Modification Proposal and other Modifications; and

- the provision of a dual notification process should not be progressed on the basis of the indicative quotation provided by the NETA Central Service Agent. However, further cost estimates should be sought from third parties for the provision of dual notification to determine if this service should be provided. Until the results of such a competitive tender were received, the Group considered that the Modification should remain within the Assessment Procedure.

It was subsequently noted that Section F of the Code does not specifically allow for competitive tendering within the Assessment Procedure of the Modification process. Therefore legal advice was sought by ELEXON on how to progress this aspect of the Modification. The legal advice provided to ELEXON stated that a Modification Group is required to recommend whether or not to proceed with a Modification Proposal based on information and costs provided. Consideration of who should develop and/or provide such a service is undertaken by ELEXON during implementation of an approved Modification. This advice was communicated to the Group in the subsequent drafting of the Assessment Report before it was finalised.

On the 26 July 2001 the Panel considered the Assessment Report issued by the Group. The Assessment Report recommended that the provision of enhanced ECVAAs should be developed as a priority and implemented via the Alternative Modification; that the ECVAAs should be required to provide an enhancement to the performance of the ECVAAs service; and that dual notification should not be progressed on the basis of the current quotation (timescales and costs) provided by the NETA Central Service Agent. The Panel voted unanimously to recommend the Alternative Proposal.

ELEXON published a Draft Modification Report on 30 July 2001 that invited respondents' views by the 13 August 2001. In the Draft Modification Report, the Panel recommended that the original Modification Proposal should be rejected and that the Alternative Modification be approved.

Respondents' views

In total, ELEXON received 10 responses to the consultation on the Draft Modification Report P04. Of the responses, 7 respondents expressed support for implementing the Alternative Modification and three respondents did not. Of the responses, 6 supported implementing the original Modification Proposal, one did not and three did not comment.

Comments received in support of the Alternative Modification suggested that enhanced ECVAAs reporting would assist Parties in verifying the accuracy of contract notifications. One respondent suggested that enhanced ECVAAs reporting would provide almost all the benefits that dual notification would provide without the significant development costs and disruption to existing

processes. Another respondent recognised that there was split opinion in the Group and consultations on whether the original Modification Proposal or the Alternative Modification better furthers the applicable BSC Objectives and welcomed the Panel's decision to recommend the Alternative Modification.

Some respondents that opposed the rejection of the original Modification Proposal suggested that while enhanced reporting would provide some benefits, dual notification will provide a better solution to reducing the commercial risks associated with contract notification and would therefore better further the achievement of the applicable BSC Objectives. Some respondents questioned the decision by the Panel to reject dual notification given that the provision of the service for dual notification had not gone out for competitive tender as the Group had recommended.

Panel's Recommendation

The Panel met on 23 August 2001 and considered the Modification Report, the views of the Modification Group and the consultation responses received.

The Panel recommended that the Authority should reject the original Modification Proposal and that the Alternative Modification should be approved and if approved implemented on the 27 March 2002.

Revised Modification Report

The Modification Report for Modification Proposal P04 that was sent to the Authority on the 3 September 2001 specified an Implementation Date of 27 March 2002. In February 2002, it was recognised that the Authority had not yet made a decision and that the work necessary by the industry to implement the Alternative Modification could not be completed by the proposed Implementation Date. The BSC Panel therefore agreed at its meeting on 14 February 2002 to seek the Authority's permission to withdraw the Modification Report and to consult on a revised Implementation Date. The Authority agreed to the withdrawal of the Modification Report and a consultation on a revised Implementation Date was undertaken by ELEXON.

At its meeting on 14 March 2002, the BSC Panel considered the results of the consultation on a revised Implementation Date. The Panel agreed that the Implementation Date for Modification Proposal P04 should be amended to recommend that the Alternative Modification be approved with an Implementation Date of the release date for BSC Systems which first occurs not less than 3 months after the date of the Authority's decision. ELEXON resubmitted the Modification Report containing this revised recommendation to the Authority on the 21 March 2002.

The revised Modification Report explained that, on the basis of a 3 month lead time for parties, the effect of the proposed Implementation Date would be that an Authority decision by the end of April 2002 would lead to an Implementation Date of 10 August 2002 and that an Authority decision after the end of April 2002 but before the end of August 2002 would lead to an Implementation Date in December 2002. On the 10 May 2002 ELEXON wrote to Ofgem to confirm that the Release Strategy for the BSC Systems Delivery Programme has been established and as a result, it is now possible to clarify that the implementation date in December referred to in the revised Modification Report would be 10 December 2002.

Ofgem's view

Ofgem¹⁰ considers that there were procedural irregularities in Modification Proposal P04. The BSC provides for the Panel at any stage during the Assessment Procedure to issue such directions as it sees fit to the Group in consequence of the Authority's view (Section F 2.6.10 (c)). In the Assessment Procedure of P04 the Panel issued a direction to the Group to present the enhanced ECVAAs reporting option as an Alternative Modification in the revised Assessment Report without seeking the Authority's view. However, the Group did agree to consider Enhanced ECVAAs reporting as an Alternative Modification subsequent to the Panels instruction and recommended the implementation of Enhanced ECVAAs reporting as a priority via the Alternative Modification route. In addition, the Draft Legal Text for the original Modification Proposal was not consulted upon in the Draft Modification Report. However, Ofgem does not consider that this gives preference to the Alternative Modification as sufficient detail was provided upon the original Modification Proposal in the Assessment Process including a Requirements Specification and Impact Assessment to enable participants to give the original Modification Proposal due consideration. Ofgem believes that these issues were not material and sufficient to justify rejecting the Modification Proposal on the basis of procedural irregularities.

Ofgem has given full consideration to the original Modification Proposal (Dual Notification) and the Alternative Modification (Enhanced ECVAAs Reporting). Ofgem considers, having had regard to its statutory duties, that the Alternative Modification would better facilitate the achievement of the applicable BSC Objectives and the original Modification Proposal would not better facilitate the achievement of the applicable BSC Objectives.

Ofgem believes that the Alternative Modification enhances ECVAAs reporting by giving more timely feedback of successful notifications and real time reporting of within-day notifications. Enhancing reporting allows Trading Parties to be more aware of their contract position and give them greater control over managing their contract notification. Enhanced ECVAAs Reporting would better enable Parties to identify and rectify errors and omissions and reduce the chance of

¹⁰ Ofgem is the office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

erroneous notifications. In addition, Ofgem considers that the Alternative Modification maintains incentives on participants to continue to develop robust systems for contract notification and risk management. For these reasons Ofgem believes that the Alternative Modification would further the BSC Objective (d) of the efficient implementation of the balancing and settlement arrangements.

Ofgem believes that enhancing ECVAA reporting will increase Parties confidence in their ability to determine their current trading position. This potentially will encourage market participants to trade closer to real time and within-day. An associated improvement in liquidity would increase competition and therefore Ofgem believes that the Alternative Modification would further the achievement of the applicable BSC Objective (c) of promoting effective competition in the generation and supply of electricity.

Ofgem recognises that the Panel at their meeting on the 18 April 2002 accepted Change Proposal CP755¹¹ which provides the same enhancements to ECVAA reporting as outlined in the Alternative Modification Proposal. Ofgem considers that the Alternative Modification Proposal should still be implemented so that the commitment on the ECVAA to provide the enhancements to reporting are contained within the BSC as opposed to a Code Subsidiary Document. Ofgem considers that this will provide greater transparency to the market.

Ofgem believes that the original Modification Proposal (Dual Notification) reduces the incentives on participants to develop robust systems of contract notification and risk management. Under single notification the responsibility and risk for matching the correct traded volumes and notifying them to central systems lies with the two Trading Parties. Participants can determine which aspects of the risk in contract notification they want to manage themselves, and which they want to mitigate through commercial contracts with nominated Notification Agents. Commercial agreements can be undertaken with Notification Agents where they take the commercial liabilities of an erroneous contract notification once they have confirmed a trade to the Counterparty. In addition, some third party Notification Agents already provide large elements of the proposed dual notification service to participants.

Ofgem believes that the market provides more efficient and competitive services for contract notification than if this service and the responsibilities of failure are solely borne by NETA Central Systems with the costs being smeared back across the industry as a whole.

Therefore Ofgem believes that the original Modification Proposal would not further the achievement of the applicable BSC Objectives (d) promoting efficiency in the implementation

¹¹ Details of Change Proposal CP755 and the Panel Decision can be found on the ELEXON website, www.elexon.co.uk.

and administration of the balancing and settlement arrangements and (c) of promoting effective competition in the generation and supply of electricity.

The Authority's decision

The Authority has therefore decided to direct that the Alternative Modification P04, as set out in the Modification Report dated 21 March 2002, should be made and implemented.

Direction under Condition C3.5 (a) of NGC's Transmission Licence

Having regard to the above, the Authority, in accordance with Condition C3.5 (a) of the licence to transmit electricity granted to NGC under Section 6 of the Electricity Act 1989 as amended (the "Transmission Licence"), hereby directs NGC to modify the BSC as set out in the Alternative Modification in the Modification Report dated 21 March 2002.

The Modification is to take effect from 10 December 2002.

In accordance with Condition C3.5 (b) of NGC's Transmission Licence, NGC shall modify the BSC in accordance with this direction of the Authority.

Please do not hesitate to contact me on the above number if you have any queries in relation to the issues raised in this letter or alternatively contact Anthony Doherty on 020 7901 7159.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Sonia Brown". The signature is written in a cursive style with a large initial 'S'.

Sonia Brown

Head of Electricity Trading Arrangements

Signed on behalf of the Authority and authorised for that purpose by the Authority

Attachment 1

Legal Text to Give Effect to the Proposed Modification

BSC Section V to read:

TABLE 3 – ECVAA REPORTING

Name of report	Frequency	Recipient	General Description
Acceptance Feedback Report for valid ECVNs	Promptly after successful validation	Parties, ECVNA	For each Contract Trading Party, a positive feedback to report the acceptance of those ECVNs where the effective date of the ECVN is no greater than 72 Settlement Periods ahead
Acceptance Feedback Report for valid MVRNs	Promptly after successful validation	Parties, MVRNA	For each Contract Trading Party, a positive feedback to report the acceptance of those MVRNs where the effective date of the MVRN is no greater than 72 Settlement Periods ahead