

September 2002

**INITIAL ASSESSMENT OF MODIFICATION
PROPOSAL - P98**

Dual Notification of Contract Positions

Prepared By ELEXON Limited

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b Distribution

Name	Organisation
Each BSC Party	Various
Each BSC Agent	Various
The Gas and Electricity Markets Authority	Ofgem
Each BSC Panel Member	Various
energywatch	Energywatch
Core Industry Document Owners	Various

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1 SUMMARY

Modification Proposal P98 'Dual Notification of Contract Positions' (P98), included in Annex 1, was submitted on 2 September 2002 by Dynegey UK Limited, in accordance with Section F 2.1.1 of the Balancing and Settlement Code ('the Code').

Modification Proposal P98 seeks to introduce a (voluntary) dual notification system within the BSC systems. It should be noted that Modification Proposal P98 seeks to address the perceived defect that were identified under Modification Proposal P4 (raised in March 2001). Modification Proposal P98 seeks to utilise the definition and assessment work undertaken under Modification Proposal P4, based upon the Requirements Specification (014AAR V1.0).

Modification Proposal P4 consisted of the Proposed Modification, which sought to implement dual contract notification and an Alternative Modification, which sought to implement enhanced reporting from the ECVAAs. The Authority determined that Alternative Modification P4 should be made, and that Proposed Modification P4 should not be made, on the basis that the Authority did not believe that Proposed Modification P4 better facilitates the Applicable BSC Objectives.

As Modification Proposal P98 seeks to implement the mechanism proposed and defined in the Requirements Specification drafted for Modification Proposal P4, the Proposal can be considered to be clearly defined. However, there are several issues outlined in section 12 that need to be addressed, and which can be summarised as follows:

1. Consideration of the Authority decision letter for Modification Proposal P4;
2. Consideration of the cost benefits of implementation of Modification Proposal P98, including identification of the likely take up of the voluntary dual notification process;
3. Definition and consideration of processes (and consequences thereof) required to support failure of the dual notification system;
4. Consideration of the Requirements Specification for P4 to ensure that it is still robust given current system functionality, and is still reflective of the requirements of parties with regards to a dual notification system; and
5. The Impact Assessment provided by the BSC Central Service Agent for Proposed Modification P4 has expired, and requires revisiting against the current baseline.

On the basis of this Initial Written Assessment, the Panel is invited to:

- **NOTE the results of the Initial Written Assessment;**
- **DETERMINE that Modification Proposal P98 should be submitted to the Assessment Procedure in accordance with section F2.6 of the Code;**
- **AGREE the Assessment Procedure timetable such that an Assessment Report should be completed and submitted to the Panel for consideration at their meeting of 12 December 2002;**
- **DETERMINE that the Assessment Procedure should be undertaken by the Settlement Standing Modification Group with appropriate experts on contract notification; and**
- **AGREE any refinement to the Modification Group Terms of Reference.**

2 INTRODUCTION

This Report has been prepared by ELEXON Ltd. on behalf of the Panel, in accordance with the terms of the Code. The Code is the legal document containing the rules of the Balancing Mechanism and imbalance Settlement process and related governance provisions. ELEXON is the company that performs the role and functions of the BSCCo, as defined in the Code.

An electronic copy of this document can be found on the ELEXON website, at www.elexon.co.uk Copies of the Requirements Specification (014AAR V1.0) and the Authority decision letter are also available on the BSC Website, as follows:

ftp://www.elexon.co.uk/ta/modifications/modsprops/hP004/P4_Dual_Not_Req_Spec.pdf

ftp://www.elexon.co.uk/ta/modifications/modsprops/hP004/P4_Ofgem_Decision.pdf

3 DESCRIPTION OF THE MODIFICATION PROPOSAL

A copy of the Modification Proposal, as submitted by its Proposer, can be found at Annex 1 to this report.

Description of the Proposed Modification

Modification Proposal P98 seeks to implement a dual notification process within the BSC Systems. Dual notification is the process whereby agreed contract volumes are submitted by both Counterparties to a centralised matching process and where valid, contract volumes are matched and submitted to settlement. The proposed process is defined in detail in the Requirements Specification for Modification Proposal P4, referenced in section 1.

In contrast, single notification is the submission of volume notifications by one nominated ECVNA on behalf of both Counterparties, into the Central Services, where valid contract volumes are submitted to settlement.

Modification Proposal P98 seeks to implement dual notification such that it is provided as an optional process. Where Trading Parties wish to continue utilising the single notification process to the exclusion of dual notification, there will be no impact on that Trading Party.

Justification for the Proposed Modification

The Proposer of Modification Proposal P98 asserts that the Modification seeks to address several issues:

- The industry is currently unnecessarily paying for the costs of notification errors that arise from the single notification system;
- Parties may have notifications made against them that they are unaware of, which they did not trade; and
- The higher risk associated with trading near to real time, which discourages parties from trading near to real time and particularly disadvantages smaller less predictable generators.

4 IMPACT ON BSC SYSTEMS AND PROCESSES

BSC System / Process	Potential Impact of Proposed Modification
Contract Notification	The Energy Contract Volume Aggregation Agent (ECVAA) system requires amendment to the receipt and processing of contract notifications to support the addition of the dual notification functionality specified in the Requirements Specification (014AAR, V1.0, 24 May 2001).
Credit Checking	The process of credit checking should be unaffected by the implementation of dual notification. However, the implementation of dual notification may require amendment to the service levels for credit checking in order to give more time prior to running the credit check, in order enable the dual notification matching functionality to match contract notifications received right up to Gate Closure. However, it is expected that the additional time required for such matching would be minimal.
Reporting	<p>The Energy Contract Volume Aggregation Agent (ECVAA) system requires amendment to support the additional reports associated with the dual notification functionality specified in the Requirements Specification (014AAR, V1.0, 24 May 2001).</p> <p>It should be noted that Modification Proposal P98 may require implementation of a 'screen based' reporting system as part of the implementation of dual notification. Therefore this will have additional impact on reporting.</p>
Dispute Resolution	The scope of Trading Disputes will require amendment to encompass disputes arising from failures of the dual notification system, for example, disputes arising from failed / erroneous matches.

5 IMPACT ON OTHER SYSTEMS AND PROCESSES USED BY PARTIES

System / Process	Potential Impact of Proposed Modification
BSC Parties	BSC Parties choosing to utilise the dual notification process will be impacted by the requirement to amend the manner in which contracts are notified, as set out in the Requirements Specification (014AAR, V1.0, 21 May 2001), and by the requirement to reflect these amendments, and the obligations associated with them, in any commercial contracts with their Counterparties, for example the Grid Trade Master Agreement (GTMA).
Transmission Company	If the Transmission Company chooses to utilise the dual notification process to make their forward trades, then they will be impacted by the requirement to amend the manner in which contracts are notified, as set out in the Requirements Specification (014AAR, V1.0, 21 May 2001), and by the requirement to reflect these amendments, and the obligations associated with them, in any commercial contracts with their Counterparties, for example the Grid Trade Master Agreement (GTMA).

6 IMPACT ON DOCUMENTATION

6.1 Impact on Balancing and Settlement Code

BSC Section	Potential Impact of Proposed Modification
P: Energy Contract Volumes and Metered Volume Reallocations	Section describes the obligations with regards to the submission and processing of Energy Contract Volume Notifications (ECVNs) and Metered Volume Reallocation Notifications (MVRNs), therefore this section requires amendment to reflect the obligations and processes implemented by the dual notification system. This should also include any provisions for dual notification failure.
W: Trading Queries and Trading Disputes	Section W may require amendment to reflect the additional scope for Trading Disputes introduced by the implementation of the dual notification process.

BSC Section	Potential Impact of Proposed Modification
X: Definitions and Interpretation	New definitions and variables may be required to support the dual notification process.
X: ANNEX X-1 General Glossary	
X: ANNEX X-2 Technical Glossary	

6.2 Impact on Code Subsidiary Documents

Code Subsidiary Document	Potential Impact of Proposed Modification
BSC Procedures	BSCP 71 'ECVNA and MVRNA Registration, Authorisation and Termination' requires amendment to reflect any potential changes to the manner in which Energy Contract Volume Notification Agents (ECVNAs) and Metered Volume Reallocation Notification Agents (MVRNAs) are Authorised, have their Authorisations Terminated, or request Keys, resulting from the implementation of dual notification.
BSC Service Descriptions	The Energy Contract Volume Aggregation Agent (ECVAA) Service Description requires amendment to reflect the obligations and processes required to support dual notification.
Reporting Catalogue (and other Data Catalogues)	Any amendments to existing reports, or new reports required to support dual notification will impact the Reporting Catalogue and the NETA Data File Catalogue (NDFC) (and the Interface Definition and Design (IDD) document, owned by the BSC Central Service Agent), by the requirement to reflect the amendments.

6.3 Impact on Core Industry Documents

No impact identified at this time.

7 IMPACT ON OTHER CONFIGURABLE ITEMS

Item	Potential Impact of Proposed Modification
BSC Central Service Agent ECVAA System Documentation	The BSC Central Service Agent owned ECVAA system documentation (User Requirements Specification, Design Specification, System Specification, Operational Service Manual, etc.) require amendment to reflect the functionality for dual notification.

8 IMPACT ON ELEXON

Area of Business	Potential Impact of Proposed Modification
ELEXON Procedures	<p>ELEXON will be impacted by the requirement to administer Trading Disputes relating to dual notification, and therefore procedures will be required to be implemented to support the new functionality.</p> <p>New processes may be required to deal with dual notification system failures.</p>

9 IMPACT ON FINANCIAL ARRANGEMENTS AND BUDGET

No impact identified at this time.

10 IMPACT ON BSC AGENT CONTRACTUAL ARRANGEMENTS

BSC Agent Contract	Potential Impact of Proposed Modification
Logica (BMRA, CRA, CDCA, SAA, ECVAA, TAA(CVA))	<p>It is expected that the implementation of dual notification would require additional provisions in the existing contractual arrangements to support the obligations, responsibilities and additional cost associated with implementing and operating dual notification.</p>

The Authority rejected the original Modification Proposal P4, on the basis that it would not further the applicable BSC Objectives (c) and (d). The central issues cited by Ofgem in the decision letter were:

- Whether the Modification Proposal would reduce incentives on participants to develop robust systems of contract notification and risk management; and
 - Whether the market would be able to provide more efficient and competitive services of contract notification than if this service and the responsibilities of failure are solely borne by NETA Central Systems.
2. P98 propose that the dual notification system is voluntary. Therefore, consideration is required of the associated cost allocation issues. It is proposed that an initial industry consultation is undertaken (to determine the likely take up of the Dual Notification service);
 3. The consequences of, and processes required to support failure of the dual notification system were not considered as part of Modification Proposal P4. Therefore a definition of a robust failure system is required and consideration of any associated issues;
 4. The Requirements Specification for dual notification was drafted and finalised on 21 May 2001. This will need to be reviewed to incorporate changes in the BSC baseline and any industry requirements;
 5. Interaction with CP755 'Enhanced ECVAA Reporting' (implemented on 13 August 2002) and the approved Alternative Modification P4 (to be implemented on 10 December 2002), both which deliver enhanced contract notification reports. The effect of these on P98 will need to be considered; and
 6. Following on from point 4, the Impact Assessment provided by the BSC Central Service Agent for Proposed Modification P4 has expired, and was based upon system functionality and understanding at the time of the Impact Assessment request. It is not unreasonable to assume that any Impact Assessment request made now could potentially yield a different cost, timescale and impacts

ANNEX 1 – MODIFICATION PROPOSAL

Modification Proposal	MP No: P98 <i>(mandatory by BSCCo)</i>
Title of Modification Proposal <i>(mandatory by proposer):</i> Dual Notification Of Contract Positions.	
Submission Date <i>(mandatory by proposer):</i> 02 September 2002	
Description of Proposed Modification <i>(mandatory by proposer):</i> Introduce a voluntary dual notification system for contract positions between BSC parties. The new process would be based on the specification drawn up under modification P4.	
Description of Issue or Defect that Modification Proposal Seeks to Address <i>(mandatory by proposer):</i> <p>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 submitting 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.</p> <p>At the current 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 through, 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 occurred, and at what price, but with dual notification that dispute will not involve the additional cost of imbalance charges.</p> <p>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 occur under a single notification system.</p> <p>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.</p> <p>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 occurring 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</p>	

<h2 style="margin: 0;">Modification Proposal</h2>	<p>MP No: P98 <i>(mandatory by BSCCo)</i></p>
<p>notification system is not robust.</p> <p>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 imbalance costs that were associated with the Enron collapse were derived from the system operator 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.</p> <p>Where parties do not agree with a notification under a dual notification 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 remain 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 notification raises, such as the need for 24 hour cover.</p> <p>Given the costs of a new system (Logica quotes less than £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 notification system, all citing 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.</p> <p>In its decision on P4, Ofgem wanted to maintain pressure on participants to operate robust systems. Dynegy can state categorically 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.</p> <p>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.</p>	
<p>Impact on Code <i>(optional by proposer):</i></p> <p>Section P: 2.3-2.38 of the BSC - significant impact</p> <p>Section V: Reporting - possible impact</p>	

Modification Proposal	MP No: P98 <i>(mandatory by BSCCo)</i>
Impact on Core Industry Documents <i>(optional by proposer):</i> BSCP 71 BSCP533 - PARMS possibly BSCP534 - PARMS Techniques - possibly BSCP535 - Technical assurance of suppliers and supplier agents - possibly Reporting Catalogue – possibly	
Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties <i>(optional by proposer):</i> Energy contract notification systems Reporting systems Possibly on disputes resolution	
Impact on other Configurable Items <i>(optional by proposer):</i>	
Justification for Proposed Modification with Reference to Applicable BSC Objectives <i>(mandatory by proposer):</i> <p>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.</p> <p>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.</p> <p>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 facilitating 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.</p>	
Details of Proposer: Name: Lisa Waters Organisation: Dynegy Telephone Number: 020 8334 7265 Email Address: lisa.waters@dynegey.co.uk	

Modification Proposal	MP No: P98 <i>(mandatory by BSCCo)</i>
Details of Proposer's Representative: Name: Rekha Patel Organisation: Dynegy Telephone Number: 020 8334 7267 Email Address: rekha.patel@dynegy.co.uk	
Details of Representative's Alternate: Name: Organisation: Telephone Number: Email Address:	
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. 1 page.	