



Direct Dial: 020-7901-7412

18 August 2003

The National Grid Company, BSC Signatories and  
Other Interested Parties

Our Ref: MP No: P98

Dear Colleague

**Modification to the Balancing and Settlement Code (“BSC”) - Decision and Direction in relation to Modification Proposal P98: “Dual Notification of Contract Positions.”**

The Gas and Electricity Markets Authority (the “Authority”) <sup>1</sup> has carefully considered the issues raised in the Modification Report<sup>2</sup> in respect of Modification Proposal P98: “Dual Notification of Contract Positions”.

The BSC Panel (the “Panel”) recommended to the Authority that Proposed Modification P98 should not be made.

Having carefully considered the Modification Report, the Panel’s recommendation and the results of a further consultation upon the costs of the proposal, and having regard to the Applicable BSC Objectives and the Authority’s wider statutory duties<sup>3</sup>, the Authority has decided to direct a Modification to the BSC in line with the Proposed Modification P98.

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 Proposed Modification P98, as set out in the Modification Report.

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

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<sup>1</sup> Ofgem is the office of the Authority. The terms “Ofgem” and “the Authority” are used interchangeably in this letter.

<sup>2</sup> ELEXON document reference P098RR, Version No. 1.0, dated 14 February 2003.

<sup>3</sup> Ofgem’s statutory duties are wider than the matters that the Panel must take into consideration and include amongst other things social and environmental guidance provided to Ofgem by the government.

## Background to the proposal

There are strong incentives on participants to balance their individual trading positions and minimise the costs to the 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 (one hour before real time). Gate Closure is the last point at which Parties can make contract notifications to, and correct their contract position with, BSC Central Systems. Contract notifications are only registered if they are notified from a participant’s system via communications links to the Energy Contract Volume Aggregation Agent (“ECVAA”) System and acknowledged before Gate Closure. 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. Trading Parties with a position of energy imbalance will be exposed to the relevant Energy Imbalance Prices for the relevant Settlement Period.

Prior to NETA Go-Live<sup>4</sup> consideration was given by market participants, the Department of Trade and Industry (“DTI”) and Ofgem on whether to have a system of dual or single contract notification. The DTI and Ofgem determined that the process for making contract notifications to the ECVAA System would be done via single notification. Under the arrangements for single notification the counterparties appoint a single Notification Agent<sup>5</sup>, 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 2 September 2002, Dynergy (the “Proposer”) proposed Modification Proposal P98: “Dual Notification of Contract Positions”.

It was the view of the Proposer that the current system of single notification creates a risk of contract positions being notified against Parties without their knowledge, particularly for those Parties that do not operate 24 hours a day, 7 days a week, and that there is unlimited settlement liability associated with this risk. The Proposer therefore considered that, in removing this risk, the Modification Proposal would promote effective competition by encouraging and facilitating trading and reducing barriers to market entry. The Proposer also considered that dual notification would increase liquidity closer to real time in the markets as it provides a more robust trading mechanism. Therefore the Proposer considered that the Modification Proposal better facilitates the achievement of Applicable BSC Objective<sup>6</sup> (c) promoting effective

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<sup>4</sup> NETA Go-Live was the 27 March 2001.

<sup>5</sup> Reference to ‘Notification Agent(s)’ includes both Energy Contract Volume Notification Agents (ECVNA’s) and Metered Volume Reallocation Notification Agents (MVRNAs).

<sup>6</sup> 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;
- (e) without prejudice to the foregoing objectives and subject to paragraph 3A, the undertaking of work by BSCCo (as defined in the BSC) which is:
  - (i) necessary for the timely and effective implementation of the proposed British Electricity Trading and Transmission Arrangements (BETTA); and
  - (ii) relevant to the proposed GB wide balancing and settlement code;and does not prevent BSCCo performing its other functions under the BSC in accordance with its objectives.

competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity.

It was the Proposer's view that, under a single contract notification system, in the event of a notification error, whilst Parties' Grid Trade Master Agreement ("GTMA")<sup>7</sup> contracts may allow them to claim monies back from the Party at fault, the industry is unnecessarily paying for errors that would be impossible under a dual notification system. The Proposer considered that, assuming that its own experience of notification errors is representative, the industry is moving around millions of pounds a year because the single contract notification system is not robust. In addition, it was the Proposer's view that, where Parties do not agree with a notification under a dual notification system, they can be sufficiently certain that they can contact their counterparties, agree their positions and correct their contract notifications, since if an agreement is not reached the contract will remain un-notified. It was therefore the Proposer's view that the Modification Proposal would increase the efficiency of the market by reducing the risks associated with trading, particularly close to real time and that the more efficient the market the easier it is for NGC to discharge its licence obligations. Therefore the Proposer considered that the Modification Proposal better facilitates the achievement of Applicable BSC Objective (a) the efficient discharge by the licensee of the obligations imposed upon it by its licence.

### **The Modification Proposal**

The Modification Proposal seeks to modify the BSC so that a voluntary dual notification system is implemented within the BSC Central Systems alongside the existing single notification system.

Under dual notification both counterparties nominate a Notification Agent to notify the contract on their behalf under the relevant Notification Agent Authorisation<sup>8</sup>. When making a contract notification the Notification Agent would be required to specify the pair of counterparties and their nominated Energy Accounts. Any notification received from the Notification Agent is validated by the ECVAA. If any part of the submission fails validation, or is to be refused under Credit Default rules, then the contract notifications for the affected Settlement Periods are rejected individually and notified to the counterparties in a Rejection Feedback Report ("RFR"). Where the submission is accepted, the contract notification volumes are matched and an Acceptance Feedback Report ("AFR") is generated, containing the detail of what has been accepted and matched by the ECVAA.

The Modification Proposal also seeks to implement a web-based view of contract notifications so that all Parties can determine their position at any time. The web-based view would provide a secure view for each Party and Notification Agent of all the notifications made against their Authorisation(s). It is further envisaged that the web-based view will provide the ability for queries to be run on the data and the results of such queries to be downloadable. This web-based view would also be applicable to single notification Authorisations. A further proposed enhancement is to enable the submission by Parties of contract notifications directly via the web-based facility under their Notification Agent Authorisation.

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<sup>7</sup> The GTMA describe the framework on which counterparties bilaterally trade, confirm, notify and settle energy accounts.

<sup>8</sup> A Notification Agent Authorisation authorises the appointed Notification Agent to submit, while it is effective, contract notifications on behalf of the Relevant Contract Parties to be taken into account in Settlement.

The Modification Proposal specifies that no amendments would be made to the current provisions and definition of an ECVAA System Failure<sup>9</sup>. As with single notification there would be no provisions put in place to cover Notification Agent systems failure under dual notification. The scope of Trading Queries and Trading Disputes would be extended to encompass disputes for dual notification. Therefore following the upholding of any Trading Dispute contract positions would be amended ex post by the ECVAA.

The Settlement Standing Modification Group (“the Group”) established by the BSC Panel to undertake the Assessment Procedure in respect of the Modification Proposal, considered that there should be minimal change to Parties systems and processes. Therefore the dual notification process is designed to run seamlessly alongside the single notification process. Under the dual notification process, if a pair of counterparties wishes to use single notification, then the Authorisation is set up such that each counterparty nominates the same Notification Agent, to notify on their behalf. In addition, the Group considered that the single notification process would be enhanced by the provision of a web-based facility.

The Group considered the potential for exposure to unlimited liability as a consequence of an erroneous or malicious notification under single notification. The Group considered that although the probability of such extreme circumstances is relatively low, the materiality could be very high. Further, the Group considered that such notifications could be potentially catastrophic for the Party that has been erroneously or maliciously notified against and that there could be detrimental knock-on effects for other Parties. The Group considered that there are commercial arrangements in place outside of the BSC to deal with these circumstances, for example the GTMA. However, it was noted that these commercial arrangements would not address the circumstance where the Notification Agent has made an erroneous notification and they can not meet their obligations under the commercial contract in the event of insolvency or administration. In addition, the Group considered that dual notification may improve the efficiency of the commercial disputes resolution process where there have been erroneous notifications made as it would improve the ability of Parties to identify where the culpability for an erroneous notification lies.

The Group noted the BSC Central Service Agent development and implementation costs associated with Modification Proposal P98 of £1,888,540 (excluding ELEXON effort of approximately 500 man days) and the ongoing BSC Central Service Agent costs for operation and maintenance of approximately £800,000 per annum. The Group also noted that there would be further costs to the industry from renegotiating the GTMA and changing Party notification systems and processes. Some members of the Group considered that it was almost impossible to quantify the benefit of a dual notification system since, under the worst case scenario of a catastrophic Party failure, the benefits of having a dual notification system in place could be considerable in comparison to the costs of implementing it. However some members of the Group considered that the risk could be managed / mitigated.

The Group considered the impact that implementation of dual notification may have on the liquidity of the market. Some members of the Group considered that any reduction in notification risk may have the effect of increasing liquidity in the trading markets. However, other members of the Group considered that the implementation of the enhanced web-based reporting would have a more material effect on liquidity and that dual notification may have

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<sup>9</sup> See Section P, 5.1.1 (c) of the BSC.

very little effect on liquidity in the traded markets. The Group considered the issue to assess whether notification risk is the reason why there is little within day trading and therefore relatively low liquidity. The Group concluded that if the sole reason for not trading within day is the notification risk, then dual notification has the potential to improve the liquidity within day. However, if this is not the case, then the implementation of dual notification is likely to have more limited impact on liquidity.

The Group considered the possibility of ELEXON procuring a dual notification service from an external commercial provider, rather than from the current BSC Central Service Agent. The Group noted that there were a number of issues associated with an external provider of a dual notification service including additional costs to establish and maintain a new contract for an additional BSC Agent, increased complexity of the ECVAA System Failure process, and potentially new interfaces from the (external) dual notification service provider into the ECVAA. In addition a commercial dual notification provider may be required to reproduce the ECVAA's rules for validating contract notifications to ensure that there are no rejections on the grounds of validation by the ECVAA following successful matching by the commercial dual notification provider. The Group determined that the dual notification service as set out in the Modification Report could only be provided by the current BSC Central Service Agent as it provides enhancements to the single notification process and consistency between single and dual processing, that could not be provided by an external commercial provider.

The Group considered whether there are alternative services currently available to mitigate the contract notification risks identified by the Proposer. The Group considered that commercially provided dual notification services are available but that they are expensive and the providers of such services limit the liability. This is because, in the event the commercial provider's systems fail or they make an erroneous notification, the provisions for ECVAA Systems Failure do not extend to them and the contract positions of the Parties using the commercial service could not be amended ex post. Therefore the majority of the Group considered that the commercially provided services do not address the issues that the Modification Proposal is seeking to address. The Group considered that the implementation of enhanced ECVAA Reporting<sup>10</sup> has been useful to help manage contract notification risk. However, some Group members considered enhanced ECVAA Reporting does not address the issue of the potential exposure to unlimited liability where an erroneous or malicious notification has been made against a Party.

The Group considered that the Modification Proposal would provide enhanced contract notification facilities, in particular the web-based reporting. The majority of the Group considered that these enhancements may reduce contract notification risk and better facilitate the achievement of Applicable BSC Objective (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. However, the majority of the Group considered that the costs associated with the implementation of dual notification are detrimental to Applicable BSC Objective (d) promoting efficiency in the implementation and administration of the balancing and settlement arrangements. The majority of the Group considered that this

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<sup>10</sup> On 28 March 2001 Dynegey UK Limited proposed Modification P04: "Dual Energy Contract Notification". During the Modification Process, the Modification Group developed an Alternative Modification Proposal which enhanced ECVAA reporting. Further to the recommendation by the Panel in the Final Modification Report that the Alternative Proposal should be accepted and after careful consideration, the Authority decided to direct that the Alternative Modification Proposal P04 should be made with an Implementation Date of 10 December 2002.

would outweigh the benefits to competition and therefore that the Modification Proposal would not better facilitate the achievement of the Applicable BSC Objectives overall.

ELEXON published a draft Modification Report on 9 January 2003 which invited respondents' views by 30 January 2003.

### **Respondents' views**

In total, ELEXON received nine responses to the consultation on the draft Modification Report. Of the responses, one expressed support for the Proposed Modification, seven did not support the Proposed Modification and the remaining one was neither in favour nor opposed to the Proposed Modification.

Of the respondents that did not support the Proposed Modification six considered that the implementation and operational costs involved are significant, both to BSC Central Systems and Parties, and the perceived benefits do not justify the additional costs. One of these respondents considered that the solution proposed is probably the cheapest that could be arrived at, but is still a very expensive way of solving the problem of unlimited liability which is a risk most Parties view as having a very low likelihood of occurring. One of these respondents commented that they were supportive of the principle of dual notification at NETA Go-Live and they still are, however, the implementation costs of Proposed Modification P98 are prohibitive.

Three respondents considered that introducing parallel dual contract notification processes would introduce added operational complexity to the market place and increase the risks associated with notifying contract positions. One of these respondents considered that the existing market provisions for contract notification are understood by the industry and are working reasonably well. Two of these respondents suggested that providing alternative processes for contract notification would increase the chances of mistakes being made, especially at times of stress.

Four respondents considered that the risks of exposure to unlimited settlement liability can be mitigated by the use of various mechanisms, including contractual and legal recourse and the enhanced ECVAA reporting. One of these respondents considered that enhanced ECVAA reporting has provided a facility that allows for discrepancies with contract notifications to be identified in a timely manner and thereby allowing Parties time to undertake corrective action to amend their notified contract position. One of these respondents considered that it should be the responsibility of Parties to ensure their own processes and systems are robust.

The respondent that supported the Proposed Modification had a number of comments. In particular, they considered that there is a risk, albeit an unlikely one, of scenarios associated with malicious notification by a market participant that has entered into administration, which could result in massive, unlimited liability of other market participants to imbalance charges. This respondent considered that dual notification of contracts offers the scope for removing this risk and therefore the benefits clearly outweigh the development costs. In addition, this respondent suggested that dual notification would also promote competition in the market by reducing the cost of entry and operation imposed by single notification and by removing the unlimited liability for notification errors which in itself could deter a potential entrant.

## **Panel's Recommendation**

The Panel met on 11 February 2003 and considered Proposed Modification P98, the draft Modification Report, the views of the Group and the consultation responses received.

The Panel agreed with the rationale for the recommendations made by the Group with regards to the Proposed Modification. Therefore the Panel recommended Proposed Modification P98 should not be made.

It should be noted that the BSC contains no provision for the Panel to change or amend its recommendation following the publication of the Modification Report. Therefore the Panel's recommendation was made without knowledge of the revised costs associated with the Proposed Modification submitted to Ofgem by ELEXON on 6 June 2003 (see below).

The Panel recommended that in the event that the Authority determines that Proposed Modification P98 should be made, the Implementation Date should be 5 July 2004, where an Authority determination is received prior to 8 April 2003. Should an Authority determination be received after this date, but prior to 19 August 2003 then the Implementation Date should be 8 November 2004.

## **Request for ELEXON to provide clarification on the costs associated with the Proposed Modification**

When considering the Assessment Report the Panel noted the BSC Central Service Agent's estimate of implementation costs associated with Proposed Modification P98, and considered these costs to be significant. During the Report Phase, ELEXON reviewed the development and implementation costs associated with the Proposed Modification, as requested by the Panel. It was determined, during informal discussions between ELEXON and the BSC Central Service Provider, that there may be the potential to reduce the development and implementation costs of the BSC Central Service Provider and of ELEXON. However, it was noted that these costs would not be finalised until after the initiation of the project to implement the Proposed Modification (should an Authority determination to this effect be received) when detailed requirement specifications and resultant impact assessments are produced. It was not proposed to investigate the development and implementation costs further with the BSC Central Service Agent prior to this, as this would incur further, and potentially significant, impact assessment expenditure.

As the costs associated with the implementation of the Proposed Modification are central to the Group's and the Panel's recommendations on 11 April 2003, Ofgem wrote to the Panel Chairman to request that ELEXON should seek to finalise these costs with the BSC Central Service Provider in order to assist the Authority in making its determination.

On 6 June 2003, ELEXON responded to Ofgem to clarify the costs associated with Proposed Modification P98. ELEXON instructed the BSC Central Service Agent to undertake a detailed level impact assessment to determine and finalise the costs associated with the implementation and operation of the Proposed Modification for two options: a full solution (Option 1) and a part solution (Option 2).

Option 1 includes the web-based notification submission and web-based reporting functionality and was the same solution as the solution the BSC Central Service Agent estimated would cost £1,888,540 for development and implementation (excluding ELEXON effort of approximately 500 man days) and £800,000 per annum operation and maintenance. This solution was also the same as the preferred implementation solution of the Group. Option 2 excludes the web-based notification submission and web-based reporting functionality.

The costs associated with implementing both Option 1 and 2 were significantly reduced following the BSC Central Service Agent detailed level impact assessment. The following table provides a summary of the reductions in cost.

<b>Cost/Option</b>	<b>Development and Implementation</b>	<b>Operation</b>	<b>Maintenance</b>
<b>Original P98</b>	£1.9 million	£430K	£365k
<b>Option 1: Full original solution</b>	£1.3 million (-30%)	£235k (-46%)	£305k (-17%)
<b>Option 2: No web based functionality</b>	£750k (-60%)	£235k (-46%)	£175k (-52%)

It should be noted that ELEXON did not undertake analysis of the costs to Parties resulting from the renegotiation of the GTMA contracts as this was deemed beyond the terms of reference of the request by Ofgem.

**Ofgem invitation for views on clarified costs**

On 2 July 2003 Ofgem published a letter seeking views from market participants and interested parties as to whether the cost reductions in the development, implementation and operation of Proposed Modification P98 had altered their view as to whether the Proposed Modification better facilitates the achievement of the Applicable BSC Objectives.

Ofgem received 13 responses to the consultation on the clarified costs. Having considered the reduction in costs four respondents supported the Proposed Modification and nine did not.

The respondents that did not support the Proposed Modification considered that whilst there have been reductions in the costs the perceived benefits did not justify the costs. In general these respondents considered that the recent implementation of enhanced ECVAAs reporting in combination with the GTMA processes for recovering costs from erroneous notifications enable Parties to manage the risk of the potential for exposure to unlimited settlement liability. These respondents considered that significant costs would be incurred by most Parties to modify their existing systems and processes and to renegotiate GTMA contracts to accommodate dual notification.

Two respondents were concerned that the introduction of a voluntary dual notification system may divide the market with some participants only dealing with counterparties who use their preferred method of notification. One of these respondents considered that the implementation of a voluntary dual notification system would impose additional costs on new entrants through ensuring they are able to comply with both a single and dual notification system.

Three of the respondents that did support the Proposed Modification considered that the reduction in costs further reinforced their view that the benefits exceeded the costs. One respondent did not originally support the modification due to the prohibitive costs involved but as a result of the revised costs supported the Proposed Modification.

One respondent considered that malicious notification or a market participants' entry into administration could result in a Party being exposed to unlimited liability in imbalance charges. The respondent considered that in these circumstances contractual recourse through the GTMA is insufficient since the counterparty responsible for the error may be in administration. This respondent considered that the existence of unlimited liability is a major systemic risk to the market, which could result in the cascading failure of several market participants. Two respondents suggested that the modification could encourage new entry by removing the risk of unlimited liability and promoting competition and liquidity. Another respondent considered that many of the claims since Go-Live associated with notification errors could have been avoided with dual notification since they are more likely to have easily been identified and resolved before Gate Closure.

The respondents that did support the Proposed Modification specified a preference for implementation Option 1. One of these respondents commented that the ability for both trading counterparties to notify, monitor on a screen-based system and modify in real time matched/unmatched contracts prior to delivery will reduce contract notification risk and will enhance liquidity closer to Gate Closure. Another of these respondents considered that the web-based solution will be advantageous to some of the smaller market participants or newer entrants to the market.

### **Ofgem's view**

Having carefully considered the Modification Report, the Panel's recommendation and the additional information provided by Parties to Ofgem on the clarified costs associated with the Proposed Modification, Ofgem considers, having regard to the Applicable BSC Objectives and its statutory duties, that Proposed Modification P98 will better facilitate achievement of the Applicable BSC Objectives.

*Applicable BSC Objective (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*

Ofgem considers that in order to promote effective competition in the generation and supply of electricity it is important that all artificial barriers to entry within the wholesale trading arrangements are removed.

In considering the Proposed Modification Ofgem has noted the Group's conclusion that, although the number of erroneous notifications that have resulted in significant settlement liabilities have been relatively few and that the risk of malicious notifications resulting in significant settlement liabilities is relatively low, the potential exists for unlimited settlement liability. In addition Ofgem has noted the Group's conclusion that such erroneous or malicious notifications could be potentially catastrophic for the Party that has been notified against and that there could be detrimental knock-on effects for other Parties.

Ofgem has also noted the Group's conclusion that there are means of mitigating the risk of erroneous or malicious notifications through robust single notification processes combined with monitoring ECVAAs Reports and that in addition that there is a legal recourse available to Parties through the GTMA.

It is Ofgem's view that, although these measures can mitigate the risk of erroneous or malicious notifications, the potential for unlimited liability still exists. In addition Ofgem agrees with the Group that legal recourse through the GTMA does not address the circumstance where the ECVAAs cannot meet their obligations under the commercial contract, for example where either they are insolvent or where they are in administration.

After two years' operational experience of the wholesale electricity trading arrangements and no commercial means identified to reduce this unlimited settlement liability, Ofgem considers that the potential for this unlimited liability represents a barrier to entry within the wholesale trading arrangements. It is Ofgem's view that the introduction of a voluntary dual notification facility will give Parties the scope to remove the risk of unlimited settlement liability due to erroneous or malicious notifications and that the removal of this barrier will promote effective competition in the generation and supply of electricity. In reaching this conclusion Ofgem has had particular regard to representations put forward by new entrants into the arrangements. The option for these Parties to dual notify contracts will remove this barrier to entry whilst giving all Parties the option of continuing to trade using single contract notification.

In addition to introducing the option of dual contract notification the Proposed Modification also seeks to introduce a web-based facility to provide Parties with a real time view of their contract position and the ability to submit contract notifications via this facility. As the web-based facility is not notification system specific it will provide benefits for Parties using single notification as well as dual notification. Ofgem agrees with the Group and the Panel that the proposed web-based facility would enable Parties to more efficiently manage their contract notifications and reduce contract notification risk. In addition Ofgem's considers that the ability to notify and watch trades clear would align the operational arrangements more with the gas market. It is Ofgem's view that the reduced risk and increased efficiency in contract notification associated with the web-based facility should further facilitate competition and potentially encourage liquidity closer to Gate Closure.

Therefore Ofgem agrees with the Group and the Panel that the Proposed Modification would better facilitate the achievement of the Applicable BSC Objective (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.

*Applicable BSC Objective (d) promoting efficiency in the implementation and administration of the balancing and settlement arrangements*

The current single contract notification arrangements have been in place for over two years. In some ways the notification arrangements have worked as expected as participants have had incentives to put in place and maintain robust risk management systems. In addition certain commercial services have developed albeit with the disadvantage that they are unable to provide protection against all of the risks associated with single contract notification.

Ofgem considers that one of the strongest incentives to efficient trading is the knowledge that insufficiently robust risk management systems can result in trading errors and that losses are a likely consequence of such errors. Consequently Ofgem is of the opinion that it is essential that there should be strong incentives on participants to deliver correct notifications. If the incentives to have robust risk management systems in place were inadequate it would be likely that notifications would need to be frequently adjusted for errors that could adversely affect the efficient administration of the BSC.

Under the Proposed Modification no amendments would be made to the current provisions and definition of an ECVA System Failure and there would be no additional provisions put in place to cover Notification Agent systems failure under dual notification. Therefore, Ofgem considers that Parties would still have the incentive to ensure that their notification systems and processes are sufficiently robust. Ofgem agrees with the Group that the Proposed Modification P98, in introducing a voluntary dual notification system, would maintain the incentives for Parties to maintain robust contract notification systems.

However it is Ofgem's view that there are limitations in the current framework which have effected the overall implementation and administration of the balancing and settlement arrangements. For instance since NETA Go-Live substantial costs have been incurred under the balancing and settlement arrangements due to claims made as a result of erroneous contract notifications. In addition to the central costs of dealing with claims disputes there have additionally been non-central costs to individual Parties as a consequence of litigation, a process which can be both time consuming and expensive.

As stated previously, it is Ofgem's view that Proposed Modification P98 would increase efficiency in contract notification. Ofgem considers that dual notification could promote efficiency in the balancing and settlement arrangements by potentially reducing the number of claims under the BSC associated with erroneous contract notification. In addition Ofgem agrees with the Group and the Panel that since the web-based facility will provide Parties with the ability to notify contracts and watch trades clear in real time it will allow all Parties to be more aware of their contract positions and give them greater control over managing their contract notifications. It is Ofgem's view that this will further promote efficiency in the balancing and settlement arrangements.

Therefore Ofgem considers that there are a number of arguments in support of the view that the Proposed Modification will better facilitate achievement of the Applicable BSC Objective (d). However these have to be weighed against the costs associated with the implementation of the modification.

The main reason that the majority of the Group, respondents and the Panel considered that the Proposed Modification is detrimental to Applicable BSC Objective (d) is because, in their view, the implementation and operational costs involved are significant and the perceived benefits do not justify the additional costs. Further, a number of respondents considered that additional costs would be incurred by those Parties choosing to modify their existing systems and processes to accommodate dual notification. In addition, a number of respondents noted that, if the Proposed Modification is implemented, all Parties will be required contribute to the implementation and operational costs irrespective of whether or not they intend to use a dual notification system.

Ofgem acknowledges that Parties choosing to utilise dual notification would be required to make changes to their existing systems and processes that would have an associated, though unspecified, cost. Ofgem considers that, since the cost to Parties of updating their systems and processes will differ for each Party, the decision whether to use a single and/or dual notification system will be a commercial decision to be made by each Party, taking into account the costs and benefits as perceived by that Party. Ofgem would like to note that, in the future, should Parties consider that they will incur significant costs to their systems as the result of a Proposed Modification, it would help inform the Authority's decision as to whether the Proposed Modification would better facilitate achievement of the Applicable BSC Objectives if details of such costs could be provided, either in the form of a consultation response or directly to Ofgem.

Ofgem acknowledges that the full benefits of the Proposed Modification will not be available to all Parties immediately as some Parties may wish to continue to use a single notification system. However, Ofgem considers that since the Proposed Modification will allow all Parties the opportunity to use a dual notification system it is appropriate that the implementation and operational costs be borne by the industry as a whole. In addition, Ofgem notes that the benefits of the web-based facility to be introduced by the Proposed Modification, which will allow Parties a real time view of their contract position and the ability to submit contract notification via the facility, would be available to all Parties.

As previously stated, Ofgem considers that the Proposed Modification will provide some benefits for the efficiency of the balancing and settlement arrangements. In addition, in determining its view as to whether the costs associated with the implementation of the Proposed Modification are detrimental to Applicable BSC Objective (d), Ofgem has taken into consideration the significant reduction in costs presented to Ofgem by ELEXON. It is Ofgem's view that the implementation costs are still significant despite the reductions in costs presented by ELEXON but that these costs must be balanced against the benefits in terms of efficiency outlined above. Ofgem therefore considers that the Proposed Modification is neutral against the Applicable BSC Objective (d).

In summary, Ofgem considers that the Proposed Modification will better facilitate achievement of the Applicable BSC Objectives (c) but is neutral against the achievement of Applicable BSC Objective (d). Overall Ofgem considers that the benefits of introducing the Proposed Modification associated with the promotion of competition and enhanced efficiency outweigh the detrimental impact on efficiency associated with the costs imposed both centrally and to Parties in implementing the Proposed Modification. It is therefore Ofgem's view that on balance the Proposed Modification should be made and implemented.

### **The Authority's decision**

The Authority has therefore decided to direct that the Proposed Modification P98, as set out in the Modification Report, 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 Modification Report for the Proposed Modification.

The Implementation Date for Proposed Modification P98 is 8 November 2004.

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 contact me on the above number if you have any queries in relation to the issues raised in this letter. Alternatively, contact Matthew Buffey on 020 7901 7088.

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**

**Director, Electricity Trading Arrangements**

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