

ESB NATIONAL GRID

PROPOSALS FOR LIABILITY STATUS

UNDER THE TRADING AND SETTLEMENT CODE

January 2002

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1. EXECUTIVE SUMMARY

1.1 Background

The liability immunity of the SSA and TSO is coming to an end on 31 January 2002 under the Trading and Settlement Code (Code). As a result, the CER has requested that ESB National Grid (ESBNG) prepare a paper for consultation on proposed options going forward.

This paper addresses the liability of the SSA and TSO due to its obligations under the Code only (including the Rules – i.e. Appendix 7 of the Code). It does not address for example, liability issues arising out of the TSO's obligations under the Grid Code.

Post 31 January 2002, ESBNG is exposed to possible litigation and claims for loss and damages unless some provision is made for Liability Protection.

1.2 Areas of Responsibility

ESBNG's areas of responsibility under the Code are outlined in section 4 including – application process, processing, generation metering, IT system development and Code interpretation.

1.3 Assumptions

A number of assumptions are made in section 5. It is worth mentioning also the limitation of ESBNG's role in that ESBNG is relying on the provision of significant data and information flows from MRSO/DSO and hence can only be held responsible for activities after receipt of this data.

1.4 Principles and Objectives

There are a number of principles and objectives which need to be considered including:

- Any solution should facilitate a cost-effective approach to managing liability in the overall market;
- Parties must be held responsible only for those matters that are within their direct control or influence;
- Parties must be afforded every opportunity to adequately manage the exposures they have;
- Those companies with costs that are subject to regulatory approval must be allowed to recover the costs associated with managing their exposures;
- Companies must be allowed to earn a fair return, commensurate with, among other things, the exposures they assume;

- The solution should encourage transparency and facilitate the introduction of changes required by CER;
- The solution should be sufficiently robust for longer term requirements and not just the immediate solution; and
- There should be a coherent approach across the market. To the extent that liability protection is lifted then each Party should bear its portion of the risk.

In addition, the solution needs to reflect that the corporate structure of EirGrid will be different from ESBNG, with impacts on the ability to carry risk and potentially ability to obtain an affordable insurance quote, which will provide sufficient cover. Insurance is a tool to manage the exposure and hence preliminary cost ranges are included to facilitate comparison of options.

A recent review in Australia on Liability Protection and Market Operators dealt with similar issues. Reference is made to that review in this document.

It should also be borne in mind that a market audit has taken place and will take place probably on an annual basis. This gives assurance to the market on the operation of the settlement process asides from any liability issues.

1.5 Options

Option 1: No Liability

The Liability Protection currently prevailing under Section 11 of the Code could be extended for a period of 3 – 5 years until the market becomes more established and the 2004 review has taken place. If the 2004 review recommends substantial changes to the system then a period of reduced or no liability would appear reasonable to implement until the system is sufficiently robust again.

Advantages:

- This option is most probably the cheapest as it avoids unnecessary high insurance premiums and is therefore not costly for the players in the market;
- It is more flexible to system changes and facilitates implementation of modifications;
- It aids a more informal and interactive environment for the embryonic market that we are in as TESS (Transitional Electricity Settlement System) is still evolving;
- It avoids litigation, along with the associated time element and costs.

Disadvantages:

- A situation could arise whereby a generator or supplier may have exposure. This could however be mitigated by the Participant's own insurance;
- This option may be perceived as not incentivising the performance of public service providers. But this perception could be managed via the market audit together with performance targets and incentive schemes.

Option 2: Capped Liability

Should the liability protection, be lifted then caps should be installed limiting the extent of the liability. It has been indicated to us that unlimited cover is not insurable and that some cap or limit needs to be installed in order to be able to receive a quote. This was also noted in the Australian review. Two caps could be implemented, the first covering a per event scenario and the second being an overall cap. A suitable level of deductible and a claim threshold should also be implemented.

Liability should be in respect of direct losses only, i.e. no liability for consequential losses etc. This is further detailed in section 9.

Again, if liability is lifted, the entities must be allowed to earn a fair return, commensurate with, among other things, the exposures they assume.

Advantages:

- Capped liability would probably be considered the next cheapest to the no liability option;
- At the same time this option provides reasonable compensation;
- Uncapped or unlimited insurance is not available.

Disadvantages:

- There remains some possible exposure for Parties in the market.

Associated Costs of Options

Marsh Ireland has conducted an initial review of the current situation and has come up with a number of estimated premium ranges based on different options. It must be noted that this review is based on preliminary discussions and does not represent a firm quotation. This premium relates primarily to the SSA functions under the Code. As regards the TSO duty to collect and validate generation meter data, this issue is still being examined as regards exposure and premium cost. As a result, the indicative premium above may rise substantially in order to obtain cover for the generation metering role.

Option 1 - No Liability

No cost

Option 2 - Capped Liability

Limit of Indemnity	EUR 6.35m (IEP 5m) With Automatic Reinstatement
Deductible	EUR 12,700 (IEP 10,000)
Premium Range	EUR 55k estimated (may not be sufficient for Generation Metering)

This limit of indemnity only relates to direct damages and excludes liability for indirect and for consequential losses. The SSA and TSO cannot take unlimited risks. Unlimited insurance is not available.

It is worth noting that the premium could rise significantly in future years depending on claims made.

Level of Settlement:

This estimated premium is based on a certain level of settlement carried out by the SSA. Should this level of settlement increase then the premium would also increase.

1.6 Conclusion

This paper discusses two options. The first option, no liability, is the most economic and would best facilitate the embryonic market that we are currently in. It would be more flexible to system changes and implementation of modifications and aid a more informal and interactive environment due to the fact that the TESS system is still evolving to some degree. It also avoids litigation and the associated delays and costs. Under this option the protection currently prevailing under the Code could be extended pending the 2004 review.

The second option, capped liability, is the other reasonable option. It is based on direct losses only and is capped at a certain limit. The insurers have indicated to us that unlimited insurance is not available and hence this option was not explored further. The initial estimated premium could rise significantly once the exposure and estimate has been established for generation metering. The estimated premium may rise in future years, e.g. due to any claims made.

In coming to a decision one must bear in mind that the preferred solution should encourage transparency and facilitate the introduction of changes required by CER. It should facilitate a cost-effective approach to managing liability in the overall market. Parties must be held responsible only for those matters that are within their direct control or influence. Companies must be allowed to earn a fair return, commensurate with, among other things, the exposures they assume.

In addition, there should be a coherent approach across the market. To the extent that liability protection is lifted then each Party should bear its portion of the risk. The solution should be sufficiently robust for longer-term requirements and not just the immediate solution. Those companies with costs that are subject to regulatory approval must be allowed to recover the costs associated with managing their exposures. Force Majeure should be excluded from any liability.

Should the liability protection be lifted, as it is a non-trivial matter, a full legal review of the Code will be required.

2. INTRODUCTION

2.1 Background

The TSO and SSA are currently protected from liability for loss or damage arising from or in connection with the Trading and Settlement Rules (Rules), time taken to carry out calculations under the Rules, results of those calculations and errors in metered data, except in the case of negligence or wilful default arising after 31 January 2002.

See Appendix 1 for extract of Section 11 of the Code and Appendix 2 for CER Decision.

2.2 Scope

This paper addresses the liability of the SSA and TSO due to its obligations under the Code only (including the Rules – i.e. Appendix 7 of the Code). It does not address for example liability issues arising out of the TSO's obligations under the Grid Code.

2.3 Purpose

The purpose of this paper is to examine and outline the various Liability Protection options that might be available to ESBNG going forward with regards to its obligations under the Code. This paper does not address the obligations of ESBNG under the Grid Code for example nor Transmission Use of System billing etc.

2.4 Justification

Post 31 January 2002 ESBNG is exposed to possible litigation and claims for loss and damages unless some provision is made for Liability Protection.

3. CURRENT STATUS

The TSO and SSA are currently protected from liability for loss or damage arising from or in connection with the Rules, time taken to carry out calculations under the Rules, results of those calculations and errors in metered data, except in the case of negligence or wilful default arising after 31 January 2002.

Section 11.1. (C) of the Code states:

(C) Notwithstanding Section 39 of the Sale of Goods and Supply of Services Act 1980, neither the Transmission System Operator nor the Settlement System Administrator shall have any liability for any loss or damage arising or resulting from or in connection with:

- (i) the Electricity Trading and Settlement Rules; or*
- (ii) the time taken to carry out the calculations required by the Electricity Trading and Settlement Rules; or*

- (iii) the results of calculations carried out in accordance with the Electricity Trading and Settlement Rules; or*
- (iv) any errors in metered data, except, in any such case, if and to the extent that such loss or damage is caused by the negligence or wilful default of the Transmission System Operator or the Settlement System Administrator, as the case may be, after 19th February, 2001 (or such later date as the Commission may determine).*

See Appendix 1 for full extract of Section 11 of the Code.

This date was extended by the CER until 31 January 2002 (see Appendix 2 for copy of the CER's decision).

This protection was given due to the TESS system being in a state of early development.

The TESS system is still in a state of development in that a number of modifications are still in the process of being designed and / or implemented.

4. AREAS OF RESPONSIBILITY

Outlined below are a number of the areas of responsibility that exist within ESBNG under its duties under the Code. These areas of responsibility give rise to risks, which in turn would need to be insured – should the liability protection be lifted.

Section 1.4 of the Code (see Appendix 4) outlines the roles of the TSO and SSA which are in brief:

- TSO:
 - Dispatch generators above 10MW;
 - Schedule of energy transfers over interconnector;
 - Recover cost of ancillary services and of resolving system constraints.
- SSA:
 - Calculate uninstructed and instructed constraints and energy imbalances;
 - Imbalance quantities and spill prices;
 - Issue invoices and arrange payments for imbalances;
 - Recover cost of operating trading and settlement system.

Section 14.2 of the Code states that the TSO shall provide:

“For Generators meter registration and metered data collection, validation, aggregation and transfer services, in each case in respect of electricity generating units that are directly connected to the transmission system.”

The market activities of the SSA and TSO are shown separately below for the purpose of clarity only. It should be borne in mind that under Section 8 of Statutory Instrument 445 of 2000 the SSA is a sub-function of the TSO:

“8. (1) Subject to paragraph (2), the transmission system operator shall have the following exclusive functions:

- (a) ...;*
- (b) ...;*

- (c) ...;
- (d) in accordance with-
- (i) the conditions in the licence granted in accordance with section 14(1)(e) of the Act of 1999,
- (ii) the grid code prepared under section 33 of the Act of 1999, and
- (iii) any Regulations made by the Commission under section 9(1)(d) of the Act of 1999, including any requirements which the Commission may impose on the transmission system operator in relation to the role of system settlement administrator, ...”

4.1 SSA Roles:

4.1.1. Application Process

The SSA processes applications for entities wishing to become Market Participants. This duty arises under Section 9 and Appendix 3 of the Code. The application must comply with Agreed Procedure 09. There is a deemed responsibility on the SSA to process these applications in an equitable and timely manner.

It is worth noting that the mandatory and optional data exchange testing (generally carried out as part of the accession process) is not intended to relieve the Participant of the responsibility to ensure that its nominations are technically correct. The situation could arise where the Participant completes the tests satisfactorily but then fails in actual trading. Passing the test does not mean that the SSA had confirmed that the Participant’s systems were correct.

4.1.2. Processing

Under the Electricity and Trading Rules (Appendix 7 of the Code) (Rules) there are numerous processes and calculations to be performed by the SSA. Such processes and calculations include Inc and Dec prices, the Ex-Post Unconstrained Schedule, instructions profiling, generation energy settlement, supplier settlement, bilateral settlement and more. It is the responsibility of the SSA to ensure its processes follow exactly the numerous calculations that are enshrined within the Rules.

4.1.3. Timetable

Currently Section 11.1.(C) of the Code mentions that the TSO and SSA shall not be liable for any loss due to “time taken” to carry out the calculations required under the Rules. Under Section 23, the SSA publishes a settlement timetable and will be expected to adhere to it.

4.1.4. IT System Development

Appendix 1 to the Code states that the SSA is the operator of the electricity settlement system. SSA systems are defined in Appendix 1 as “means all operating systems, compilers, software and computer and other systems necessary or used by the Settlement System Administrator for the operation of the Electricity Trading and Settlement Rules”. Under Section 5 of the Code, the CER may at times direct that a modification be made to the Rules. The SSA must correctly interpret that direction followed by designing, implementing and testing the modification to the IT system which should then accurately reflect the CER direction.

4.1.5. Interpretation of the Code

For various reasons the SSA carries out interpretations of the Code, be it for internal or external purposes.

4.1.6. Modifications Panel

It may also be worth raising the risk that if a problem has been raised by the SSA but the Modifications Panel or the CER either delay or deny a modification request. The SSA should either be held harmless from this process or be allowed to implement the changes unilaterally. The concern is that in delaying a decision (or rejecting the request outright) the SSA would be left to operate a system which it knew was wrong (and could give rise to claims) but was not allowed to fix.

4.2 TSO Roles:

4.2.1. Dispatch Instructions

Under Section 1.4 of the Code, the TSO is required to dispatch all generating units with capacity above 10 MW on the basis of generator nominations and, to the extent that dispatch needs to be different from those nominations for system security and stability reasons, of generator prices for incremental or decremental changes to nominations.

With the advent of non-firm financial access to the transmission system the TSO effectively determines, through the issuing of dispatch instructions, the level of access afforded to non-firm generators. While generators with firm access receive compensation when dispatched down for transmission constraints, those with non-firm access do not. Thus the dispatch instructions play a key role in determining the settlement for these units.

Pending a legal review, the assumption is made that detailed responsibility regarding Dispatch Instructions is covered under the Grid Code and not the Trading and Settlement Code.

4.2.2. Generation Metering

ESBNG carries out the role of generation metering which includes meter registration and testing, metered data collection, validation, aggregation and transfer services, in each case in respect of electricity generating units that are directly connected to the transmission system. This is an area, in addition to the settlement process, where errors may occur which could impact on XNOM and spill prices and imbalance payments.

4.3 Trading and Settlement Code & CER

From a legal point of view the governing document is arguably the Trading and Settlement Code, and in particular Appendix 7. Care will be needed to ensure that the Code reflects the decisions and determinations as made by the CER. Currently the published version of the Code (version 2.0) does not reflect all such decisions and determinations.

4.4 Nominations

During the drafting of the Trading and Settlement Code (including Appendix 7), it was attempted to clarify the obligations on Participants to get their nominations right. Nevertheless there is the possibility of losses to Participants because of errors or omissions in either their own nominations or the nominations of another Participant. The SSA does not take responsibility for checking the quality or correctness of nominations (other than checking that it is compatible with the relevant parts of TESS). If the SSA were to accept liability it would be necessary to carry a full review of the Code to ensure that the limits of the SSA's liability were clearly defined, including, for example, clarity on the definition of gate closure.

5. ASSUMPTIONS ON ROLES AND RESPONSIBILITIES

5.1 Assumptions Made

It is assumed that:

1. The MRSO/DSO has correctly collected customer meter data, validated it , applied Distribution loss factors and allocated it to suppliers accurately;
2. The MRSO/DSO has correctly collected embedded generation data;
3. The Change of Supplier process is operating correctly;
4. There will be no change to Section 11.2 of the Liability section of the Code, relating to the SSA/TSO having no liability as regards bilateral contract notifications.

5.2 Limitation of ESBNG's Role

ESBNG is relying on the provision of significant data and information flows from MRSO/DSO and hence can only be held responsible for activities after receipt of this data.

6. DEFINITION OF LIABILITY

6.1 Liability Protection

Direct Loss or Damage

Direct loss or damage does not include loss of profits, loss of use, loss of revenues, loss of production, loss of earnings, loss of contract or loss of savings that may be suffered by and/or whether caused by breach of contract, breach of statutory duty, tort, (including negligence) any other indirect, special or consequential loss or damage whatsoever loss or damage and/or howsoever arising out of or in any way connected with a SSA/TSO act and/or omission.

Direct losses relate to the settlement of imbalances i.e. net of bilateral positions. Direct losses do not relate to decisions taken on bilateral contracts.

6.2 Mitigation of Liability

Disputes Process

A Disputes Process is currently in the process of being approved. This will give structure and aid clarity to the boundaries between disputes and liability cases. The Dispute Process should reduce the number of liability cases. In conjunction with this, it will be necessary to have defined time limits. This has been raised at the Modifications Panel.

A provision should be incorporated in the Code that any claims less than a certain claim threshold be settled via the Disputes Process and that the CER's decision be final regarding such claims.

Whatever is agreed as regards the liability status will need to dovetail into the Disputes Process.

Liability Caps

Another way of mitigating the liability is to impose a cap on the liability exposure. A cap could be introduced both on single per event basis and on a cumulative total of all events.

Accordingly we would suggest that a concept along the following lines could be included in the Code:-

Neither the SSA/TSO shall have any liability for consequential Losses whether for breach of contract, negligence, statutory duty for any act or omission and the aggregate liability of the SSA/TSO shall in no case whatsoever exceed [specify amounts as per insurance cover limits agreed for any one incident or total maximum aggregate liability] for direct loss or damage provided always adequate insurance cover can be obtained by SSA/TSO.

7. OTHER CONSIDERATIONS

7.1 Coherent Approach to Market

A coherent approach to the overall market is necessary. Being the interface for issuing invoices there is a risk that the SSA would bear all the risk of the market i.e. MRSO and SSA risk. Obviously this would not be a coherent or equitable approach. To the extent that liability protection is lifted then each Party should bear its portion of the risk.

7.2 Future Costs to the Market

In the case where protection might be lifted, adverse claims against insurance will inevitably raise the cost of the insurance or perhaps make the risk uninsurable, increasing the cost to the players in the market.

Issues to bear in mind as regards insurance costs are cost volatility (changes in annual quotes) and the capacity of insurance to cover the risk and quantum of claims.

7.3 Force Majeure

Situations of Force Majeure must be considered if protection is lifted, as these are obviously cases outside the control of the operator or entity assuming the risk.

7.4 Internal Testing

The lifting of any Liability Protection will result in additional testing and checking. The validation process that takes place currently is a rigorous one and an insurance company and/or auditors might insist on additional onerous measures to mitigate the risk of being sued.

This possible additional testing could take place in more than one area resulting in additional time required to complete the settlement timetable and with possible longer timeframes for reporting. The area of Modifications to the system would also be affected resulting in either additional consultants and/or staff required to achieve the target date or resulting in a longer implementation timespan. It is considered that an extensive increase in testing in the duration to software release would be necessary if liability protection is lifted.

7.5 Legal Review of the Code

If the liability protection is to be lifted, a detailed legal review of the Code (and, in particular, Appendix 7) will be necessary to ensure as far as possible that:

- each party's responsibilities are well defined so that it is clear who is liable for any particular failure of the system or breach of obligation;
- the standard required in the discharge of these responsibilities is established. How might such standards vary between differing obligations?
- the consequences of any failure are set out. For instance, are there cases where the remedy available should be limited to a re-run of settlement rather than a financial claim for loss? Should the Code provide that an adjustment to one day's trading should not affect the calculations made for any preceding or following day?

8. REFERENCE TO OTHER COUNTRIES

8.1 Australian Market

A recent similar review took place in Australia on the topic of Market Operators and Liability positions¹. It is worth noting that there are jurisdictional differences, for example legal interpretations and situations (e.g. the term "Good Faith" would not appear to have a legal meaning in Ireland).

¹ "Liability Regime for National Electricity Market MSO Functions – Final Review – MSOIAC2, 23 May 2001"

The Australian Market Operator is very similar to ESBNG in many ways – for example - both have insignificant capital bases and income comprises of fees paid by Participants to reimburse direct costs.

Main Findings

Initially no liability attached to the Market Operator in Australia. Then prior to the Australian review it was the case that Liability was Fault Based (i.e., necessary to prove fault, there was however, statutory immunity for directors, officers, employees and there was no protection in the case of bad faith).

It was felt that the change in Liability Protection led to reduced transparency.

Two recommendations were made. The first was that liability should be based on good faith, certain standards should be achieved, liability should be capped at same level as present, and liability would continue for bad faith².

The second recommendation was that a further detailed examination of the situation should take place, covering additional perspectives.

8.2 Other Countries

The Australian Review also referred to situations in other countries, for example: -

England and Wales have no statutory Liability Protection for NGC but NGC is a public listed company with substantial assets and is for profit.

New Zealand, MCo, liability is capped within the service provider deeds, MCo is a private company with assets at risk and is for profit.

Canada, Alberta, regulation is in place regarding Liability Protection for the Power Pool. There is immunity from liability except in the case of - wilful misconduct, negligence, breach of contract or where the act was not done in good faith. Defence costs are recoverable via fixed charges to Participants. The Power Pool is a statutory entity with few assets, it is not for profit, and it is required to meet certain obligations as regards transparency. A general review of liabilities in the restructured market is currently underway.

9. PRINCIPLES AND OBJECTIVES

9.1 Market Audit

Under Section 26 of the Code, the SSA has, at the request of the CER, appointed a firm of internationally recognised auditors to “conduct a review and/or audit of the Trading

² Using a marking system based on a number of different objectives (e.g. cost, practicality, accountability, transparency, public interest) the option that scored the overall best was the Capped Liability (with good faith) option.

and Settlement System and its operations, procedures and processes for one or more given periods.” (extract from Section 26.1 of the Code).

A copy of the Market Auditor’s report is provided to each Party to the Code and the CER.

These audits, most likely to be on an annual basis, give a high level of assurance to the market as to the operations, processes and procedures undertaken by the SSA.

9.2 Encourage Correct Processing

At all stages the encouragement of correct processes and procedures is seen as a necessary principle.

9.3 Transparency of Operation

The principle of transparency is seen as very important to the market, both to the current players and especially to companies contemplating entry to the market. Thus, one does not wish to impose any barrier to entry by reducing transparency.

Should the Liability Protection be lifted there is a realistic possibility that it could impinge on transparency. For example, any reporting where there is no requirement or obligation to report will not be covered by the insurance– unless that is specifically agreed with the insurers and this would add to the insurance cost. Thus, from an insurance perspective, ESBNG could be curtailed leaving a less than ideal level of transparency in the market place both for current Participants and potential Participants.

The CER has published a paper for consultation concerning “Access to Information under the Trading and Settlement Code”. An extract from the conclusion therein emphasises the importance of transparency in the market place:

“The Commission wishes the market to be as transparent as possible, in order to encourage and inform new entrants to the market”.

9.4 Manage Costs to Participants

It is a principle of the Market Operator that it should manage the costs charged to Participants. A number of risks are outside the control of the Market Operator and thus the cost of mitigating those risks can likewise be outside the control of the Market Operator. Indeed even insurance premiums for risks assumed in one year could rise dramatically over the coming years, again, outside the control of the market operator to a large degree.

In a regulated environment where the costs of an operator are regulated, the operator should be allowed to recover the costs of managing any risks.

In addition, the operator should be allowed to earn an adequate return which reflects any additional risks assumed (currently the SSA can only recover, under the Trading and Settlement Code, its costs of operation).

The most cost-effective option to the market is to extend the Liability Protection currently in place under the Code. Other insurance arrangements can be expensive and there is no guarantee of future insurance costs or indeed of future quotes.

9.5 Risk and Responsibility

If the responsibility of a risk does not lie with a Party then that Party should not assume that risk. Parties should not be held responsible for risks that are not directly within their control or influence.

9.6 Longer Term Solution

While considering what is the best solution as regards Liability Protection, due consideration should be given to the longer-term solution.

As ESBNG is still under the legal umbrella of ESB any quotes received for limited liability insurance or other options will most likely be discounted ESB quotes. Once EirGrid is established the quotes will increase, most likely substantially. Thus this factor should be built into any proposed solutions.

The final long-term solution could well bring with it a significant cost which in turn would be borne by the market. It has also been indicated that over the coming years the cost of insurance could also rise rapidly due to new IPPs coming on stream.

9.7 Risk Vs Reward

Under Statutory Instrument No. 445 the TSO is allowed to earn a profit. This implies that, as with any commercial company, any risk will need to be balanced with a potential return.

9.8 Establishment of EirGrid

Examining the circumstances of ESBNG while still under the legal umbrella of ESB is reasonable only for the period of time that ESBNG remains part of ESB. Once EirGrid is established then there are a number of additional factors to consider.

EirGrid will be a substantially smaller company than ESB and thus will not enjoy the economies of scale such as discounts on insurance costs. Secondly, again due to EirGrid expected size, it could well have difficulty in even obtaining a quotation. EirGrid's ability to carry risk is likely to be questioned.

If any risk is taken, then the corporate structure needs to reflect the risks. Insurance is a tool to manage the exposure and hence preliminary cost ranges are included to facilitate comparison of options.

It is proving difficult to get a quote for EirGrid given its current embryonic status. There is also a perception concern i.e. ESB would be a better insurance bet as opposed to EirGrid.

9.9 Disputes Vs Liability Cases

A distinction must be drawn between a dispute and the instigation of a liability case. There is a separate Disputes Paper currently with the Modifications Panel. In the case

where a reconciliation or rerun under the Code will not solve the matter then the Dispute Process should be followed.

9.10 Cost of Processing Legal Claims

If liability protection is lifted and if claims ensue for whatever reason, then there will be an additional cost to the SSA of processing and defending these claims, which depending on the claim could be substantial.

9.11 Gross Negligence or Wilful Default

If liability was based on gross negligence or wilful default, this would have to be proven before liability could attach.

9.12 Negligence or Wilful Default

Similar to the last option, negligence or wilful default would have to be proven before liability could attach.

9.13 Direct Losses Only

Direct loss or damage does not include loss of profit, loss of revenue, loss of production, loss of earnings, loss of contract or any other indirect, special or consequential loss or damage whatsoever arising out of or in any way connected with an act under the Code. Direct losses relate to the settlement of imbalances i.e. net of bilateral positions. Direct losses do not relate to decisions taken on bilateral contracts.

It is only reasonable to limit any liability to direct losses only. The Courts would most probably favour limited compensation in the case of unlimited losses claims – e.g. limit it to income or tariff paid.

Consequential Losses by their nature are more difficult to define and are potentially unlimited. Unlimited insurance is not available.

9.14 Section 18 of the Code

When the liability issue has been determined, Section 18 of the Code will need to be amended to reflect the determination. A copy of Section 18 is included at Appendix 3.

10. OPTIONS

The costs associated with the options below have been supplied by Insurance Consultants³.

³Letter from Marsh Ireland dated 14/Dec/2001

10.1 Option 1: No liability

The Liability Protection currently prevailing under Section 11 of the Code could be extended for a period of 3 – 5 years until the market becomes more established and the 2004 review has taken place. If the 2004 review recommends substantial changes to the system then a period of reduced or no liability would appear reasonable to implement until the system is sufficiently robust again.

Advantages

- This option is most probably the cheapest as it avoids unnecessary high insurance premiums and is therefore not costly for the players in the market.
- It is more flexible to system changes and facilitates implementation of modifications.
- It aids a more informal and interactive environment for the embryonic market that we are in as TESS is still evolving.
- It avoids litigation, along with the associated time element and costs.

Disadvantages

- A situation could arise whereby a generator or supplier may have exposure. This could however be mitigated by the Participant's own insurance.
- This option may be perceived as not incentivising the performance of public service providers. But this doubt could be managed via the market audit together with performance targets and incentive schemes.

10.2 Option 2: Capped Liability

Should the liability protection be lifted then caps should be installed limiting the extent of the liability. It has been indicated to us that unlimited cover is not insurable and that some cap or limit needs to be installed in order to be able to receive a quote. This was also noted in the Australian review. Two caps could be implemented, the first covering a per event scenario and the second being an overall cap.

A deductible of EUR12,700 has been also recommended, any claims below which must be met by ESBNG and not by the insurers. This deductible is per event. A suitable claim threshold could also be implemented – whereby a Participant must bear a certain level of the cost themselves before they can claim.

It is worth noting that the premium could rise significantly in future years depending on claims made.

Advantages

- Capped liability would probably be considered the next cheapest to the no liability option.
- At the same time this option provides reasonable compensation.
- Uncapped or unlimited insurance is not available.

Disadvantages

- There would be still some possible exposure for generators or suppliers.

The Australian Review quotes a number of advantages for the capped liability option.

10.3 Associated Costs of Options

Marsh Ireland has conducted an initial review of the current situation and has come up with a number of estimated premium ranges based on different options. It must be noted that this review is based on preliminary discussions and does not represent a firm quotation.

Option 1 - No Liability

As there is no liability attaching, there is no associated insurance cost.

Option 2 – Capped Liability

Limit of Indemnity	EUR 6.35m (IEP 5m) With Automatic Reinstatement
Deductible	EUR 12,700 (IEP 10,000)
Premium Range	EUR 55k estimated (may not be sufficient for Generation Metering)

This premium relates primarily to the SSA functions under the Code. As regards the TSO duty to collect and validate generation meter data, this issue is still being examined as regards exposure and premium cost. As a result, the indicative premium above may rise substantially in order to obtain cover for the generation metering role.

This limit of indemnity only relates to direct damages and excludes liability for indirect and for consequential losses. The SSA and TSO cannot take unlimited risks. Unlimited insurance is not available.

Limit of Indemnity

This limit is per annum and can be used up over one event or many events.

Level of Settlement

This estimated premium is based on a certain level of settlement carried out by the SSA. Should this level of settlement increase then the premium would also increase.

Timing of Cover

If the policy is cancelled, no cover will apply for an event that took place during the currency of the policy but was reported after its expiry.

11. CAVEATS

A detailed legal review may be necessary to be undertaken by ESBNG to determine exactly the implications of any change to the liability status.

12. CONCLUSION

This paper proposes two options. The first option, no liability, is the most economic and would best facilitate the embryonic market that we are currently in. It would be more flexible to system changes and implementation of modifications and aid a more informal and interactive environment as TESS is still evolving. It also avoids litigation and the associated delays and costs. Under this option, the protection currently prevailing under the Code could be extended pending the 2004 review.

The second option, capped liability, is the only other reasonable option. It is based on direct losses only and is capped at a limit. It has been indicated to us that unlimited liability is not available. This option provides reasonable compensation.

In coming to a decision one must bear in mind that the preferred solution should encourage transparency and facilitate the introduction of changes required by CER. It should facilitate a cost-effective approach to managing liability in the overall market. Parties must be held responsible only for those matters that are within their direct control or influence. Companies must be allowed to earn a fair return, commensurate with, among other things, the exposures they assume.

If any risk is taken, then the corporate structure needs to reflect the risks. Insurance is a tool to manage the exposure and hence preliminary cost ranges are included to facilitate comparison of options.

In addition, there should be a coherent approach across the market. To the extent that liability protection is lifted then each Party should bear its portion of the risk. The solution should be sufficiently robust for longer-term requirements and not just the immediate solution. Those companies with costs that are subject to regulatory approval must be allowed to recover the costs associated with managing their exposures. Force Majeure should be excluded from any liability.

APPENDIX 1 – Section 11 of T&S Code

11. TRADING AND SETTLEMENT

11.1 Electricity trading and settlement rules

- (A) The rules and procedures for electricity trading and settlement (the “Electricity Trading and Settlement Rules”) are set out in Appendix 7 (Electricity Trading and Settlement Rules).
- (B) The Electricity Trading and Settlement Rules set out in this version of the Code remain to be further developed. The Parties acknowledge that, although the commercial intent of the Electricity Trading and Settlement Rules is sufficiently clear and they consider the TSO Systems and the SSA Systems to be capable of giving effect to the Electricity Trading and Settlement Rules, neither the Electricity Trading and Settlement Rules nor the TSO Systems nor the SSA Systems have been fully developed, trailed or tested before the introduction of the Code in February 2000. Accordingly, any omissions, inconsistencies, inaccuracies, failings and errors in the Electricity Trading and Settlement Rules, the TSO Systems or the SSA Systems will need to be addressed in accordance with Section 5 (MODIFICATION OF THE CODE).
- (C) Notwithstanding Section 39 of the Sale of Goods and Supply of Services Act 1980, neither the Transmission System Operator nor the Settlement System Administrator shall have any liability for any loss or damage arising or resulting from or in connection with:
- (i) the Electricity Trading and Settlement Rules; or
 - (ii) the time taken to carry out the calculations required by the Electricity Trading and Settlement Rules; or
 - (iii) the results of calculations carried out in accordance with the Electricity Trading and Settlement Rules; or
 - (iv) any errors in metered data, except, in any such case, if and to the extent that such loss or damage is caused by the negligence or wilful default of the Transmission System Operator or the Settlement System Administrator, as the case may be, after 19th February, 2001 (or such later date as the Commission may determine).

APPENDIX 2 – CER Decision 20th November 2001

Amendments to Section 11.1 of the Trading and Settlement Code regarding Liability of Market Operators and System Operators 20th November 2001 CER/01/158

Introduction

This document contains a decision by the Commission for Electricity Regulation under Regulation 3(4) of SI No. 49 of 2000 – Electricity Regulation Act, 1999 (Trading Arrangements in Electricity) Regulations, 2000.

Commission's Decision

The Commission hereby decides that the modification to the text, as specified in Appendix 1 will be put in place in the Trading and Settlement Code (“the Code”).

This decision will extend the period for which Section 11.1 of the Code applies and change the date of commencement of liability to the first day in February 2002. This decision also includes the Distribution System Operator and Meter Registration System Operator within the remit of Section 11.1.

Background to Decision

On the 1st November 2001 the Commission extended the date of commencement of liability for the Settlement System Administrator to permit them to put enduring liability provisions in place and to allow a public consultation process on the issue to be undergone.

On 8th of November 2001 the Meter Registration System Operator (MRSO) Representative on the Trading and Settlement Code Modification Panel brought a proposed modification to the panel. It was asserted that the MRSO and Distribution System Operator as the DSO or MRSO systems were not fully developed or tested before the introduction of the Code in February 2000 either.

Subsequently the Transmission System Operator (TSO) requested that the provisions for it be extended for it also.

Commission's Considerations

The Commission has decided to approve these modifications to the Code as the Commission is of the opinion that the current liability provisions should apply to all market operators and system operators until the 1st of February 2002, at which time market operators and system operators will be required to have put enduring solutions in place.

The Commission has requested a consultation paper from the market operators and system operators on how the issue of liability should be addressed and what the enduring solution should be. The Commission envisages that this should be available for public consultation on the website (www.CER.ie) in December 2001.

Tom Reeves

Commission for Electricity Regulation 20th November 2001

Appendix to CER Decision:

11. TRADING AND SETTLEMENT

11.1 Electricity trading and settlement rules

- (A) The rules and procedures for electricity trading and settlement (the “Electricity Trading and Settlement Rules”) are set out in Appendix 7 (Electricity Trading and Settlement Rules).
- (B) The Electricity Trading and Settlement Rules set out in this version of the Code remain to be further developed. The Parties acknowledge that, although the commercial intent of the Electricity Trading and Settlement Rules is sufficiently clear and they consider the TSO Systems, the SSA Systems, **the DSO systems and the MRSO systems** to be capable of giving effect to the Electricity Trading and Settlement Rules, neither the Electricity Trading and Settlement Rules nor the TSO Systems nor the SSA Systems **nor the DSO systems nor the MRSO systems** have been fully developed, trailed or tested before the introduction of the Code in February 2000. Accordingly, any omissions, inconsistencies, inaccuracies, failings and errors in the Electricity Trading and Settlement Rules, the TSO Systems or the SSA Systems **or the DSO systems or the MRSO systems** will need to be addressed in accordance with Section 5 (MODIFICATION OF THE CODE).
- (C) Notwithstanding Section 39 of the Sale of Goods and Supply of Services Act 1980, neither the Transmission System Operator nor the Settlement System Administrator, **nor the Distribution System Operator nor the Meter Registration System Operator** shall have any liability for any loss or damage arising or resulting from or in connection with:
- (i) the Electricity Trading and Settlement Rules; or
 - (ii) the time taken to carry out the calculations required by the Electricity Trading and Settlement Rules; or
 - (iii) the results of calculations carried out in accordance with the Electricity Trading and Settlement Rules; or
 - (iv) any errors in metered data,

except, in any such case, if and to the extent that such loss or damage is caused by the negligence or wilful default of the Transmission System Operator or the Settlement System Administrator, **or the Distribution System Operator or the Meter Registration System Operator**, as the case may be, after **31st January, 2002** (or such later date as the Commission may determine).

APPENDIX 3 – Section 18 of T&S Code

PART 8: LIMITATION OF LIABILITY AND FORCE MAJEURE

18. LIMITATION OF LIABILITY

18.1 Limitation of liability

(A) Subject to the following provisions of this Section, each Party agrees and acknowledges that:

(i) no Party shall be liable to any other Party for loss arising from any breach of the Code or the Framework Agreement other than (but without prejudice to any other provision of the Code which excludes or limits liability in respect of any breach) for loss directly resulting from such breach and which at the relevant date was reasonably foreseeable as not unlikely to occur in the ordinary course of events from such breach in respect of:

(a) physical damage to the property of any other Party; and/or

(b) the liability (in law) of any other such Party to any other person for loss in respect of physical damage to the property of such other person, provided that the liability of a Party in respect of any such loss shall not exceed €100,000 per event or incident or series of related events or incidents; and

(ii) no Party shall in any circumstances be liable in respect of any breach of the Code or the Framework Agreement to any other Party for:

(a) any loss of profit, loss of revenue, loss of use, loss of contract or loss of goodwill; or

(b) any indirect or consequential loss or any incidental or special damages (including punitive damages); or

(c) except as provided in paragraph (A)(i)(b) and paragraph (D), loss resulting from the liability of any other Party to any other person howsoever and whensoever arising.

(B) For the purposes of paragraph (A)(i) the “relevant date” is the date of the Framework Agreement except that where the breach in question would not have been a breach of the Code but for a Modification of the Code, the relevant date shall be the date of such Modification.

(C) Paragraph (A) is without prejudice to any provision of the Code which provides for an indemnity, or which provides for any Party to make a payment to another.

(D) Nothing in the Code shall exclude or limit the liability of any Party for death or personal injury resulting from the negligence of such Party.

18.2 Exclusion of certain rights and remedies

(A) The rights and remedies of the Parties pursuant to the Code and the Framework Agreement are exclusive and not cumulative and exclude and are in place of all substantive (but not procedural) rights or remedies expressed or implied and provided by common law or statute in respect of the subject matter of the Code, including any rights or remedies of any Party in tort (including negligence and nuisance) or misrepresentation and accordingly, but without prejudice to sub-section 18.1(D) (Limitation of liability), each Party (to the fullest extent permitted by law):

(i) waives any rights or remedies; and

(ii) releases each other Party from any duties, liabilities, responsibilities or obligations arising or provided by common law or statute in respect of the subject matter of the Code.

(B) Without prejudice to paragraph (A), where any provision of the Code provides for any amount to be payable by a Party upon or in respect of that Party's breach of any provision of the Code, each Party agrees and acknowledges that the remedy conferred by such provision is exclusive of and is in substitution for any remedy in damages in respect of such breach or the event or circumstance giving rise thereto.

(C) For the avoidance of doubt, nothing in this Section shall prevent any Party from or restrict it in enforcing any obligation (including suing for a debt) owed to it under or pursuant to the Code.

18.3 Residual provisions

(A) Each provision of this Section shall be construed as a separate and severable contract term and shall as respects any Discontinuing Participant survive that Participant ceasing to be a Participant. If one or more of the provisions of this Section is held to be invalid, unlawful or otherwise unenforceable, the other or others of such provisions shall remain in full force and effect and shall continue to bind the Parties.

(B) Each Party acknowledges and agrees that the provisions of this Section are fair and reasonable having regard to the circumstances as at the date of the Framework Agreement.

APPENDIX 4 – Section 1.4 of T&S Code

1.4 Role of the Transmission System Operator and the Settlement System Administrator

(A) The Transmission System Operator shall be required to perform the following functions in relation to the electricity trading arrangements:

(i) dispatch all generating units with capacity above 10 MW (Generators with units of between 5 MW and 10 MW can elect to have those units centrally dispatched. Generating units of less than 5 MW will self-dispatch) on the basis of generator nominations and, to the extent that dispatch needs to be different from those nominations for system security and stability reasons, of generator prices for incremental or decremental changes to nominations

(ii) agree and implement a schedule of energy transfers across the interconnector with Northern Ireland, in co-operation with the transmission system operator there; and

(iii) recover the costs of procuring ancillary services and of resolving system constraints.

(B) The implementation of the IME Directive also necessitates the performance of a market and settlement function. The Settlement System Administrator shall be required to:

(i) calculate uninstructed and instructed constraint and energy market imbalances - in aggregate and by market participant - between actual quantities generated and consumed, adjusted as necessary for losses, instructed quantity of energy generation by the Transmission System Operator and final nominated contractual quantities in each and every settlement period;

(ii) identify or calculate imbalance quantities and spill prices in each and every settlement period;

(iii) issue invoices and arrange payments for imbalances; and

(iv) recover the costs of operating the trading and settlement system, as a separate element in transmission use of system charges.