Bringing choice and value to customers

Shippers, Transco and other Interested Parties

Direct Dial: 020 7901 7346
Email: roger.morgan@ofgem.gov.uk

19 November 2004

Dear Colleague,

Modification Proposal 637: ''Introduction of a financial incentive performance regime for the resolution of User Suppressed Reconciliation Values (USRVs)"

The Office of Gas and Electricity Markets ('Ofgem') has carefully considered the issues arising from modification proposal 637 "Introduction of a financial incentive performance regime for the resolution of User Suppressed Reconciliation Values (USRVs)" and has directed Transco to implement the modification. This letter explains the background to the modification proposal and outlines the reasons for Ofgem's decision.

Background

The Network Code recognises that in certain circumstances meter reads may generate NDM and DM reconciliation values. Reconciliations are generated from a meter reading obtained in accordance with the code (must reads or 'Daily Metered' readings) and which fail validation checks and become a Suppressed Reconciliation Value (SRV) and are not invoiced by Transco.

Data provided by shippers can also cause suppressions. These are User Suppressed Reconciliation Values (USRVs) and relate to items within the indicated charges caused by the reconciliation of gas to a meter reading causing an adjustment from the previously estimated or deemed quantities.

Transco's Network Code refers to an ancillary document known as the Network Code Reconciliation Suppression Guidelines. The Suppression Guidelines detail the validation criteria for NDM and DM reconciliation values, the Transco/shipper processes, and performance standards for managing the investigation and resolution of values, which fail the prescribed suppression tolerances. The guidelines set out a number of rules and principles. For example:

- Transco is responsible for the investigation, resolution and subsequent release of reconciliation values generated from daily reads and must reads (reconciliation values generated from readings obtained under sections M3.6 and M4.1 of the code).

- Shippers are responsible for the investigation and resolution of all other meter point reconciliation values (USRVs).

- Standards of performance on shippers to resolve a percentage of USRVs in a prescribed period of time.

Transco suggests that the current performance by shippers to investigate the validity of the underlying data and notify Transco either to release the USRV or to process a re-reconciliation is consistently below standard.

Transco argue this is problematic for the following reasons:

- The number of unresolved filter failures for a particular period will remain suppressed unless investigated and released and excluded from the next available reconciliation invoice;

- There is a considerable backlog of USRV items outstanding with shippers. With the backlog increasing there is no incentive on shippers to both clear their backlogs and implement measures to ensure the timely resolution of ongoing filter failures;

- There is no Reconciliation by Difference (Rbd) incentive for shippers with only Larger Supply Point portfolios to resolve their USRVs. Filter failure suppressions submitted to such shippers via the NDM reconciliation process remain subject to the documented standards. Failure by Larger Supply Point (LSP) shippers to resolve their USRVs could have an adverse impact upon Rbd shippers.

Financial effect of suppressions

Concerns have been expressed by shippers and Transco about the volumes of unresolved USRVs. In particular, where the reconciliation would result in a debit to shippers, there is no incentive to clear backlogs and ensure the timely resolution of ongoing filter failures.

Transco suggests that based on an extrapolation of previous reconciliations/suppressions the estimated energy calculated shipper by shipper, based on their previous percentage drift between allocated and actual energy may represent in monetary terms an accumulated value of close to £23m in energy.

Modification Proposal

This Modification was proposed by Transco after being developed in a sub-group of its Supply Point and Billing Workstream. The proposal aims to improve shipper performance in resolving unresolved suppressed NDM Reconciliation Values through the implementation of an incentive framework.

Transco suggest that implementation of this modification should:

- Reinforce the contractual obligations placed upon shippers to resolve USRVs;
- Increase certainty for shippers (charged through Rbd);
- Ensure that appropriate and cost reflective charges were applied to shippers in respect of their use of Transco's facilities.

USRV Backlog

All items in the suppressed pot as at the implementation date will be assessed for the 95 per cent standard with the first date for the application of potential incentives being the 20th of the second month following implementation. Also, the backlog will be analysed and any items which are over four months old will incur an incentive payment of £30 for each item. On the 20th of each subsequent month, a charge of £30 would apply to each item in the backlog over four months old at that date.

Ongoing performance incentive

For USRVs received from Transco between the 21st of a month and 20th of the following month, (period X), each shipper shall provide a full response to Transco for 50 per cent of such queries by the 20th of month X + 1, and for 95 per cent of such USRVs by the 20th of month X + 2.

Whilst no incentive is applied on the 50 per cent performance, shippers will be required to use all reasonable endeavours to ensure that no less than 50 per cent of the USRVs that are suppressed are not suppressed in the immediately following month.

For each Shipper:

All USRVs from month X not responded to by month X+2 below the 95 per cent standard would be subject to an incentive payment of £20. If performance was 95 per cent or over, no incentives would be payable.

No further charge would apply in the third month.

All subsequent USRVs from month X not responded to by month X+4 will attract an incentive payment of £30.

All subsequent USRVs from month X not responded to by month X >4 and above will attract an incentive payment of £30 for each subsequent month until responded to.

Where the number of USRVs in a month increases by 50 per cent or more compared to the average number for the previous six months and the increase is more than 20 USRVs, the standard will be increased by one month.

All sums received via incentive payments will be allocated to the Rbd community as per the current Rbd invoicing system (based upon market share for the relevant LDZ for the relevant period) after deduction of a two per cent administration charge. The two per cent charge will be deducted to cover the additional costs incurred by Transco of calculating, issuing, collecting charges and allocating, issuing and paying the corresponding credits.

<u>Incentive Cap</u>

An overall monthly cap for total incentive payments of £100,000 will apply. Where this value is exceeded a scaling methodology will be used.

In the event that the cap is exceeded, the amounts payable by shippers in respect of that month will be reduced pro rata such that the aggregate of such reduced amounts is equal to the monthly cap.

In the event of non-payment of incentives, all such charges would be allocated once relevant funds have been collected. Charges collected in a given quarter would be allocated to Rbd shippers within the first month of the following quarter.

Transco's Views

Transco supports this modification. Transco is concerned about the current performance of a number of shippers who are failing to investigate the validity of underlying data associated with USRVs and failing to notify Transco to process the reconciliation or undertake re-reconciliation. Transco suggests that this has created the following commercial issues for shippers.

- There is a considerable backlog of USRV items latest figures suggest 28,121 (as of Nov 04) outstanding. Transco suggests that there is no incentive for shippers to resolve USRVs that would result in a debit to shippers.

- Failure by larger supply point shippers to resolve USRVs could have adverse impact on shippers whose portfolios are reconciled via RbD.

Transco has indicated that it would require a three to six month lead time to introduce the modification. This time period would be used to implement the administration arrangements to support the regime and to allow shippers to adequately prepare and improve their USRV performance.

Shippers Views

The majority of RbD shippers support the modification whilst the majority of I&C shippers who responded do not support the proposal. Shippers views are set out and discussed below.

<u>Conquest reliability</u>

One theme emerging from shippers is that the modification does not take into consideration the role of Transco in releasing suppressions once valid data has been provided. For example, the systems Transco will use to allow shippers to process USRVs is unreliable and may cause inappropriate charges unless improvements are made.

Since receipt of the final modification report Ofgem has sought assurances that Transco is able to support the introduction of the incentive regime. Crucial to this is a reliable Conquest system[1] that enables shippers to monitor and resolve USRVs.

Ofgem understands that Transco has improved the reliability of its Conquest platform and the difficulties (outages) shippers were experiencing have diminished since these improvements were put in place. This experience is supported by a number of shippers who in their representations to this modification raised concerns about the reliability of Conquest, in particular, its role in USRV resolution.

Identifying USRVs

A number of shippers expressed concerns that Transco is unable to provide timings for when suppressions were first identified. Some shippers suggest that being able to track and validate USRVs is important if they are to be subject to an incentive regime.

Transco suggests that a specific 'date stamp' is not visible to shippers but it is able to monitor the age of filter failures as all USRVs are given a sequential reference number. This number can be used by shippers and Transco to track USRVs.

Administering the incentive regime

A number of shippers raised concerns about how Transco will monitor and administer the incentive regime. Ofgem is sympathetic to shippers concerns and suggests that an incentive regime will require robust reporting and administration if disputes and additional costs are to be avoided.

In its final modification report Transco states its intentions to further develop its mechanisms to monitor and report USRV resolution performance. Ofgem has subsequently sought further clarification in this respect.

Transco has provided the following overview:

- shortly after the 20th of each month, Transco will extract details of all outstanding USRVs and identify those that have failed against the two month or four month standard;

- immediately (after validation) each shipper with failures in each category is sent a file with Conquest (on line query management facility) reference numbers;

- incentives will be calculated in accordance with modification rules, with a view to them being invoiced in the second month following the end of the billing period, to allow time for validation and preparation of the invoice;

- supporting invoice information will be issued five days before the invoice – the invoice would include Conquest reference numbers to enable validation;

- disputing charges would be in accordance with existing invoicing dispute mechanisms. However, by issuing details of all liable items early in the process it should reduce the

[1] The Conquest query service allows shippers to query data in respect of their own supply points; it is itself subject to agreed standards of service for query resolution.

number of disputes. Items that have been cleared would be removed from USRV reporting counts and calculations prior to issuing an invoice. Transco's conquest systems would be used by shippers to query invoice charges;

- on a quarterly basis, the total amount collected would be aggregated by LDZ and apportioned to all RbD shippers in each LDZ on the basis of their SSP market share for that quarter. Transco already operates this process for SRVs.

<u>Incentives on shippers</u>

A number of respondents support the introduction of a financial incentive regime and suggest that action needs to be taken to incentivise shippers who have been reluctant to devote resources to process USRVs. In particular, one respondent suggests that the modification will place greater incentives upon shippers to deal with USRVs and ensure correct allocation of energy to supply points within their portfolio. This would in turn reduce the incorrect allocation of energy and related transportation charges to the Rbd processes and those shippers and suppliers of small supply meter points.

Ofgem's views

Ofgem is sympathetic to the concerns raised by shippers. However, in Ofgem's view the current level of unresolved USRVs is unsatisfactory. Ofgem understands that Transco's attempts to escalate USRVs with shippers has not led to a significant reduction in the numbers of outstanding USRVs. Also, the sub-group that developed this modification proposal did not support other options to address performance i.e invoking sanctions, cancelling USRVs and automatically releasing USRVs invoices after a pre-determined timeframe.

Given that a number of shippers have rejected putting in place further measures (outside of the code) to increase shipper performance it does not seem unreasonable for Transco to seek to put in place contractual obligations to govern USRVs. Whilst it is disappointing that shippers have not resolved USRVs in a timely manner, in Ofgem's view it is prudent for Transco to ensure that transportation and energy charges are allocated to the appropriate shippers' and market sectors.

Transco suggests that it has attempted to escalate shippers USRVs in a number of ways. For example, via meetings with shippers at contract management level, urging shippers to make more use of the filter failure team established by Transco, providing training to shippers' operational staff and targeting the worst offenders. However, these measures have failed to significantly reduce the numbers of outstanding USRVs.

Since discussions commenced on the development of an incentive regime the number of outstanding USRVs were reduced from 37,000 to under 25,000. Whilst this reduction was welcomed the numbers have gradually increased to 28, 121. Without the introduction of more robust obligations on shippers the numbers of outstanding USRVs may continue to rise and shippers may only resolve USRVs that are in their favour i.e results in credits.

It is appropriate to protect the interests of shippers that are affected by poor USRV performance via the Network Code. Ofgem supports the introduction of an incentive regime as it puts in place a solution to incentivise shippers to resolve USRVs for the following reasons:

- the incentive regime creates more certainty for RbD shippers;
- the modification puts in place more robust contractual obligations with respect to USRVs and promotes the timely resolution of suppressed NDM reconciliations.

Ofgem has given consideration to the appropriateness of the proposed monthly cap on liability. Whilst such a cap may dull the incentives to perform to an appropriate standard, Ofgem also considers that higher liability may be unnecessary and inappropriate in this instance. Ofgem expects Transco to share with shippers regular reports detailing USVR performance and the effectiveness of the financial incentives. These reports (Transco provide some of this information already) should illustrate amongst other things, how shippers have responded to the levels of outstanding USRVs, the time taken to resolve USRVs, financial liabilities incurred and the accuracy of released suppressions. Transco should also review the appropriateness of the two per cent charge after one year of implementation to ensure the charges reflects the costs of providing this service.

Ofgem's decision

Ofgem has decided to consent to this modification to the Network Code as the implementation of an incentive framework should improve shipper performance in resolving USRVs for the following reasons:

- The introduction of an incentive regime increases certainty for shippers charged through RbD;
- the modification seeks to reinforce the Network Code obligations on shippers to resolve USRVs;
- the implementation of a incentive framework should ensure that costs are applied to shippers in respect of their use of Transco's systems.

Ofgem believes that modification 0637 better facilitates the achievement of Transco's Network Code relevant objectives of securing effective competition between relevant shippers and relevant suppliers and the efficient and economic operation of its pipe-line system as outlined under Amended Standard Condition 9 of Transco's GT licence.

Ofgem notes that the legal text has been subject to further iterations by Transco and that the industry has had an opportunity to comment on such changes. If further discrepancies are identified it is open to shippers/Transco to raise additional modifications.

If you have any queries in relation to the issues raised in this letter please do not hesitate to contact roger.morgan@ofgem.gov.uk or via telephone on 020 7901 7346.

Yours sincerely

Nigel Nash
Head of Market Infrastructure