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UNC Modification Proposal 0117 -
'Amendment to Invoice Billing Period"

Dear Julian,

Thank you for your invitation seeking representation with respect to the above Modification Proposal.

General

The NTS Shrinkage Manager feels it necessary to take the unusual step of providing representation for the above proposal as a consequence of the perceived intent to effect the commercial risk environment without due consideration to the meter assurance environment.

The NTS Shrinkage Managers role is to procure gas on behalf of all Users to help maintain NTS system balance allowing for Unaccounted for Gas (Meter Errors manifesting as daily linepack change), Own Use Gas (fuel gas for compressor usage needed for system operation) and for CV Shrinkage. The funding for this activity is via the SO commodity charge. The NTS Shrinkage Provider is incentivised to be efficient and economic in the procurement of Gas by a risk/reward framework.. Whilst performing in the region where the Shrinkage Provider can share in the risk/reward he shares the benefit in a ratio of 25:75 Shrinkage Provider to the Users, and risk in a ratio of 20:80 Shrinkage Provider to Users. Once outside of those margins 100% of the benefit or risk is borne by the Users.

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The NTS Shrinkage Manager supports the principle of introducing an efficient and economic limit to invoicing for retrospective billing periods, however we do not support 0117 as it stands for 3 key reasons:

1) The proposal is potentially discriminatory. There is a significant risk that a sub group of the community will benefit to the detriment of the wider community, as detailed in our specific responses below. At this point, there has been insufficient time to carry out a reasonable and fair assessment of the impact of this proposal on all parties. Nor is there any content in the proposal as to how an agreed baseline for implementation should be achieved to avoid discriminatory outcomes i.e. should the reconciliation pot be cleared? How will known, but as yet unprocessed, errors be dealt with to avoid discrimination between parties? Etc.

2) The objective of cost reflectivity for fair regulation is undermined by an arbitrary close-out period, particularly where the close-out period has not been considered in the context of the relevant prevailing meter assurance and maintenance regime. This leads to point 3.

3) There is a significant risk that a reactive change, in isolation, could lead to perverse outcomes in terms of the interaction between the commercial regime and physical operations. Invoices are driven by the measurement regime. The control environment for revenue critical data is both complex and complicated. Whilst we support the review of the risk and control assurance regime underpinning invoices, we recognise that this review would need sufficient time and rigour to ensure perverse incentives do not result from an arbitrarily shortened invoice period. There has been no evidence presented as to whether this proposal increases the risk profile to the gas measurement regime, decreases it or has specific positive or negative outcomes for different Users or User groups. Given the complex inter-relationships of invoices, dependence on measurement data and varied incentives (commercial and regulatory) which fall within the influence of this proposal, we consider there has been insufficient time for full analysis of this revenue critical area. Any proposal which risks less rigorous ongoing measurement assurance will lead to the need for the Shrinkage Manager to intervene more frequently and carry greater overhead on behalf of all Users in order to mitigate increased risk. It is therefore not clear that this would lead to improved economic and efficient operation or improved cost targeting.

Our specific responses are further detailed below.

1. The Modification Proposal

The Proposer states that:-

"This modification proposes to limit the period in respect of which a demand for payment can operate retrospectively to no more than two years two months from the date on which the relevant invoice is issued."

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The trigger for this Proposal has been a single reconciliation (SE LDZ Offtake Meter Error) which the proposer believes will result in an unreasonable commercial impact to shippers active in the relevant LDZ. The effect of the Proposal however contradicts the intention as it limits the ability to appropriately allocate the energy to the area in which it has been used.

The NTS Shrinkage Manager considers that the essence of this proposal does not reflect the view that Ofgem put forward in its response to Proposal 642 when it was said:-

"*Whilst significant and unforeseen energy reconciliations can reduce certainty for both the GT and Users, it is correct that energy balancing revenues be adjusted in light of better information about the actual off-take of gas.* "

A measurement under registration from NTS to an LDZ results in the NTS Shrinkage Provider having to procure gas at market rates to help maintain the balance of the system. This NTS Shrinkage Procurement is funded primarily by the Users as a whole via the current market mechanisms with any under or over recovery being passed back through SO commodity rates via the NTS Shrinkage Incentive. This procurement action is necessary in order to maintain the NTS linepack at the target level and hence maintain the pressure within the NTS. Whilst the meter remains in error the NTS Shrinkage Provider continues to accrue costs associated with the amount of gas flowing un-registered into the relevant LDZ. During the error period the NTS and DN Transporter is prevented from realising the transportation revenue associated with un-registered gas flowing into the relevant LDZ. The Users that are active in the LDZ during the period of error will be metering the gas that was un-registered through the offtake out to their End Users and charging accordingly.

The NTS Shrinkage Manager believes that it is only possible to target the costs to the Users that have benefited from supplying gas to their End Consumers (without incurring the associated transportation costs – lost revenue for Transporters) by ensuring errors can be allowed to reconcile over the duration of the error period taking into account prevalent legislation.

Applying a two year two month limit on the ability to request payment discriminates against the Users that have borne the costs but have not benefited from supplying gas without paying the related transportation costs. This view seems to echo the sentiments of Ofgem's comments in response to the Proposal 642 when it is stated:-

"It would be unreasonable to deprive any party of monies they were due by introducing an inappropriate point of cessation. "

The NTS Shrinkage Provider believes the proposed two year and two months restriction on demand for payment for retrospective billing is in essence discriminatory as it does not facilitate efficient apportionment of costs and compromises the principles behind the introduction of the NTS Shrinkage Incentive.

The NTS Shrinkage Incentive seeks to incentivise the NTS Shrinkage Provider to minimise the amount of Unaccounted for Gas, CV Shrinkage and Own Use Gas by offering a risk reward framework which enables the community as a whole to share the benefit from out

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performing the targeted volumes. By limiting the period over which retrospective demands can be made the Users as a whole will carry the exposure of the Users benefiting within the impacted LDZ for reconciliations extending over two years two months.

The background to the proposal suggests that with regard to the costs incurred by Users as a whole through the inappropriate procurement of gas through NTS Shrinkage:-

"Shippers will be attributed a proportion of this cost dependent on their current market share in the South East LDZ, even though the majority were not active in this area for most of the period covered by the reconciliation process."

The NTS Shrinkage Provider would counter the claim as it is estimated that twenty five of the twenty eight Users anticipated to share the impact of this reconciliation did indeed have varying degrees of the domestic sector in the SE LDZ during the meter error period.

2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives

The relevant objective to secure the effective competition between relevant Shippers and between relevant Suppliers is not facilitated by the introduction of this Proposal. To the contrary, the NTS Shrinkage Provider believes that the introduction of a two year two month limit on the demand for payment limits the ability to correctly allocate costs and hence is potentially discriminatory. This view is based on the fact that the whole community has borne the costs of errors such as that currently seen within the SE LDZ in that they have paid for the procurement of NTS Shrinkage provision. The parties that have benefited are the Users that have been active in the impacted LDZ who have supplied and charged the customers for this gas but have not individually paid for bringing the gas into the LDZ. The introduction of this Proposal will introduce an arbitrary time limit and cap on the monies passing back to the community that has borne these costs and will protect the subset of Users within the LDZ that should have been targeted with the costs for the full duration of the meter error.

3. the implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

The introduction of an arbitrary time limit and cap on the appropriate apportionment of costs within the market will have no effect on the provision of the Shrinkage Manager Role as part of the operation of the system.

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4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) Implications for operation of the System:

There will be no benefit to the provision of the Shrinkage Manager Role as part of the operation of the NTS system from implementing this Proposal. The processes will continue to be assessed around the change in linepack to determine the requisite level of NTS Shrinkage in order to effectively procure gas and thus help to maintain a Total System balance.

b) Development and capital cost and operating cost implications:

The NTS Shrinkage Provider would expect costs to be incurred to develop and implement changes to revenue critical systems.

c) Extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

d) Analysis of the consequences (if any) this proposal would have on price regulation:

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5. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

6. The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

The anticipated cost and scale of change to appropriately develop the requisite processes, procedures and IT systems to support this proposal should not be under-estimated. Whilst the Proposal appears to only consider LDZ reconciliation, which, in itself could be seen as discriminatory, the impact across the whole of the energy balancing, invoicing, query and adjustment processes together with the capital cost of amending the systems that support the revenue streams for the whole market would be significant.

7. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

The NTS Shrinkage Provider is not aware of the implications for Users.

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8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- None Identified

Disadvantages

- Under this Proposal, where meter errors are identified that are of a duration greater than two years and two months, costs will not be accurately apportioned to parties that are likely to have accrued them. The Users as a whole will carry the majority of the exposure. The NTS Transporter will share this exposure in the ratio of 20% of the risk or 25% of the reward as set out in the framework of the NTS Shrinkage Incentive.
- This Proposal has potential to enable Users to delay the submission of meter reads within the NDM Large Supply Point suppressed reconciliation process to gain a commercial advantage.
- This Proposal appears to assume that reconciliations are only in one direction however, meter errors result in under and over registrations and this proposal will also impede the ability to credit those Users in an impacted network when over registrations occur at an offtake meter.
- The reconciliation that triggered this proposal has demonstrated that following identification of a complex metering issue, it can take a significant amount of resource, time and effort to arrive at a robust view as to the magnitude and materiality of the error. Once this is linked to prevailing industry-agreed guidelines the timeline from point of identification to reconciliation can be a protracted process. There is a requirement for these processes to ensure that actions to correct for such substantial errors are made with the appropriate control and due diligence. The implementation of this proposal may make it inefficient for transporters to drive to apportion costs appropriately for very large errors which contrary to the proposals intention exposes the Users as a whole to the majority of the risk through the NTS Shrinkage incentive mechanism where the Users carry 80% of the risk and 75% of the reward up to a cap and collar, over which carry the whole exposure.

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11. Summary of the Representations

12. The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

Compliance with safety or other legislation is not facilitated by the implementation of this Proposal.

14. Programme for works required as a consequence of implementing the Modification Proposal

The consequence of implementation would result in a large programme of work to develop and modify multiple areas of the Uniform Network Code and would result in a large change management programme to amend revenue critical systems supporting the whole industry.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

The implementation of the proposal could not be delivered in the proposed timetable.

16. Implications of implementing this Modification Proposal upon existing Code Standards of Service

The proposal does not enhance the existing code Standards of Service.

Please let me know if you, or the SME assigned to this Proposal, require any further information to enable preparation of the Final Modification Report.

Yours sincerely

Paul Gallagher
NTS Shrinkage Manager

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