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Dear Julian,

RE: URGENT MODIFICATION PROPOSAL 0122 – “Restriction of invoice billing period to price control”

Thank you for the opportunity to comment on the above urgent modification proposal.

British Gas Trading (BGT), as the proposer of this modification, fully supports its immediate implementation.

Background

The recent emergence of the Farningham metering error issue triggered urgent modification proposal 0117 to be raised by EDF Energy. 0117 proposes to limit the period in respect of which a demand for payment can operate retrospectively for no more than twenty-six months from the date on which the relevant invoice is issued.

Whilst BGT are supportive of the principle behind modification 0117, i.e. to introduce a prescribed limit as described above, we have major concerns with regard to the proposed solution and its potential implications, which we believe will not provide the industry with an equitable solution.

Our concerns with modification proposal 0117 are detailed within our response letter to that modification dated 9 November 2006.

In order to address these concerns and to ensure that the proposed Farningham adjustment does not pre-date the previous price control period, BGT raised modification proposal 0122, which was duly granted urgent status by the Authority on 6 November 2006.

The Proposal

Modification proposal 0122 seeks to address the same key points as modification proposal 0117, but proposes to limit the period of retrospection to a fixed backstop date of 1 April 2002, this date being the beginning of the price control period in effect when the Farningham metering error was discovered.

It is proposed that the fixed date of 1 April 2002 will be included within the Uniform Network Code (UNC) until varied by a further modification proposal and should be applied to the invoice reconciliation arising from the Farningham metering error issue.

The solution proposed by this modification would prospectively apply equally to both debits and credits, where parties had been either over or under billed. Therefore where a future error comes to light and it is recognised that the commencement of the error was prior to 1 April 2002, no correction would be taken by the Transporter to either collect or refund monies to relevant Users prior to this date.

It is our opinion that the introduction of the 1 April 2002 date provides a clear and sensible solution and brings alignment with the start of the latest price control period and addresses one of the key weaknesses of any proposal that seeks to set a fixed maximum period over which invoice adjustments can be made, that being the possibility that price controls will have to be re-opened.

Benefits of the Proposal

BGT believe that that this proposal sets out an effective solution that will provide a number of benefits which are significantly over and above both the existing arrangements contained within the Uniform Network Code and that proposed by urgent modification proposal 0117. The benefits of our proposal are set out below:

1. Improved Stability and Certainty

It is widely recognised that stability and certainty are key considerations for all Users. We believe that modification proposal 0122 seeks to provide much needed stability and certainty to the framework of industry transportation charging, specifically relating to the retrospection of over and under billed charges. The potential for and extent of invoice adjustments will be reduced, as a direct result of the approval of our proposal. This will create increased commercial certainty, and will add to the stability of invoicing arrangements, business planning, financial forecasting and the operation of the competitive market as a whole.

2. Reduced risk of perverse incentives upon Gas Transporters

Our proposal will reduce the potential for perverse commercial incentives upon Gas Transporters.

Generally the System Operator is in a position of neutrality on energy balancing and transportation charging matters. From this position of neutrality Shippers gain confidence

that the Transporter does not benefit from managing the system in a manner, which is either biased towards other shippers, or towards the Transporter itself. It is this confidence which has resulted in the Transporter being vested with responsibility for overseeing many critical industry processes

The ability of Transporters to claim income over and beyond that which is set out in the existing price control, can compromise the neutrality of the Transporters. This creates potential for the following:

- A wholly inappropriate incentive for Gas Transporters to identify and process under-billed errors such as the Farningham metering error more so than over-billed errors.
- In some circumstance either directly or via xoserve, Transporters are custodians of industry processes, and this allows them access to information to which Shippers do not have access. An example might be information which shows the extent to which each Shipper is affected by a particular invoice adjustment. Normally a Transporter would have no commercial interest in this information, however when this is not the case then the Transporter is in a position of unfair influence on a matter to which it has a vested interest.

Where the Gas Transporter is no longer neutral, there are risks as described above that they could influence the energy balancing and charging arrangements to their advantage. Shippers and potential market entrants will suffer reduced confidence in the fairness and equitability of the market irrespective of whether the risk as described is real or just perceived.

3. Equitable and Accurate energy Balancing and Settlement

Our proposal uses a point in time by which settlement activity is as complete as we can expect it to be. Whilst there may be a small amount of unreconciled energy predating 1st April 2002, we believe it is unlikely that this energy is likely to be reconciled in to the future.

This is however not the case for modification proposal 0117 which seeks to impose an arbitrary period of retrospection, 0122 seeks to provide protection to the integrity of the settlement system by allowing the completion of all necessary settlement activities, thereby securing the correct allocation of costs and charges.

4. Reduced Barriers to Entry

Certainty is generally recognised as being a key part of securing the facilitation of effective competition between relevant Shippers. This proposal will further aide competition by ensuring that both incumbent market participants and new market entrants have a degree of certainty, relating to the period over which over and under billed charges will be retrospectively recovered.

5. Positive incentives upon Transporters

The setting of a backstop date of 1 April 2002, increases the positive incentives upon Transporters, particularly in respect of identifying and resolving LDZ offtake metering errors and other billing accuracy activities, in a timely and efficient manner.

6. Avoids the creation of perverse incentives upon Shippers

This proposal avoids the creation of any perverse commercial incentives upon Shippers to impact settlement arrangements e.g. the delay of reads submitted into settlement and delaying the resolution of suppressed reconciliations. This again serves to protect the settlement system, especially with respect to RbD Shippers.

7. Increased Regulatory Certainty

Our modification will remove the need for regulatory guidance upon the extent to which various issues were treated in the closure of price controls that pre-dated the present price control. As a result Shippers and Transporters will benefit from increased regulatory certainty.

In addition by limiting retrospection to 1 April 2002 (the start of the current price control period), our proposal reduces the likelihood that Transporters will request Income Adjustments for events in the present price control period. That is to say that our proposal will not fetter the rights of the Transporters to recover revenue for events in the present price control period, this is not the case for modification 0117.

8. Limitation Act 1980

The Limitation Act seeks to limit the extent to which invoices can be backdated beyond a period of 6 years. The Uniform Network Code allows, at least in theory, for invoices to be generated that date back to 1st February 1998. There may be different opinions as to the circumstances under which the Limitation Act applies and the Uniform Code does not. Such uncertainty is counter to the operation of an effective competitive market. Our modification eliminates the present contention between the Uniform Network Code and the Limitation Act.

9. Simplicity

Our modification allows for simpler industry arrangements, with a clear point in time beyond which charges cannot be backdated. Reducing the need to fallback to price controls, different shrinkage incentive regimes, etc. In addition it will reduce the requirement for document storage and audit trails that currently should date so far back as 1st February 1998.

10. Efficient and cost Effective Solution

The proposal provides a cost effective and simple solution to administer.

UNC Review Proposal 0126

Further to the progression of modification proposal 0122, BGT have raised UNC review modification proposal 0126, which is due to be discussed at the Modification Panel meeting on 21 December 2006.

Modification proposal 0122 can and should in our view be implemented immediately and irrespective of 0126. Modification proposal 0126 can then build upon 0122.

Extent to which implementation of the proposed modification would better facilitate the achievement of the Relevant Objectives

A11.1 (a) – the efficient and economic operation of the pipeline system.

Compared to the current situation, this proposal increases the incentives on Gas Transporters to ensure that all relevant metering and invoicing processes are operating efficiently, as intended and as expected by Shippers, Suppliers and their customers.

Primary legislation in the form of the Limitations Act 1980 recognises that vendors should be incentivised to render appropriate bills within an appropriate period. We believe that, given the importance of the Transporter's role in the industry, including demand forecasting, system balancing etc, greater incentives and a more stringent timescale than those under the Limitations Act, i.e. those proposed within proposal 0122, should be brought to bear.

Further, ongoing Transporter requirements for the storage of relevant documentation and audit trails will reduce.

A11.1 (b) (i) and (ii) - the coordinated, efficient and economic operation of (i) the combined pipe-line system and (ii) the pipe-line system of one or more other relevant gas transporters.

Transporters would be further incentivised to ensure that LDZ offtake meters are more stringently monitored, resulting in the identification of actual metering errors across the pipe-line system in a more timely manner.

A11.1 (c) – the efficient discharge of the licensee's obligations under their license in relation to security of supply.

The incentives set out above will help to ensure that the System Operator has an accurate view of the system, which is particularly relevant when considering such areas as supply security requirements, system balancing and investment issues.

Improved accuracy of metering will ensure that the historical system data held and utilised by Transporters for these issues has an increased level of assurance.

A11.1 (d) – the securing of effective competition (i) between relevant shippers and (ii) between relevant suppliers.

Accurate information around volumes transported through the network is essential to the shipping function. If shippers have reduced confidence in the gas being metered and billed for, incentives on shippers to balance their positions, for example, is reduced. Accurate billing, including reconciliation, is key to ensuring that charges are applied fairly and equitably which underpins the aims of the competitive market.

Further, BGT strongly believes that this proposal promotes and secures effective competition by providing a greater degree of stability and certainty to all incumbent market participants and to new market entrants. It addresses concerns that the existing arrangements could be seen as a potential barrier to entry due to the financial uncertainty and risk new entrants face.

It removes the potential for perverse commercial incentives on both Shippers and Gas Transporters, as previously discussed, to be introduced or extended.

It also provides the industry with a more simplistic set of arrangement and seeks to prevent any conflict between the Uniform Network Code and the Limitations Act.

Implementation

Modification proposal 0122 was granted urgent status by the Authority, as it was considered that the proposal was linked to both:

- A specific date related event; being the earliest date that an invoice can be issued to include a reconciliation of the significant South East Local Distribution Zone metering error, recently notified to the industry; and,
- A real likelihood of significant commercial impact upon Gas Transporter, Shippers or consumers.

BGT therefore recommends that in light of the reasons why urgent status was granted to both this proposal and modification proposal 0117 and the significant commercial impact that will be placed upon Shippers as a result, that should this proposal be approved by the Authority, implementation should take place with immediate effect and be effective prior to the production of any invoices related to the Farningham metering error.

Should this proposal not be implemented, BGT are of the view that there will need to be an increased transparency of all price control period closures.

BGT are not aware of any significant system impacts or changes that will be required to implement this modification proposal.

Summary

In summary BGT believe that the objectives of this modification proposal best addresses the current issue faced by the industry and would provide an equitable solution to the Farningham metering error, whilst protecting the integrity of the price control process.

As discussed in detail earlier in our response, the benefits of this proposal and the way in which we believe the proposal would better facilitate the Relevant Objectives in summary are:

- provide both existing industry players and new market entrants with a greater degree of certainty and stability.
- removal of perverse commercial incentives upon Gas Transporters and the impacts upon their position of neutrality.
- seeks to provide protection to the integrity of the settlement system.
- reduces potential barriers to entry for new entrants.
- increases the positive incentives upon Transporters, particularly in respect of identifying and resolving LDZ offtake metering errors and other billing accuracy activities.
- avoids the creation of any perverse commercial incentives upon Shippers to impact settlement arrangements.
- provides for increased regulatory certainty.
- removes conflict between the Uniform Network Code and the Limitation Act 1980.
- provides a sensible, workable and equitable solution for all parties and overcomes the weaknesses of the current arrangements and of any proposal which seeks to set a fixed maximum period over which invoice adjustments can be made.
- provides a more cost effective and simpler solution to administer than that proposed by urgent modification proposal 0117, yet brings with it the benefits of equitability and integrity.
- helps to ensure that the System Operator has a more accurate view of the system.
- Improved utilisation of system data when considering such areas as supply security requirements, system balancing and investment issues.

Further, the proposal also provides a level of certainty and stability for Shippers from significant unforeseen reconciliations, such as LDZ metering errors, by limiting the period of retrospection and therefore exposure to all parties back to 1 April 2002, rather than

retrospective correction being permitted back into a previous price control period, as is currently the case.

Our review proposal 0126, will ensure that industry dialogue takes place to explore these complex and commercially significant issues fully to ensure that any enduring solution is fit for purpose.

Should you have any queries with regard to this response please do not hesitate to contact me.

Yours sincerely,

Chris Wright
Contracts Manager