# Modification Report
# Restriction of invoice billing period to Price Control
# Modification Reference Number 0122
Version 2.0

This Modification Report is made pursuant to Rule 10 of the Modification Rules and follows the format required under Rule 9.4.

**Circumstances Making this Modification Proposal Urgent:**

In accordance with Rule 10.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because it considered that the proposal is 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 GTs, shippers or consumers if the proposal is not granted urgency.

**Procedures Followed:**

The procedures agreed with Ofgem for this Proposal are:

| | |
|---|---|
| Ofgem grant urgent status | 06/11/06 |
| Proposal issued for consultation | 06/11/06 |
| Close out for representations | 27/11/06 |
| Final Modification Report to UNC Modification Panel | 30/11/06 |
| UNC Modification Panel recommendation (specially convened) | 07/12/06 |
| Ofgem decision expected week commencing | 11/12/06 |

## 1. The Modification Proposal

Background
The background to this proposal is the now widely discussed Farningham LDZ offtake meter error. In summary, over a period spanning almost 6 years - 13 July 1999 to 30 June 2005 - the offtake meter in question under recorded the flow of gas from the NTS into the relevant LDZ, as a result of incorrect calibration which endured without correction. Initial calculations have established that the under-recording is about 2.4TWh, equating to a value of £25.6m. Whilst there is still some dispute around the actual figures, the application of this correction would be borne by the Small Supply Point portfolio of shippers through Reconciliation by Difference (RbD).

This proposal
This modification proposal addresses the same key points as modification proposal 0117, that being to limit the period in respect of which a demand for payment can operate retrospectively. However, unlike 0117 which proposes that a period of 26 months be codified as the period for retrospection on an enduring basis, it will use as a backstop 1 April 2002, this being the beginning of the price control period in effect when the Farningham error was discovered.

This approach recognises that each Price Control period is discrete and sums of allowed revenue within each Price Control are effectively agreed and closed out.

For the purposes of clarity, this fixed date of 1 April 2002 will remain within the UNC until varied by a further modification, and will therefore be the basis for resolution of the Farningham issue, and any other similar issues that come to light. We would anticipate that this date could be varied by a modification proposal originating from our proposed Review Proposal (see below). This proposal applies equally to credits and debits i.e. where parties have been over or under billed. The effect of this proposal is therefore that, should an error come to light which is recognised to have begun prior to that date, no correction will be taken by the Transporter to either collect or refund monies to the relevant Users for periods before 1 April 2002.

In raising this proposal, the proposer is seeking to add stability and certainty to the framework of industry transportation charging. It is widely recognised that stability and certainty are key considerations for all Users.

The proposer believes that this solution is a sensible, workable and equitable solution for all parties, and overcomes the weaknesses of any proposal that sets a fixed maximum period over which invoice adjustments can be made. One of these key weaknesses is the possibility that price controls will have to be re-opened.

This Modification Proposal would set a backstop to retrospective adjustments but we do not exclude the scope for more sophisticated reconciliation closure mechanisms. These could be reviewed and developed subsequent to our proposal, and subject to more detailed analysis and discussion. Therefore, in addition to this modification, the proposer also intends to raise a Review Proposal to initiate this work. The purpose of the established Review Group will be to consider whether the current arrangements for reconciliation in a wider context as well as those as advocated by this proposal, or any other arrangements, are appropriate and fit for purpose.

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

Compared to the current situation, this Proposal increases the incentives on transporters to ensure that all relevant metering and invoicing processes are operating 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. The Proposer believes 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 herein, should be brought to bear.

**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.**

The incentives set out above will help to ensure that the System Operator has an accurate view of the system, particularly relevant when considering supply security, system balancing, or investment issues.

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

As stated above.

**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 little confidence in the gas being metered and billed for, incentives on shippers to balance their positions, for example, are reduced. Accurate billing, including reconciliation, is key to ensuring that charges are applied fairly and equitably which underpins the aims of the competitive market.

Some challenges were made by respondents to the benefits claimed for each of the relevant objectives and the perceived improvements with the provision of counter arguments for A11.1(a), A11.1(b), A11.1(c), A11.1(d). These centred on whether the claimed improvement in incentives and hence performance would be seen in reality, and whether the introduction of an arbitrary cut-off date would have unintended consequences and be discriminatory

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

The incentives brought about by the proposal, in particular accurate metering, will assist in the operation of the Total System. It is also reasonable to assume that where true flows and volumes are known as a result of accurate metering, supply security will be enhanced. No detriment to industry fragmentation has been identified.

NG SM expressed concerns about changing the balance between risks and incentives in order to avoid perverse outcomes leading to risk to the integrity of the revenue streams and financial controls across the gas industry.

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

**a) implications for operation of the System:**

System operation will be improved where based upon accurate flow data. Transporter business metrics should also improve with accuracy of invoicing and the resulting cash flow. By increasing the incentive to bill accurately it also limits Transporter liability to adjustments where errors fall into a previous price control period.

**b) development and capital cost and operating cost implications:**

Transporters will be further incentivised to ensure that meters, in particular, are regularly checked to ensure correct calibration and function. This could potentially result in increased operating costs. However, this will bring operations into line with industry expectations. In the long term, incidences of costly and time consuming rebilling will be avoided.

Some respondents believe costs would be incurred to develop and implement changes.

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

The relatively small costs reasonably incurred referred to in (ii) above would be passed through to Users through transportation charges in the normal way.

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

None, other than the pass through of relevant costs incurred through ensuring accuracy of equipment and operations.

## 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

Implementation of this Proposal will increase Transporters' exposure to under recovery where an error results in a debit that falls prior to 1 April 2002. However, this is avoided by instigation of processes to ensure accurate recording and charging. Conversely, Transporters would benefit where such an error results in a credit that is not passed through to Users. Therefore, transparency of processes is key to ensure symmetry.

TGP argued the level of contractual risk would be reduced. However the NG SM believed contractual risk to it would be increased by retrospectively prohibiting its ability to reassess exposure in a previous price control period.

## 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 NG SM identified that implementation of the Proposal would create systems costs because of its impact across the whole of the energy balancing, invoicing, query and adjustment processes together with amending the systems that support the revenue streams for the whole market.

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

The implications on Users largely mirror those on Transporters. There would be a risk of not recovering over payments, but also a lack of exposure to demands for payments to rectify an historic Transporter failing.

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

No such implications have been identified.

## 9. Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

No such consequences have been identified.

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

**Advantages**

- A defined date limiting retrospective adjustments adds certainty and is simpler for all parties to operate in terms of invoice generation, invoice validation, query management and dispute resolution.
- Provides strong incentive upon Transporters to implement and maintain accurate measuring, billing and invoicing systems and processes.
- Reduces exposure, particularly of smaller players and new entrants, to unforeseen costs.
- Protects and reinforces the integrity of the current regulated prices and price controls.
- Prevents perverse incentives to defer resolution of known billing issues.

**Disadvantages**

- Increases User exposure to losses where overpayments fall into the previous price control period i.e. prior to 1 April 2002.

Additional Disadvantages identified were:

- Where meter errors are identified that extend beyond 01 April 2002 costs will not be accurately apportioned to parties that are likely to have accrued them.
- The Proposal unduly discriminates against the NTS Shrinkage Manager
- Not an enduring solution, with an additional proposal required to address the perceived failings of the UNC.

- Fails to improve clarity and the intention of the UNC, allowing parties to interpret the intention of the UNC to their advantage.
- Fails to provide an increased incentive on the relevant parties to ensure meter accuracy.
- Any costs smeared back would continue to be beneficial to Users who had lost market share over the period at the expense of those Users who had gained.
- Significant system development, implementation and testing costs for the invoicing regime.
- Would curtail the ability of NG NTS to maximise the efficient and economic targeting of costs.
- Does not seek the settlement of all existing notified invoiced or other billing issues prior to changing the close out period.
- Undermines the principles of the UNC change process relating to the avoidance of retrospective changes.
- Setting a precedent which may increase the perceived risk for all parties from the application of retrospective changes.

## 11. Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Representations were received from the following parties:

| Organisation | Abbreviation | Position |
|---|---|---|
| British Gas Trading | BGT | Supports |
| EDF Energy | EDF | Comments |
| energywatch | | Comments |
| E.ON UK plc | EON | Supports |
| Gaz de France | GDF | Supports |
| National Grid Distribution | NG UKD | Not in Support |
| National Grid Shrinkage Manager | NG SM | Not in Support |
| National Grid Transmission | NG NTS | Not in Support |
| RWE npower | RWE | Supports |
| Scotia Gas Networks | SGN | Not in Support |
| Scottish Power | SP | Supports |
| Scottish and Southern Energy | SSE | Not in Support |
| Total Gas and Power | TGP | Supports |
| Wales & West Utilities | WWU | Not in Support |

energywatch raised concerns with regard to the re-distribution of the monies involved and potential impact on consumers as eventually the total liability will be passed through to domestic consumers.

NG NTS detailed some key concerns, which included: using UNC Modification Proposals to address specific and known disputes; movement away from current rules applying to LDZ Meter error reconciliations before current outstanding reconciliations are completed; and consideration of invoicing query resolution.

 

NG SM was concerned that the Proposal represents a reactive short term solution that does not consider risks to financial processes, core IT systems and critical data management.

RWE suggested that creating a time limitation might encourage selective non-resolution of User Suppressed Reconciliation by allowing them to “time out” to the detriment of the RbD community.

Some concerns were raised about restricting reconciliation to a specific price control period having inappropriate and unintended consequences.

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

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

**13. The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence**

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence.

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

NG SM believed that implementation might result in a large programme of work to develop and modify multiple areas and might also 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)**

An Ofgem decision is expected in the week commencing 11 December 2006. The Proposer suggests that the Proposal could be implemented with immediate effect following direction from Ofgem.

Responses received suggest immediate implementation may be impractical.

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

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

 

## 17. Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

At the Modification Panel meeting held on 07 December 2006, of the 8 Voting Members present, capable of casting 10 votes, 5 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel did not recommend implementation of this Proposal.

## 18. Transporter's Proposal

This Modification Report contains the Transporter's proposal not to modify the Code and the Transporter now seeks agreement from the Gas & Electricity Markets Authority in accordance with this report.

## 19. Text

The preparation of text has not been requested.

Signed for and on behalf of Relevant Gas Transporters:

**Tim Davis**
**Chief Executive, Joint Office of Gas Transporters**

Signature:

Date :