

Mr Julian Majdanski

Joint Office of Gas Transporters
Ground Floor Red
51 Homer Rd
Solihull
B91 3QJ

Paul Gallagher

NTS Shrinkage Manager
Network Operations
UK Transmission
National Grid

07786 126789
01926 654109
Paul.Gallagher@uk.ngrid.com

www.nationalgrid.com

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UNC Modification Proposal 0122 version 2.0 -
“Restriction of invoice billing period to Price Control”

Dear Julian,

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

Background

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 Manager's 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 within the current price control period (1st Apr 2002 to 31st Mar 2007) 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.

In the previous price control period the NTS Shrinkage Managers Role of procuring gas to help maintain the NTS system balance remained the same however during this period (1st Apr 1997 to 31st Mar 2002) this was funded from National Grids operating expenditure (OPEX).

Modification Proposal 0122.

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 this Proposal for 4 key reasons:

- 1) The Proposal is potentially discriminatory:
 - It unduly discriminates against Shrinkage Manager and to the advantage of a number of Users with NDM portfolios in the South East LDZ prior to 1st Apr 2002. The NTS Shrinkage Manager has incurred OPEX to procure NTS Shrinkage Gas, to investigate and identify the error for correction (in accordance with the UNC) but is then denied the benefits of those corrections properly identified.
 - It prevents the correction of any commercial advantage to the subset of Users active in the LDZ have gained from the supply of gas to end consumers within the LDZ without accruing the associated costs.
 - The Proposal does not outline how an agreed baseline for implementation should be achieved to avoid discriminatory outcomes i.e. should the existing notified events be cleared? How will known, but as yet unprocessed, errors be dealt with to avoid discrimination between parties?

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

3) The Proposal represents a reactive short term solution borne out of commercial expedition. It does not consider the risks to:-

- a. Financial processes
- b. Core IT systems
- c. Critical data management

These elements all support the industry wide revenue streams and an amendment to these would have audit (eg. Sarbannes Oxley) implications and create risk for the published accounts for parties in the market place.

There is a risk that a reactive change, in isolation, might 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 robust processes and procedures can be implemented to address the issues associated to metering errors.

We would welcome a review to undertake a considered invoicing wide review incorporating:-

- a. Meter assurance activity, including the potential introduction of incentives
- b. Underlying business and system processes
- c. Meter data validation and receipt.
- d. Alignment of agreed industry timescales with Limitation Act

- e. Implementation of the revised future proofed business rules to ensure no discrimination in the implementation
- f. a full and thorough Impact assessment of any proposed changes including the resolution of outstanding issues e.g. duplicate meters and reconciliation suppressed pot

We believe that such a review would provide the industry with an appropriate opportunity by which to fully explore the implications surrounding the issues raised in this Proposal. Further, this would afford all stakeholders with the opportunity to discuss and agree how these issues should be addressed in an efficient and economic manner.

This Proposal has provided no evidence presented as to whether it would increase (or decrease) the risk profile to the gas measurement regime, 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.

4) The Proposal effectively seeks to replace the Reconciliation By Difference Date (1st February 1998) whilst also proposing a review of the area. We do not believe that this represents an economic and efficient investment as it has designed in obsolescence; increases risk to core systems by requiring reactive time pressured change now, then proposes a review which might lead to further change in the short to medium term – potentially doubling the risk to core systems and wasting investment.

Our specific responses are further detailed below.

1. The Modification Proposal

The NTS Shrinkage Manager believes the arbitrary date of 1st April 2002, to be used as a backstop for retrospection, does not best serve the perceived intent of the Proposal to incentivise an improvement to revenue critical data via more effective measurement assurance. The Proposal seems to unduly discriminate against the NTS Shrinkage Manager whilst it creates positive undue discrimination for those Users shipping to NDM customers in the affected LDZ.

The role of the NTS Shrinkage Manager is to procure gas to offset NTS linepack change and hence help maintain the NTS system balance. The role remains constant irrespective of whether pre or post 1st Apr 2002. In the period post 1st Apr 2002 the Users as a whole accrue the costs of shrinkage provision via SO commodity charges, however prior to this date National Grid accrued all the costs for NTS Shrinkage Procurement through OPEX. This Proposal is an attempt to retrospectively modify the UNC to limit discrete Users direct commercial exposure, not recognising the commercial advantage this issue may have given them over other Users shipping in different LDZs during the period up to 31st Mar 2002.

The proposer acknowledges that further modification proposals might be required which we consider indicates that this Proposal is reactive and is merely seeking to address the Farningham meter error reconciliation. We do not believe that a series of contractual amendments is efficient as this would incur unnecessary industry expense and risk to revenue critical data streams which underpin the market as a whole. The xoserve UNC billing systems are complex, built around a significant amount of hard coded business rules which might represent a significant risk to the community to modify. Given these systems are at the heart of the financial regime for the gas industry and that many companies in this industry are subject to Sarbannes Oxley requirements as well as all being subject to proper governance and financial audit requirements, any risk to the regularity of the revenue stream should be clearly stated. An urgent modification will require urgent implementation; there is a very real risk that an ill considered design solution and expedient implementation to meet the short term needs of one commercial issue could put at risk the regularity of the financial accounts of all parties relying on the transportation and energy invoicing and accounting systems from xoserve. The system should be reviewed and a sustainable solution developed as a one off, measured and responsible improvement to the billing regime. We also believe that this should be consistent with the Limitation Act, for the avoidance of future doubt, should not be tied to any one PCR period given invoicing does not naturally contain itself to these arbitrary time lines but more importantly, the system solution should be future-proofed, based around a considered set of agreed business rules which reflect an appropriate way forward for the industry. This would provide an economic and efficient IS investment, would reduce the running costs of the systems because of the ability to invoke a data archiving protocol rather than having to continuously grow the capacity for data as each day passes. This would also avoid risk and the costly requirement for continued re-development of systems code and all of the implementation efforts this would require.

A review as to how this would be implemented should be undertaken – to include the management of the suppressed reconciliation pot, the close out for duplicate meters, the close out for meter errors and their adjustments. In addition, the incentives upon meter owners should be considered to ensure the appropriate alignment of meter assurance incentives, UAG management and the reconciliation regime to deliver more robust revenue management. In short, a review of the above to develop a set of business billing rules to then be developed in future-proofed billing arrangements should be sought. The short term and uneconomic reactive change to core systems would put at risk the integrity of the revenue streams across the industry and this is unjustified on the grounds of purely commercial vested interests.

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. “

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 1st Apr 2002 limit on the ability to request payment unduly discriminates against the NTS Shrinkage Manager that has borne the costs whilst a subset of Users has 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 proposal states that:-

"In raising this proposal, the proposer is seeking to add stability and certainty to the framework of industry transportation charging."

The NTS Shrinkage Manager however believes that the Proposal will not add stability, it simply restarts the clock on the same regime at a date which suits the proposer in order to avoid a current commercial issue.

The NTS Shrinkage Manager considers any "interim" solution in advance of a review group would be an unnecessary investment as even an interim solution would be costly given this is a change to core systems which underpin compliance and financial processes for published accounts – the testing and implementation efforts will be significant costs which will be wasted given the outcome from a review group is likely to require re investment in the same systems within a short period of time.

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 1st April 2002 limit on the demand for payment limits the ability to correctly allocate costs and hence is unduly discriminatory. This view is based on the fact that the NTS Shrinkage Provider has borne the costs up to 31st Mar 2002 as increased OPEX, of errors such as that currently seen within the SE LDZ in that it has 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 NTS Shrinkage Manager who 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 hence giving the subset of

users in the LDZ a commercial advantage over Users shipping in other LDZs in the period up to 31st Mar 2002.

The NTS Shrinkage Manager believes it is unduly discriminatory:-

- It is likely to benefit Users that had historically larger portfolios.
- It discriminates against Transporters that have complied with the current meter assurance standards with regard to requisite metering tolerances, maintenance standards and audit norms but would then deny them any compensation for errors identified as a result of the investment in these assurance activities.
- It might have the perverse incentive of reducing assurance efforts given there is a lesser period of time over which risk is spread.

The NTS Shrinkage Manager believes that the NTS Transporter is “...*incentivised to render appropriate bills within an appropriate period*” as the UNC ensures reads for offtake meters must be obtained by D+5. The UNC also recognises the need to correct data in light of better information through the reconciliation mechanism.

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.

The NTS Shrinkage Manager does not believe the arbitrary imposition of a limit to invoicing has any direct impact on security of supply or system balancing. The NTS Shrinkage Manager procures gas to help maintain the system balance. Commercial constraints have no direct impact on the requirements of system balancing on any given day. System balancing actions are closed out within-day and so limiting reconciliation past 1st Apr 2002 has no impact on system balance.

Curtailment of reconciliation only serves to limit the Transporters' ability to accurately reflect the costs that should have been accrued by parties without addressing the root cause. A balanced considered approach which recognises the appropriate level of commercial risk alongside the appropriate level of measurement assurance would better serve the objective.

The economic investment levels around metering in the market offer a balance of risk and incentivisation. In order to change one side of the equation then the other side needs to be considered carefully to avoid perverse outcomes leading to risks to the integrity of the revenue streams and financial controls across the gas industry. This proposal only considers one part of the equation and is therefore risky.

The NTS Shrinkage Manager believes that the arbitrary application of a 1st Apr 2002 limit to retrospection unduly discriminates against the NTS Shrinkage Manager and conversely

positively discriminates the Users within the SE LDZ who by the introduction of this proposal will be protected from being targeted with the costs they should have incurred.

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 role of the Shrinkage Manager Role in its role in balancing 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 Manager 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:

We believe that this aspect should be discussed and agreed as part of the proposed review

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

The NTS Shrinkage Manager would expect any pass through of costs associated with an incremental improvement of measurement assurance of offtake meters to be significant. The Shrinkage manager however believes that this proposal will not deliver such changes.

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

This Proposal is unduly discriminatory in that it specifically targets increasing the NTS Shrinkage Managers contractual risk by retrospectively prohibiting its ability to reassess exposure in a previous PCR.

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, 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.

The NTS Shrinkage Manager believes that this proposal applies to all invoicing and hence would incur significant costs and would expose the revenue critical systems that support the whole market place to an excessive risk by the implementation of this proposal in an ill conceived timescale.

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

- We would welcome and support any review group that seeks to address the commercial risk environment alongside the measurement assurance.

Disadvantages

- Under this Proposal, where meter errors are identified that extend beyond 1st Apr 2002, costs will not be accurately apportioned to parties that are likely to have accrued them.
- The Proposal limits discreet Users impact of a single issue whilst acknowledging it does not represent an enduring solution.
- The Proposal unduly discriminates against the NTS Shrinkage Manager
- It would create significant risk to the financial systems and processes underpinning the commercial market place in order for a subset of users to limit exposure.
- It would incur significant system development, implementation and testing costs to implement the proposal across the invoicing regime whilst it is acknowledged further modification would be required.

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

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

The consequence of implementation might result in a large programme of work to develop and modify multiple areas of the UNC and might also result in a large change management programme to amend revenue critical systems supporting the whole industry. We would welcome a full impact assessment to be undertaken by Xoserve on behalf of all stakeholders.

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

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