

**Draft Modification Report**  
**Revision to the 'User Suppressed Reconciliation Values' Financial Incentives arrangements**  
**Modification Reference Numbers 0141 and 0141A**

Version 1.0

This Draft Modification Report is made pursuant to Rule 9.1 of the Modification Rules and follows the format required under Rule 9.4

## **1 The Modification Proposal**

### Proposal 0141

Reconciliation validation 'filter' failures are generated from meter readings which are deemed by Xoserve to be out of tolerance, and are termed User Suppressed Reconciliation Values (USRV's). For all USRV's received from Xoserve, Users are obliged to provide a full response to Xoserve in accordance with the standards contained within the Uniform Network Code Reconciliation Suppression Guidelines.

Modification Proposal 0637, implemented on 21<sup>st</sup> February 2005, introduced a regime to incentivise Users to process and clear all USRV's in an efficient and timely manner.

Summary of the current regime:-

*All USRV's from month X not responded to by month X+2 below the 95% standard would attract an incentive charge of £20. All subsequent USRV's from month X not responded to by month X+4 would attract an incentive charge of £30. All subsequent USRVs from month X not responded to by month X >4 and above will attract an incentive charge of £30 for each subsequent month until responded to.*

Information recently issued by Xoserve identifies that the general level of current performance in this area is consistently below the expected standard, with large volumes of items outstanding. The age analysis within Appendix A, details the number of USRV's outstanding per month as at 20<sup>th</sup> February 2007.

Although the USRV clearance obligations and incentive regime are documented within the Uniform Network Code Principal Document and the Uniform Network Code Reconciliation Suppression Guidelines document, it is evident that the current incentive regime does not appear to be working in a sufficiently robust manner, to adequately mitigate the financial risk that unresolved USRV's present to Reconciliation by Difference (RbD).

There is currently a significant backlog of outstanding USRV items, which has increased since the implementation of Modification Proposal 0637. It is clear that the current regime, which incentivises Users to clear USRV items that could result in large debit charges to the User and equal and opposite credits to RbD and to

implement measures to ensure the timely resolution of 'filter' failures, is ineffective.

The information provided by Xoserve also shows that the incentive liability payment monthly cap of £100k, which is currently in place, is resulting in the significant scaling down of individual liability payments per outstanding USRV for both the existing £20 and £30 liability payment standards.

The effect of the scaling down of these liability payments is such that the original intention of the regime, as proposed by Modification Proposal 0637, has not been realised and its effectiveness has been significantly impacted.

To address the issue, this modification proposal seeks to increase the incentive liability payment monthly cap from the existing value of £100k to £500k. This increase has been based upon analysis undertaken by Xoserve relating to 'Scaled charges for USRV incentives' see Appendix B. This analysis clearly identifies a significant decrease in scaling factors from January 2006 to December 2006 and further identifies that a monthly cap of at least £400k is required to ensure that the scaling factor is returned to its correct value of 1.

As the trend over the months June 2006 to December 2006 shows the level of unscaled monthly incentives payments increasing from £196k to £364k and evidence that this trend is continuing, we propose that the new proposed monthly cap of £500k is both appropriate and proportionate to ensure that the original intentions of the regime implemented by Mod 637 are achieved and that the requirement for future scaling down does not occur.

The current arrangements, as defined within the Uniform Network Code under section 8.3.6, allow Transporters to retain 2% of all amounts received. These arrangements allow Transporters to cover the costs associated with the administration of the incentive regime. With the proposed increase to the monthly cap, an amendment to these arrangements are required in order to ensure that the Transporters' revenue associated with this service continues to be appropriate and cost reflective.

This Modification Proposal therefore proposes that revenue received by Transporters under the current arrangements be capped to a total of 0.5% of the monthly cap.

### **Consequence of not implementing this Proposal**

The volume of outstanding USRV's have steadily increased since the introduction of Modification Proposal 637 regime in February 2005.

Should this Proposal not be implemented, the existing regime would continue to operate in a manner not in line with its original intentions and RbD Users would continue to suffer from the current level of financial uncertainty created by unresolved items.

Due to the significant scaling down of monthly incentive payments, the existing regime does not currently provide adequate incentives upon non-RbD Users to resolve outstanding USRV's, this lack of incentive would therefore remain.

Further, it is likely that the number of outstanding USRV items would continue to increase in volume and increase the level of risk to RbD.

#### Proposal 0141A

UNC Modification Proposal 141 "Revision to the 'User Suppressed Reconciliation Values' Financial Incentives arrangements" raised by British Gas Trading (BGT) proposes to increase the incentive liability payment monthly cap from the existing £100k value to £500k. Whilst generally supportive of initiatives to address the USRV problem, E.ON does not believe that this is an appropriate measure for the following reasons :

a) It does not seek to target the incentive towards particular categories that have been highlighted as an ongoing concern by the industry, for example aged USRV's.

b) It presents a penal rather than incentivised solution

c) It does not acknowledge that there may be genuine reasons why USRV's are occurring, such as miss-matched meter asset data items that could be a consequence of comparatively recent meter competition reforms. These industry data quality issues are being addressed separately, for example by initiatives recently initiated by National Grid Metering where certain meter installations are being audited including site visits to check the physical assets. These issues could have a pronounced affect on new entrants and particularly impact shippers acquiring supply points, through no fault of their own, as the asset data may be flowing between shipper and transporter systems for the first time since RGMA implementation.

d) Shippers may attempt to take steps to mitigate the penalties by increasing resource towards USRV resolution, however there is no guarantee that xoserve will be able to match this in the short term, both in terms of people or online resource to enable prompt response to queries and their resolution.

e) The increased 'penal' charges may be viewed as being dis-proportionate compensation for the potential risk being borne by RbD Users. Resolved USRV's will include debits as well as credits to RbD shippers with consequential cash flow benefit.

Therefore E.ON's Proposal 141a retains the £100k cap but introduces a targeted approach, using an age related, progressively increasing charging structure. An illustration of how these charges would apply to current USRV levels is shown in Appendix A. The chart includes a column showing the effective capped charge per

USRV and the date relates to the year that USRV charges were first applied.

The USRV would attract an initial £30 charge in *month X+4* in line with the existing methodology. Subsequent charges of £30 would continue to apply for the subsequent 12 months. After 12 months an increased charge of £50 would apply per month. This process would continue into subsequent years with progressively increased charges applying each twelve months. The tiered charging structure would be:

First 12 months £30  
13 – 24 months £50  
25 -36 months £100  
37 - 48 months £200  
49 - 60 months £300  
61 - 72 months £400  
73 - 84 months £500

It is proposed that the new methodology will apply to all current USRV's and any arising thereafter.

*For example*

*A USRV that first had charges applied in May 2005 and still outstanding would attract a monthly charge of £100. If this continued to be un-resolved until May 2008, it would then attract a charge of £200. From May 2009 the charge would be increased to £300 and so on.*

In contrast with Mod. Proposal 141 we believe that this will deliver the following benefits :

- 1) It targets those USRV's that have been identified as proving doggedly problematic over an extended time period.
- 2) It retains the £100k cap which given the issue highlighted above provides a proportionate incentive rather than an excessive penalty.
- 3) It allows shippers to focus attention and resource and allows industry processes such as mandatory license requirements to read/inspect meters every two years to take affect.
- 4) In targeting age related USRV's it supports other industry initiatives looking at restricting the invoice billing period. (Review Proposal 126).
- 5) It promotes incremental but sustainable improvement.

The current arrangements, as defined within the Uniform Network Code under section 8.3.6, allow Transporters to retain 2% of all amounts received. These

arrangements allow Transporters to cover the costs associated with the administration of the incentive regime. Modification Proposal 141a incorporates a differential charging structure that may increase administration costs marginally, therefore E.ON recognise that Transporters may incur a small increase in costs and in recognition propose that the retained amount is increased to 2.5%.

### **Consequence of not implementing this Proposal**

The volume of outstanding USRV's have steadily increased since the introduction of Modification Proposal 637 regime in February 2005.

Should this Proposal not be implemented, the existing regime would continue to operate in a manner not in line with its original intentions and RbD Users would continue to suffer from the current level of financial uncertainty associated with age related unresolved items.

Further, it is likely that the number of outstanding USRV items would continue to increase in volume and increase the level of risk to RbD.

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

### **Standard Special Condition A11.1 (a): *the efficient and economic operation of the pipe-line system to which this licence relates;***

Implementation would not be expected to better facilitate this relevant objective.

### **Standard Special Condition A11.1 (b): *so far as is consistent with sub-paragraph (a), the coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;***

Implementation would not be expected to better facilitate this relevant objective.

### **Standard Special Condition A11.1 (c): *so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;***

Implementation would not be expected to better facilitate this relevant objective.

### **Standard Special Condition A11.1 (d): *so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;***

Implementation of either Proposal would further incentivise improvement of User performance in the resolution of suppressed filter failures by reinforcing the existing contractual obligations upon Users, and the associated incentive regime, to resolve USRVs. This would increase the level of certainty for Users charged through RbD.

By ensuring that the incentives upon non-RbD Users are adequate to resolve USRVs in a timely manner, a more accurate allocation of energy and transportation charges would be expected, and this would facilitate the securing of effective competition between Shippers and between Suppliers. The extent of this would be expected to vary depending on how Users react to the different incentives created by each Proposal.

**Standard Special Condition A11.1 (e):** *so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers' licences) are satisfied as respects the availability of gas to their domestic customers;*

Implementation would not be expected to better facilitate this relevant objective.

**Standard Special Condition A11.1 (f):** *so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.*

Implementation would not be expected to better facilitate this relevant objective.

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

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

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

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

No implications for operation of the system have been identified.

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

Some additional systems costs are anticipated by xoserve as a result of implementation.

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

No additional cost recovery is proposed.

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

No consequence for price regulation has been identified.

**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**

No such consequence is anticipated.

**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**

No impacts upon the UK Link system as a result of implementation have been identified.

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

*Administrative and operational implications (including impact upon manual processes and procedures)*

Implementation would have no impact upon Users' systems and require no system development. Some Users may be sufficiently incentivised, to a different degree under each Proposal, to change their processes to deal with USRVs.

*Development and capital cost and operating cost implications*

Users may be sufficiently incentivised, to a different degree under each Proposal, to change their processes to deal with USRVs and hence incur additional costs.

*Consequence for the level of contractual risk of Users*

No such consequence has been identified.

**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**

To a differing extent under each Proposal:

- Reinforced contractual obligations placed upon Users, and the associated incentive regime, to resolve USRVs.
- Increased incentives upon non-RbD Users to resolve USRVs in a timely manner, potentially increasing level of certainty for Users charged through RbD.

### **Disadvantages**

- Proposal 0141 may be regarded as a penal rather than incentivised solution

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

*Written Representations are now sought in respect of this Draft Report.*

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

No such requirement has been identified.

**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**

No such requirement has been identified.

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

No programme for works has been identified.

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

If a direction to implement is received, it is proposed that an implementation date is agreed with the UK Link Committee.

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



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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**

**18. Transporter's Proposal**

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

**19. Text**

The Modification Panel did not determine that text was required for inclusion in this Modification Report.

**Representations are now sought in respect of this Draft Report and prior to the Transporters finalising the Report.**

For and on behalf of the Relevant Gas Transporters:

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

Joint Office of Gas Transporters

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APPENDIX A to Proposal 0141

Source: USRV Statistics – February 2007 issued by Xoserve via e-mail on 28<sup>th</sup> March 2007

Reporting Month			
Number of Outstandings Filter Failures			
Sent Month	DEC	JAN	FEB
20/02/2007			6679
20/01/2007		4670	2613
20/12/2006	6042	3759	2192
20/11/2006	4009	2486	1914
20/10/2006	2778	2091	1541
20/09/2006	1920	1459	1196
20/08/2006	1442	1165	969
20/07/2006	1495	1227	1025
20/06/2006	1063	844	658
20/05/2006	694	603	482
20/04/2006	687	608	485
20/03/2006	732	648	553
20/02/2006	457	411	345
20/01/2006	332	292	254
20/12/2005	421	364	306
20/11/2005	678	596	502
20/10/2005	275	241	223
20/09/2005	409	360	296
20/08/2005	299	283	245
20/07/2005	250	237	206
20/06/2005	195	186	164
20/05/2005	153	151	140
20/04/2005	117	112	100
20/03/2005	102	101	85
20/02/2005	109	107	105
20/01/2005	72	72	66
20/12/2004	70	66	58
20/11/2004	58	57	53
20/10/2004	57	54	47
20/09/2004	26	26	25
20/08/2004	32	32	29
20/07/2004	30	29	26
20/06/2004	30	30	29
20/05/2004	13	12	10
20/04/2004	14	14	13
20/03/2004	7	7	6
20/02/2004	16	15	13
20/01/2004	24	24	24
20/12/2003	16	13	12
20/11/2003	14	13	11
20/10/2003	18	17	17
20/09/2003	21	19	18
20/08/2003	9	9	7

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20/07/2003	2	1	1
20/06/2003	9	8	7
20/05/2003	4	4	4
20/04/2003	2	2	2
20/03/2003	5	3	3
20/02/2003	8	8	8
20/01/2003	6	5	5
20/12/2002	6	6	6
20/11/2002	17	16	15
20/10/2002	8	8	7
20/09/2002	1	1	1
20/08/2002	13	13	13
20/07/2002	2	2	2
20/06/2002	15	13	12
20/05/2002	0	0	0
20/12/2001	1	1	1
20/11/2001	1	1	1

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APPENDIX B to Proposal 0141

**Scaled Charges for USRV Incentives**

Month	Unscaled Incentives	Scaling Factor for £100k Cap (ACTUAL)	Scaled Incentives	Scaling Factor for £200k Cap	Scaled Incentives	Scaling Factor for £300k Cap	Scaled Incentives	Scaling Factor for £400k Cap	Scaled Incentives
Jan-06	£226,977.00	0.44057327	£100,000.00	0.88114655	£200,000.00	1.00000000	£226,977.00	1.00000000	£226,977.00
Feb-06	£204,941.08	0.48794531	£100,000.04	0.97589024	£200,000.00	1.00000000	£204,941.08	1.00000000	£204,941.08
Mar-06	£205,273.81	0.48715376	£99,999.91	0.97430841	£200,000.00	1.00000000	£205,273.81	1.00000000	£205,273.81
Apr-06	£196,789.47	0.50815590	£99,999.73	1.00000000	£196,789.47	1.00000000	£196,789.47	1.00000000	£196,789.47
May-06	£226,044.98	0.44238979	£99,999.99	0.88477966	£200,000.00	1.00000000	£226,044.98	1.00000000	£226,044.98
Jun-06	£196,960.84	0.50771473	£99,999.92	1.00000000	£196,960.84	1.00000000	£196,960.84	1.00000000	£196,960.84
Jul-06	£230,734.79	0.43339762	£99,999.91	0.86679603	£200,000.00	1.00000000	£230,734.79	1.00000000	£230,734.79
Aug-06	£265,006.68	0.37734852	£99,999.88	0.75469796	£200,000.00	1.00000000	£265,006.68	1.00000000	£265,006.68
Sep-06	£287,842.68	0.34741161	£99,999.89	0.69482399	£200,000.00	1.00000000	£287,842.68	1.00000000	£287,842.68
Oct-06	£319,696.00	0.31279716	£100,000.00	0.62559431	£200,000.00	0.93839147	£300,000.00	1.00000000	£319,696.00
Nov-06	£338,465.53	0.29545065	£99,999.86	0.59090212	£200,000.00	0.88635318	£300,000.00	1.00000000	£338,465.53
Dec-06	£364,627.58	0.27425287	£100,000.16	0.54850486	£200,000.00	0.82275729	£300,000.00	1.00000000	£364,627.58

Source: Presentation provided by Xoserve to the Distribution Workstream on 22<sup>nd</sup> March 2007

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APPENDIX A to Proposal 0141A

Source: USRV Statistics March 2007

<i>Initial Year</i>	<i>Total Number</i>	<i>Fee</i>	<i>Uncapped Value</i>	<i>Capped Value</i>	<i>Effective capped charge per USRV</i>
<b>2001</b>	<b>2</b>	£500	£1,000	£78.65	£39.32
<b>2002</b>	<b>55</b>	£450	£24,750	£1,946.55	£35.39
<b>2003</b>	<b>94</b>	£400	£37,600	£2,957.18	£31.46
<b>2004</b>	<b>349</b>	£350	£122,150	£9,606.91	£27.53
<b>2005</b>	<b>2291</b>	£100	£229,100	£18,018.37	£7.86
<b>2006</b>	<b>9970</b>	£50	£498,500	£39,206.28	£3.93
<b>2007</b>	<b>11946</b>	£30	£358,380	£28,186.05	£2.36
<b>Total</b>	<b>24707</b>		£1,271,480	£100,000.00	