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8 June 2007

Dear Julian,

RE: MODIFICATION PROPOSAL 0141 – ‘Revision to the ‘User Suppressed Reconciliation Values’ Financial Incentive arrangements’

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

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

We have set out in detail under the following headings, why we believe that this modification proposal better facilitates the achievement of the relevant objectives of the Uniform Network Code.

1. Executive Summary
2. Background
3. The Modification Proposal
4. Benefits of our Proposal
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6. Implementation

1. Executive Summary

In February 2005, modification proposal 637 implemented a regime to incentivise Shippers to process and clear User Suppressed Reconciliation Values (USRVs) in an efficient and timely manner. This modification proposal seeks to revise the current arrangements.

1. Current levels of outstanding USRVs are at unprecedented and unacceptably high levels.
2. It is evident that the existing regime is not being operated in accordance with the original intentions of modification proposal 637, in terms of the financial levels of the incentive payments.
3. Analysis shows that significant scaling down of incentive payments has taken place, directly due to the limitations of the existing monthly cap.
4. This has subsequently reduced the effectiveness of the regime and has significantly impacted Shipper performance levels.
5. There is a clear requirement to increase the monthly cap to ensure that incentive payments do not continue to be significantly devalued and ineffective.
6. Increased levels of outstanding USRVs are resulting in increasingly high levels of unreconciled energy and are providing unacceptable levels of risk and uncertainty to RbD.
7. There is a requirement to revise arrangements for Gas Transporter cost recovery associated with the administration of the incentive regime, to ensure continued cost reflectivity.
8. The implementation of this proposal will ensure that the existing incentive regime is strengthened and operates going forward in a more effective manner and is in keeping with the original intentions of modification proposal 637.
9. We believe that our proposal better facilitates the achievement of the relevant objectives of the Uniform Network Code. It reinforces the existing contractual obligations placed upon Shippers to resolve USRVs, increases the level of certainty for Shippers charged through RbD and ensures that the levels of incentives upon non-RbD Shippers are adequate to resolve USRVs in a timely manner, thereby securing effective competition between relevant Shippers and relevant Suppliers.

2. Background

Reconciliation validation 'filter' failures are generated from financial adjustments, resulting from the submission of meter readings, which are deemed to be out of tolerance under the current process as defined by the Network Code Reconciliation Suppression Guidelines and are subsequently termed as User Suppressed Reconciliation Values (USRVs).

In February 2005, modification proposal 637 implemented a regime to incentivise Shippers to process and clear USRVs in an efficient and timely manner.

In summary the regime stipulates that, all outstanding USRVs from month X (X being the month of original suppression) not responded to by month X+2 below the 95% standard attracts an incentive charge of £20. Further, all subsequent USRVs from month X not responded to by month X+4 attract an incentive charge of £30, with all USRVs not responded to by month X>4 and above attracting an incentive charge of £30 for each subsequent month until responded to.

The incentive regime includes a monthly financial cap, where the amount due from all Shippers per month would not exceed £100,000. In the event that the aggregate amounts due from all Shippers for a USRV month exceeds the monthly cap, the amounts are reduced pro rata.

Following implementation of modification proposal 637 the number of outstanding USRVs initially reduced, however this trend was short lived with USRV levels soon returning and passing original levels.

It is evident that the incentive regime implemented by modification proposal 637, which incentivises Shippers to clear USRV items that could result in large debit charges to the Shipper and equal and opposite credits to RbD, is proving to be ineffective in its current form.

Information provided by xoserve shows that the incentive liability payment monthly cap is resulting in the significant scaling down of individual liability payments per outstanding USRV, for both the existing £20 and £30 liability standards and that Shipper performance levels are consistently below the expected standard.

3. The Modification Proposal

The effect of the scaling down of these liability payments is such that the original intention of modification proposal 637 and the regime it implemented, has not been realised and its effectiveness significantly impacted.

To address this issue and to ensure that the existing incentive regime operates in accordance with its original intentions, this modification proposal seeks to simply increase the incentive liability payment monthly cap from the existing value of £100k to £500k.

Due to the increase in the monthly cap and the subsequent increase in liability payments that will be due, the modification proposal also proposes to make appropriate amendments to the arrangements relating to the level of costs recovered by xoserve for administering the incentive regime.

4. Benefits of our Proposal

4.1 Increasing levels of unreconciled energy and uncertainty to RbD

The increasing number of outstanding USRV's continues to cause great concern to RbD Shippers. Un-cleared filter failures have reached unprecedented levels during the past 12 months, which has resulted in the amount of unreconciled energy reaching unacceptable levels.

The trend of outstanding USRVs continues to grow and is unsustainable in the longer term, due predominantly to the high degree of uncertainty to RbD that elevated levels of unreconciled energy poses.

The implementation of this proposal will ensure that the existing incentive regime is strengthened and operates going forward, in the manner in which it was originally intended and will result in a reduced number of outstanding USRVs and a subsequent reduction in the level of unreconciled energy and uncertainty to RbD.

4.2 Amendment to the level of the monthly cap

Since the introduction of modification proposal 637, it is evident that the current level of the monthly cap has been inappropriate to efficiently facilitate the original intentions of the proposal and the regime it introduced and has caused a serious devaluation of the £20 and £20 incentive payments. It has therefore appropriate to review and amend the value of the monthly cap.

The extent of the proposed increase has been based upon analysis undertaken by xoserve relating to 'Scaled charges for USRV incentives', as detailed in Appendix A.

This analysis clearly identifies a significant decrease in scaling factors from January 2006 to December 2006 and further identifies that a rise in the monthly cap to at least £400k is required to ensure that the scaling factor is returned to its intended value of 1 and that the incentive payments of £20 and £30 are not substantially reduced to a value which dilutes the effectiveness of the regime.

The analysis further shows that over the period June 2006 to December 2006, the level of unscaled monthly incentive payments increased from £196k to £364k. Performance in this area continues to deteriorate and there is evidence that the new proposed monthly cap of £500k is both appropriate and proportionate to ensure that the requirement for continuing and future scaling down of the incentive payments does not occur.

This proposal seeks to amend the existing regime and increase its level of effectiveness. The impact of having a regime, which truly provides an incentive on Shippers to clear their outstanding USRVs in an efficient and timely manner, will be beneficial to the industry as a whole and will reduce the levels of unreconciled energy.

4.3 Current performance levels

Information recently issued by xoserve identified that the general level of current performance relating to the resolution of USRVs, is consistently below the expected standard, with large volumes of USRVs outstanding.

The age analysis within Appendix B, details the number of USRVs outstanding per month as at 20 February 2007.

4.4 Administrative costs

The current arrangements, as defined within the Uniform Network Code under section 8.3.6, allows Gas Transporters to retain 2% of all amounts received. The recovery of this amount allows Gas Transporters to cover the costs associated with the administration of the USRV incentive regime.

With the proposed increase to the monthly cap, a review of this percentage value is required in order to ensure that Gas Transporters' revenue, associated with this service, continues to be appropriate and cost reflective.

The modification proposal proposes that the revenue received by Gas Transporters under the current arrangements is capped to a total of 0.5% of the monthly cap. This element of the proposal was agreed as an appropriate solution by the April Distribution Workstream.

The introduction of this cap is required to ensure that Gas Transporters do not over recover costs simply due to an increase in the monthly cap. During development of this proposal xoserve confirmed that the proposed increase to the incentive payment monthly cap will not in itself substantially increase the level of costs associated with the administration of the regime. The proposal therefore provides a fair and equitable solution.

In practice this would mean that Gas Transporters would continue to be able to retain 2% of all amounts received, however this would be capped at a level of 0.5%, which equates to a maximum of £2,500, of the revised £500k monthly cap.

5. Consequence of non-implementation

The volume of outstanding USRVs has steadily increased since the introduction of the modification proposal 637 incentive regime in February 2005.

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

Due to the significant scaling down of monthly incentive payments, the existing regime does not currently provide adequate incentives upon non-RbD Shippers to resolve outstanding USRVs, 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 further increase the level of unreconciled energy and the level of risk and uncertainty to RbD.

6. Implementation

As detailed within the modification proposal itself, in the event that this modification is approved, BGT recommends that implementation of the proposal is undertaken with immediate effect. The proposal does not have any impact upon systems and will require no system development, as the processes required to deliver the existing regime are already in place and operational.

During development of this modification proposal at the Distribution Workstream, it was recommended that further to the progression of modification proposal 0141, a comprehensive review of the USRV process and incentive regime is required to ascertain whether any fundamental changes are required to further improve the robustness of the process and to give appropriate consideration to the potential impacts of modification proposal 0126 discussions.

BGT fully supports this course of action and will be raising a further modification proposal in the near future for industry development. It is our view that this review of the USRV process does not detract from the aim and purpose of modification proposal 0141, as this proposal simply seeks to rectify components of the existing regime which are clearly not operating effectively and need to be addressed.

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

Yours sincerely,

Chris Wright
Commercial Manager

Appendix A

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

Reporting Month			
Number of Outstanding 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

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

Appendix B

Scaled Charges for USRV Incentives

Source: Presentation provided by xoserve to the Distribution Workstream on 22nd March 2007.

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