

Workstream Report
Revision to the 'User Suppressed Reconciliation Values' Financial Incentives arrangements
Modification Reference Number 0141

Version 1.0

This Workstream Report is presented for the UNC Modification Panel's consideration. The Distribution Workstream considers that the Proposal is sufficiently developed and should now proceed to the Consultation Phase. The Workstream also recommends that the Panel does not require the preparation of legal text for this Modification Proposal.

1 The Modification Proposal

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 21st 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 20th 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.

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 this 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.

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

Implementation would not have any impact upon the UK Link system.

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 change their processes to deal with USRVs.

Development and capital cost and operating cost implications

Some Users may be sufficiently incentivised 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

- 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

- None identified

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

No written representations have been received.

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

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

17. Workstream recommendation regarding implementation of this Modification Proposal

The Distribution Workstream considers that the Proposal is sufficiently developed and should now proceed to the Consultation Phase. The Workstream also recommends that the Panel does not require the preparation of legal text for this Modification Proposal.