

Modification proposal:	<b>Uniform Network Code (UNC): Amendment of 'User SP Aggregate Reconciliation Proportion' to incorporate historical AQ proportions (UNC 0171 and 0171A)</b>		
Decision:	The Authority <sup>1</sup> directs that proposal 0171 be made <sup>2</sup>		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	21 April 2008	Implementation Date:	To be confirmed by the Joint Office

## Background to the modification proposal

The Aggregate Non-Daily Metered (NDM) Reconciliation Charge is a charge or credit levied upon gas shippers. It is primarily used to reconcile the actual amount of gas supplied to NDM Small Supply Points (SSPs) within a Local Distribution Zone (LDZ) to the payments made by these shippers for this gas. In the event of the discovery of a historic error in the amount of gas metered as having been supplied to an LDZ, a charge or credit will be made to each shipper based on the proportion of Aggregate Annual Quantity (AQ) of gas that they supply to that LDZ. The purpose of the charge or credit is to reconcile the sums paid by shippers to the quantity of gas delivered by Distribution Network owners.

Currently, a shipper's share of an Aggregate NDM Reconciliation charge within an LDZ is based on their proportion of Aggregate LDZ AQ in the month before the invoice is issued. In the event of an historic error, a shipper will be subject to a charge or credit for the reconciliation based on the proportion of energy that they supplied within an LDZ during the month in which the error was discovered, and not on the proportion of energy supplied by the shipper over the period in which the error occurred. As an example, RWE's proposal for UNC171 cites a meter error case in the South East LDZ, in which shippers picked up a share of a £25.8m reconciliation based on Aggregate AQ shares at the point of error notification, even though in some instances these shippers had not been operative in the market at the time when the error occurred.

Three recent modification proposals have sought to address the issue of correcting historic metering errors. Modification Proposals UNC117 and UNC122<sup>3</sup> proposed limiting the period in which a demand for charge or credit can operate retrospectively. These proposals arose from a particular event, in this case the discovery of the metering error at Farningham (the same error cited by RWE in their proposal for UNC171). The modifications sought to reduce the materiality of any associated error correction, but also constituted enduring provisions that would apply to future invoicing. These proposals were found not to further the relevant objectives of the UNC and were therefore rejected by Ofgem.

The implementation of Modification Proposal UNC152V<sup>4</sup> in April 2008 introduced a maximum four-year cut off for the implementation of error correction. After

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

<sup>3</sup> 'Uniform Network Code (UNC) modification proposals 117: Amendment to Invoice Billing Period, and 122: Restriction of Invoice Billing Period to Price Control' at

<http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/16530-UNC117-122D.pdf>.

<sup>4</sup> 'Uniform Network Code (UNC) 0152V, 0152AV and 0152VB: Limitation on Retrospective Invoicing and Invoice Correction (UNC152)' at <http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/UNC152D.pdf>.

implementation of this modification, any errors occurring more than four years prior to an annually updated cut-off date<sup>5</sup> are deemed to have 'timed out' and will be ineligible for error correction.

## **The modification proposal**

### Modification Proposal UNC171

The Modification Proposal was raised by RWE npower on 19 November 2007. It proposes that a shipper's share of the Aggregate NDM Reconciliation Charge should be calculated based on that shipper's historical proportion of AQ holdings within that LDZ on the dates that the costs were incurred, providing the total energy to be reconciled exceeds a qualifying amount of 50GWh. Monies that cannot be recovered or paid will be smeared across the industry based on the same historical proportion of AQ holdings. Costs or credits apportioned to shippers subsequently merged with or acquired by other shippers will be received by the current shipper.

### Alternative Proposal UNC171A

The Alternative Proposal was raised by British Gas on 28 December 2007. It is broadly similar to the Modification Proposal other than it requires that those provisions should only apply to reconciliations occurring after a given Proposed Effective Date<sup>6</sup>, with reconciliations relating to errors occurring prior to this date being apportioned on the basis of the shipper's share of AQ within the relevant LDZ at the Proposed Effective Date. The proposer argues that this would eliminate any retrospective element occurring within the Modification Proposal, citing previous opposition to retrospective changes to industry arrangements in decision letters regarding UNC modifications 117 and 122. In addition, the Alternative Modification differs from the Proposed Modification in that it seeks to use daily Aggregate AQ values to apportion any error that has occurred after the Proposed Effective Date. The Proposed Modification would use a monthly value for Aggregate AQ derivation.

The Alternative Proposal states that where a reconciliation period crosses the cut-over date between the existing and new arrangements, a shipper's share of aggregate NDM reconciliation charge will be calculated by apportioning the volume for the period prior to cut-over based on their aggregate AQ distribution at the Proposed Effective Date and the period post this date will be apportioned (as noted above) using a daily aggregate AQ share.

## **UNC Panel<sup>7</sup> recommendation**

The UNC Panel separately considered the two modification proposals at its meeting on 21 February 2008. The Panel recommended implementation of both proposals. Additionally, the Panel determined that of the two proposals, the Alternative Proposal would better facilitate the achievement of the Relevant Objectives.

## **The Authority's decision**

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<sup>5</sup> The rolling limit is set as the four years prior to 1 April each year.

<sup>6</sup> Under the terms of the Alternative Proposal, the Proposed Effective Date is the date at which the new methodology for reconciliation is implemented.

<sup>7</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

The Authority has considered the issues raised by the modification proposals and the Final Modification Report (FMR) dated 11 March 2008. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposals which are attached to the FMR<sup>8</sup>. The Authority has concluded that:

1. implementation of the modification proposal UNC171 will better facilitate the achievement of the relevant objectives of the UNC<sup>9</sup>; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties<sup>10</sup>.

### **Reasons for the Authority's decision**

We agree with the findings of the Panel that both these proposals will better facilitate the Relevant Objectives of the UNC. However, we consider that implementation of the Modification Proposal best fulfils these relevant objectives. Therefore, in taking our decision we are disagreeing with the majority view of the UNC Panel that the Alternative Proposal best reflects the aims of the Relevant Objectives. We consider the aims of the Relevant Objectives below. Please note that unless we have directly stated otherwise we consider both proposals to be neutral to the aims of the Relevant Objectives.

*Relevant objective (d): so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition between relevant shippers, suppliers and DNS;*

By basing reconciliations on historical market share, we consider that implementation of the Modification Proposal would enable charges and credits to be more accurately targeted relative to the existing arrangements. In particular, implementation of the Modification Proposal should ensure that shippers are not unduly penalised or do not unduly benefit from a historical metering error merely as a result of their existing customer portfolio, which may have changed substantially over time since the error originally arose. We consider that a methodology that bases allocations on historical market shares across the time period in which the error has occurred would assist in avoiding market distortions that could arise through the allocation of windfall credits or significant charges.

We consider that implementing the Modification Proposal would remove a potential barrier to entry to new shippers, by eliminating the risk to potential entrants of incurring costs for historic errors occurring prior to their entry to the market. Following the implementation of Modification Proposal UNC152V, in the most extreme case under the terms of the Alternative Proposal, new entrants could potentially be exposed to costs incurred by other shippers for a maximum period of four years following the Proposed Effective Date.

We consider that the benefits noted above in relation to the Modification Proposal are more limited under the terms of the Alternative Proposal. The terms of the Modification Proposal should immediately ensure a more equitable distribution of Aggregate NDM Reconciliation across AOs from implementation for any error identified in the future. However, under the Alternative Proposal, errors occurring prior to the Proposed Effective

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<sup>8</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.com](http://www.gasgovernance.com).

<sup>9</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: [http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=6547](http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547).

<sup>10</sup>The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

Date would be allocated based on the distribution of shippers' AQ values at that date<sup>11</sup>. In such an instance charges and credits would not necessarily be levied upon those who incurred them. Whilst under the terms of UNC152V the scope for which this would apply to discovered errors would diminish over a four-year period, it represents a diminution of the benefits enjoyed under the terms of the Modification Proposal.

In effect, the Alternative Proposal represents a postponement of the improvements anticipated under the Modification Proposal. For this reason we consider that implementation of the Modification Proposal is preferable to the Alternative Proposal, as it realises these improvements in error allocation from the outset.

One respondent argues that the Modification Proposal carries a risk of imposing charges on shippers for customers who are no longer supplied by them, and therefore have no means of recovering these charges from these customers. We consider that in such a case a shipper will have, in error, benefitted from the increased difference between billed payments received for gas supplied to these customers and payments made by their shipper for their proportion of the aggregate LDZ AQ. Conversely, where a past error means the shipper has in effect overpaid, their revenue would have been reduced. We therefore consider that the Modification Proposal does not carry an undue risk associated with cost recovery from customers but instead it reallocates charges and credits to better reflect shippers' initial outlay.

We consider that both these proposals would offer an improvement on the objective's aim of furthering effective competition between shippers by ensuring charges and credits are more accurately targeted when compared to the current arrangements. However, for the reasons set out above, we consider that the aims of the objective are best reflected by the Modification Proposal.

*Relevant objective (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;*

Both proposals include the concept of a minimum threshold for a 'qualifying amount of energy', ensuring that errors for reconciliation are not immaterial. We note that xoserve have indicated that some costs will be involved in the implementation of either proposal, but that these additional costs would be fewer under the Modification Proposal than under the Alternative Proposal.

We also note that the Alternative Proposal currently proposes reconciliation using a daily AQ share, whereas the Modification Proposal proposes using a monthly basis for calculating historical AQ proportions. One respondent argued that it would be preferable to retain daily allocation for the Alternative Proposal, as there would be no dependency on historic data. One respondent has indicated that in practice it will be necessary to apply a monthly aggregate AQ portfolio split, as currently xoserve do not retain the necessary information to apply a daily split, and obtaining this information will impose more significant system costs. The respondent expressed conditional support for the

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<sup>11</sup> UNC152V sets a time limit of four years on discovery of historical errors. Errors discovered prior to this limit are deemed to have 'timed out' and no reconciliation can be made. The rolling limit is set as the four years prior to 1 April each year. Therefore under either proposal, assuming implementation in April 2008, errors occurring prior to 1 April 2004 will be deemed to have 'timed out'. Under the terms of the Alternative Proposal, this means any error occurring entirely (or partially) between 1 April 2004 and the Proposed Effective Date would be reconciled entirely (or for the period between the error occurring and the Proposed Effective Date) according to the distribution of AOs outstanding at that date.

Alternative Proposal on the basis that it was changed to require AQ calculations to be made on a monthly rather than daily basis. No such change was reflected in the final legal text associated with the Alternative Proposal. We consider that these extra costs would mean that the Alternative Proposal does not further the aims of this Relevant Objective.

#### Retrospective implementation

Three respondents expressed concern that the Modification Proposal may breach the principle that retrospective decisions affecting the UNC should not be made, although only one respondent opposed the implementation of the proposal upon that basis. Some respondents argued that such a precedent would create inherent uncertainty as to the likelihood of costs being imposed on new entrants, and that these risks would present a barrier to entry.

We do not believe that the Modification Proposal introduces the potential for retrospective changes to the UNC. An example of where we consider that reconciliation would amount to a retrospective change would be if it was seeking to redistribute monies paid under previous reconciliation arrangements, or if a rule change sought to amend a charge or credit of which a shipper had a reasonable expectation, following a previously discovered error.

However, both proposals under consideration seek to achieve a reallocation of monies based on historic error corrections on a prospective basis. Any reallocation under either proposal will only apply to errors which have yet to be identified, and charges and credits will be levied to recreate, as far as is possible, the distribution of monies as if the error had not occurred.

Whilst potential identification of historic errors necessarily entails some element of uncertainty, under the Modification Proposal, any charges or credits incurred under the future identification of historic errors would purely be borne by participants in the market at the time to which the error occurred rather than the time of identification. In addition, we consider that following implementation, interested parties will be aware of the impact of any potential error correction. New entrants to the market will also be aware that errors will be reconciled based upon historic values so that they will not become potentially liable for charges when they were not active in the market. For these reasons we do not believe that the Modification Proposal introduces any additional uncertainty to the UNC.

#### **Decision notice**

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 0171: Uniform Network Code (UNC): Amendment of 'User SP Aggregate Reconciliation Proportion' to incorporate historical AQ proportions be made.



**Kersti Berge**  
**Head of GB Markets**

Signed on behalf of the Authority and authorised for that purpose.