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Your Reference: UNC Modification Proposal 0335 & 0335A.

<u>Re: UNC Modification Proposals</u>
<u>0335 Offtake Metering Error – Payment Timescales & 0335A Significant Offtake Metering Error – Small Shipper Payment Timescales.</u>

Dear Bob,

Thank you for your invitation seeking representations with respect to the above Modification Proposals which National Grid Gas Distribution ("NGD") would like to oppose.

Do you support or oppose implementation?

0335: Not in Support
0335A: Not in Support

If either 0335 or 0335A were to be implemented, which would be your preference?

0335A.
Of the two Proposals, NGD is least opposed to the alternative, although we remain unconvinced that it is (i) efficient for DNO resources to be used in this manner, (ii) appropriate to discriminate against categories of User in this way and (iii) provides an appropriate or effective incentive on DNO performance and consequently we are unable to provide support for either solution.

Please summarise (in one paragraph) the key reason(s) for your support/opposition.

In our opinion neither the implementation of Modification Proposal 0335 nor its alternative would: (i) better facilitate the achievement of the Relevant Objectives (in particular the efficient and economic operation of the pipe-line system and securing effective competition between relevant shippers); nor (ii) constitute an appropriate or effective incentive for DNOs to take action to minimise instances of Significant Metering Errors.

While we understand that many shippers find the resolution of offtake metering errors, and the lengthy process used to for determine the quantity of energy mis-measured frustrating, we do not believe a mechanism where DNOs temporarily fund energy reconciliations, is an appropriate solution. This Proposal is founded on two principals. First, that a sub-set of shippers are incurring negative cash flow impacts associated with under–measurement and the resulting reconciliation. Secondly, that by placing DNOs in an intermediary funding role, the resulting detrimental cash flow effect will encourage them into more diligent operation of the meters. We do not accept the cash flow argument is valid and we do not believe that the retrospective aspect of the proposal can place a behavioural incentive on any party.

Are there any new or additional issues that you believe should be recorded in the Modification Report

None identified.

Relevant Objectives:

Standard Special Condition A11.1 (a): efficient and economic operation of the pipe-line system.

The Meter Error Guidelines for managing and reporting Significant Meter Errors ("SMERs"), established by the implementation of Modification Proposal 0185VV: "Meter Error Notification Period", were developed in a cooperative environment and provide a comprehensive process for determining measurement errors. Features of this are: adequate consultation time; the accommodation of input from Users and the provision of estimated quantities; resolution by an Independent Expert and advance notice of invoicing timescales. Implementation of this regime, which superseded the "0643" process, represented an improvement in overall transparency and allowed Users to assess the impacts of meter errors at an early stage. We believe this process is robust and once the adjustments have been determined the costs should be placed and cleared as quickly as possible. This principle is contrary to the mechanics put forward in either of these Proposals.

NGD does not consider that it is either efficient or economic to introduce another party (namely the relevant downstream transporter), together with the additional administration and duplication of certain activities that this would entail, into the existing process for invoicing Significant Meter Error adjustments. In our opinion this would only serve to generate additional costs with no discernable benefit to consumers.

NGD also considers that it would not be efficient to extend the existing period over which SMER adjustments are invoiced any further. Taking the Farningham Significant Meter Error as an example, the error period lasted a number of years (>5) and we would question the logic in invoicing the correction over a similar timeframe. Using the duration of the error as a basis for the timeframe over which such charges should be invoiced by the DNO could result in potentially perverse outcomes which may not necessarily assist Shipper cash flow in the manner intended. As the Proposals currently stand there is no correlation between the magnitude of the error (and as a result the amount that will be invoiced to the Shipper) and the period over which any resulting charges are invoiced. As a result where an error of a relatively small magnitude occurs over a long period of time the resulting charges would be invoiced by the DNO to the affected Shipper over a correspondingly long period whereas an error of greater magnitude (which potentially could give rise to a larger payment being due from the Shipper) could be invoiced over a shorter period if the duration of such error was short.

In addition it is possible that determining the period over which an SMER should be invoiced in this manner could create other problems. For example, in the case of an error invoiced last year (commonly known as the "orifice plate calibration error"), where a number of errors were dealt with as one, because they shared a common cause, it would have posed problems in relation to determining the appropriate timeframe over which the resulting charges should be invoiced because the error period varied between 5 and 15 months.

In any event, we do not agree that correction to the RbD allocation to shippers with a Small Supply Point portfolio is detrimental to a shipper's cash-flow or that the reconciliation invoice is a surprise. Had the meter worked correctly, the "error" gas would have been allocated to shippers on the gas flow day; the error correction process simply puts right something that should have happened earlier. In terms of a cash flow shock, estimates of the financial adjustment are issued very early in the process and most SMERs take about a year between detection and invoicing. By the time the invoices are issued, shippers have had ample time to accrue for the reconciliation values. Under the current SMER process the potential for disputes is effectively dealt with before the invoice is issued to the Shipper and we believe the process provides sufficient periods of notice to Shippers of the estimated charges that will be invoiced once the process is completed to enable ample time for organisations to accrue for any such payments due (examples of recent significant errors are set out at paragraph 2 below). To add another level of complexity into the process which effectively forces the DNO into the position of underwriting debt i.e. funding a service/product that it has not received/had is not in our view an economic and efficient use of the DNO's resources.

The concept of invoicing to mirror the period of the error does not compliment the existing rules for Code Cut-off Date. In other words where NTS has invoiced the DNOs prior to the code cut off date, then the DNO would not be precluded from passing those costs on where the period over which payment will be made by the Shipper extends beyond this date. This represents a change to the current close-out regime and significantly changes the risk profile for existing market participants.

We do not consider that the invoicing aspects of either proposal have been constructed with sufficient clarity. In particular clarity is needed in relation to where party indebtedness lies. This is currently unclear and could be further complicated in the event of a User termination. The issue of securitisation of charges arising from SMER adjustments is also not addressed in either of the proposals. NGD considers that a requirement for affected Shippers to have a sufficient credit limit (including credit support as necessary) to cover the total amount that is determined will be invoiced as a result of a SMER adjustment (notwithstanding that such amount will be invoiced over a period of months) is essential to minimise the risk of such costs being shared amongst other market participants in the event that there is payment default by the affected Shipper.

NGD would also query the appropriateness of DNOs being invoiced by NG NTS in circumstances where it cannot clearly be seen to have received a product or service. Conversely, the principle of a DNO providing an invoice to Users for a product and service which it has not provided is also questionable and is a departure from the existing principles that underpin UNC. NGD's opinion is that implementation of either Modification Proposal would represent a significant adjustment to our risk profile under the UNC whereby DNOs would in practice be underwriting the cost of services and commodities that Shippers have already had the benefit.

Incentivisation of DNOs to effectively manage Significant Metering Errors:

Generally speaking, the management of our stock of offtake meters is effective and they operate with a high degree of reliability, that is to say that a significant percentage of gas is successfully transported through these meters with the quantity of gas incorrectly measured being very small in percentage terms. In relation to total annual throughput for all of National Grid Distribution's Networks each error related to 0.17% of total throughput (orifice plate error) and 0.03% of total throughput (Horndon) respectively. On average, approximately 99.8% of our throughput is measured correctly. Indeed, the orifice plate calibration error was attributed to the incorrect calibration of a reference jig, and consequently, we would argue wasn't due to a failure of our metering equipment. We would also like to point out that as part of this management process, many minor faults are discovered. Contrary to beliefs commonly held, the discovery of minor faults is a credit to the process not something that should regarded as a process failure. All electronic devices exposed to the elements will have failure rates and success is not about stopping failures but detecting them quickly. We take the management of offtake meters very seriously, as we understand the reliance that shippers and DNOs place on them for correctly allocating gas to network code parties and to that end we have in place a number of quality assurance steps.

In order to mitigate the risk of measurement errors DNOs undertake a number of activities, including the following:

Annual Validations: Validation of Measurement equipment is completed in accordance with Section D of the Offtake Arrangements Document ("OAD"). Upon completion of a Routine Validation a Validation Report is made available to the Upstream Party. An Exceptional Validation is performed at the request of the Upstream Party.

Daily Monitoring: Telemetered real time and derived data and previous Gas Day data is screened on a daily basis to ensure correct performance of measurement equipment.

Annual Witnessing Programme: An Annual Witnessing Programme has been established where a selection of sites are attended by the Upstream Party during the Routine Validation process. This is in place to ensure that OAD requirements are adhered to.

Annual Metering Audit: An independent metering expert is appointed to audit an Ofgem agreed selection of metering installations. This ensures compliance with validation procedures and also assesses meter performance against the requirements of conditions set out in the agreed Supplemental Agreements of OAD.

SGS Inspections: SGS, on behalf of Ofgem, complete annual inspections on DNO's metering systems as well as performing quarterly inspections (less frequently if no issues identified) on the Gas Quality (CV) systems.

The Proposer of 0335 believes that if implemented this Modification would effectively place a cash-flow burden upon DNOs, which in their view will incentivise increased maintenance activity and/or investment pressure. It is NGD's view that this Proposal does not act in any way as a suitable or proportionate incentive to encourage the effective management of these meters and will in practice divert resources which could have been directed towards such management. Sufficient incentives already exist to ensure this in the form of obligations and the process we have to go through when we have a SME. Placing bridging funding requirements on to the DNOs does not resolve any issues relating to the management of these meters, future capital expenditure programmes or current operation expenditure on them. The DNOs have sought to address issues and continue to work in good faith with regard to the management of offtake meters. Given that meter malfunctions are varied in magnitude and cause, we are concerned that the proposal gives no regard to the diverse range of issues which give rise to these errors. The DNOs are constantly learning and sharing best practice in relation to meter management and will continue to do so.

The table below is designed to give an indication of the notice periods for some of these significant adjustments and an indication of the estimates and the value of the adjustment that was ultimately invoiced. Information relating to all errors can be viewed on the Joint Office Website.

Offtake/s	Error Notified	Error Issued for Invoicing	Initial Estimate GWhs	Approx Final GWhs
Orifice Plate Errors	09/09	09/10	586	499
Horndon	12/10	1st Qtr 2012	125	160

NGD agrees with Scotia Gas Networks' view outlined in their alternative proposal that it is not appropriate to apply a solution to existing errors as this would make any Modification retrospective in its application. Modification Proposal 0335, if implemented would mean that any Significant Meter Error reported, but not having reached the stage of Meter Error Report ("MER") publication, would have to be invoiced under the newly proposed regime. NGD believes that changes to contracts which are retrospective in nature could have the effect of damaging market confidence whilst, on the basis that the error has already occurred, not having any genuine incentivisation effect.

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.

We believe that implementation of either the Proposal or the alternative would constitute undue preferential treatment of Users who have predominately RbD portfolios as against other Users who have supply points which are reconciled individually. If implemented both the Proposal and the alternative would create a scenario where domestic shippers or those with a significant domestic portfolio would be given preferential treatment versus a shipper which is expected to pay upon receipt of a valid reconciliation invoice. The alternative proposal creates a case for due discrimination in favour of "smaller" portfolio shippers. Whilst sympathising with the case put forward in relation to smaller shippers no such relief is suggested for smaller non-domestic shippers in relation to any larger reconciliation that they might receive. Given that a domestic shipper will have invoiced its customers based on Meter Readings over the period in question then it can be argued that to some extent a cash flow benefit will have already been enjoyed and query the extent to which it is necessary to build a risk premium into Shipper charges. Notwithstanding this it is not clear why extending the period over which the shipper pays for SMER adjustments significantly impacts the level of risk premium that a Shipper would factor into its prices (a claim put forward in the Proposal).

Impacts and Costs:

Implementation of these Proposals could give rise to incremental financing costs for DNOs.

Implementation:

We have nothing to add to the information put forward in the Draft Modification Report.

Legal Text:

NGD is satisfied that the text as published by the Joint Office within the Draft Modification Report meets the requirements of the Modification Proposal.

Is there anything further you wish to be taken into account?

Shippers have not provided any evidence in the Draft Modification Report to show the impacts that the current process for invoicing Significant Meter Errors has on the risk premium incorporated in their own charges to consumers and how implementation of this Proposal would change matters. While we oppose implementation of these proposals, we are aware that large offtake metering errors, (and one in particular), have become a concern to shippers, although every offtake metering malfunction affects the allocation of costs between RbD shippers and all shippers through NTS shrinkage. We understand that the main purpose of this proposal was for DNOs to feel some financial pressure for such occurrences but, as we have already stated, we believe that the proposed remedy for placing these costs on DNOs uses inappropriate reasoning. If this proposal was about incentivising our performance in detecting & correcting meter malfunctions then that is where the discussion should have focused, and a balanced risk-reward framework, referencing the investment and operating costs associated with this activity, should have been the objective.

We trust that this information will assist in the compilation of the Final Modification Report.

Please contact me on 01926 653559 (alan.raper@uk.ngrid.com) should you require any further information

Yours sincerely,

Alan Raper.