Modification proposal:	**Uniform Network Code (UNC) 335: Offtake metering error – payment timescales (UNC335) and Significant Offtake Metering Error – Small shipper payment timescales (UNC335A)**		
Decision:	The Authority[1] has decided to reject these proposals[2]		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	27 July 2012	Implementation date:	N/A

Background to the modification proposals

Errors in measurement equipment at Local Distribution Zone (LDZ) offtakes from the National Transmission System (NTS) can cause misallocation of the aggregate quantity of gas allocated to supply points through the Reconciliation by Difference (RbD) mechanism. Such errors potentially affect all Users.

Following the making of a number of large adjustments through LDZ reconciliation in recent years, the process has been modified in a number of ways, including:

- UNC152V[3] introduced a maximum 5 year cut-off date for shipper exposure to charges, with any charge relating to an older date and as yet unbilled being written off by the Gas Transporter;
- UNC171[4] introduced reconciliation of historic errors based on the AQ distribution (market share) during the occurrence of the error rather than at the time of its discovery; and,
- UNC185VV[5] introduced a process to be followed in the event of a measurement error being discovered, which includes reasonable endeavours upon all relevant parties to follow a new set of guidelines relating to such errors.

The modification proposals

Whilst the modifications referred to above are recognised as having improved the transparency and equitability of the meter error reconciliation process, some Users still consider the subsequent impact on invoices should be considered. The UNC rules require the error to be reconciled, once it has been settled, through the next available energy invoice, irrespective of its size or the period to which it applies.

UNC335 proposes that the recovery of payment for any future or as yet unresolved significant offtake metering error should be spread over a period that is commensurate with the approximate duration of the error itself, i.e. an error that had occurred over a period of nine months, would be recovered through nine monthly invoices from the time the error is resolved. This proposal would apply only to those errors that are classified as being significant, i.e. >50GWh, and which incur a debit to shippers. Any error found in the shippers' favour would be paid in whole, as currently. The amounts to be invoiced would be in line with the shippers' market share during the error, in keeping with the principles established as part of UNC171.

[1] The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of Gas and Electricity Markets.
[2] This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.
[3] UNC152V: 'Limitation on Retrospective Invoicing and Invoice Correction' - http://www.ofgem.gov.uk/LICENSING/GASCODES/UNC/MODS/Documents1/UNC152D.pdf
[4] UNC171: 'Amendment of 'User SP Aggregate Reconciliation Proportion' to incorporate historical AQ proportions' - http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/171%20D.pdf
[5] UNC185VV: 'Meter Error Notification Process' - http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/UNC185%20D.pdf

It is proposed that the shrinkage manager (National Grid NTS) would be immediately paid in full by the Gas Distribution Network operators (GDNs), who are responsible for the accuracy of offtake meters. Therefore any cash flow impact would fall upon the GDNs until such time as the full reconciliation amount is recovered, which the proposer considers will incentivise the GDNs to minimise the likelihood and scale of any measurement errors on such meters.

The proposer (RWE npower) also considers that this smoothing will allow Shippers to more easily absorb the impacts of the measurement error, protecting smaller Shippers in particular from unforeseen and unbudgeted strains on their cash flow.

The alternative proposal, put forward by a GDN (Scotia Gas Networks), varies from the original in two ways:

- it would apply only to *smaller shippers*[6]; and,
- it would not have retrospective effect – applying only to significant offtake metering errors after the proposed implementation date of the modification

UNC Panel[7] recommendation

At the UNC Panel meeting held on 15 December 2011, five of ten possible votes were cast in favour of implementing UNC335, while three were cast in favour of implementing UNC335A. The UNC Panel therefore failed to achieve the majority required to recommend that either the original or alternative proposals are implemented.

When asked to express a view on which of the two proposals would better facilitate the relevant objectives, as compared to the other, again no majority view was reached.

The Authority's decision

The Authority has considered the issues raised by the modification proposal, the alternative proposal and the Final Modification Report (FMR) dated 15 December 2011. The Authority has also considered and taken into account the responses to the UNC consultation on the modification proposal and the alternative.

The Authority has concluded that implementation of either the original or the alternative modification proposal would not better facilitate the achievement of the relevant objectives of the UNC[8] and has therefore decided not to direct that either be implemented.

Reasons for Authority decision

We note that the proposer, respondents and the UNC panel commented on the two key themes of the proposals, namely that they would increase incentives upon GDNs to manage their offtake meters in an efficient manner and that, in reducing cash flow shocks to shippers, they would facilitate effective competition. We have therefore assessed the proposals against relevant objectives a) and d). We consider that the proposals would have a neutral impact on the other relevant objectives.

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[6] For the purpose of UNC335A, smaller shippers are defined as those with fewer than 100,000 small supply points and/or where the combined organisational shipper Code Credit Limit is less than or equal to £500,000. All other shippers would be debited/credited in the next available energy invoice, as currently.

[7] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

[8] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/Pages/EPRInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRFiles%2fStandard+Special+Condition+PART_A_-_Consolidated_+-+Current+Version.pdf

We have had regard to a late representation to the Joint Office's consultation, which is available on its website, but not reflected within the FMR. Including this late submission, we note that there were eleven responses to the Joint Office consultation. Responses to the original proposal were broadly balanced, with five respondents in support and six opposed to its implementation. One of the respondents stated that their support for the original was qualified, but did not elaborate on the reasons why within the response. We also note that the six respondents who were opposed to UNC335 being implemented were all Gas Transporters (GTs) or affiliated to a GT.

There was less support for the alternative proposal, with only two respondents offering clear support, another offering qualified support, and a further respondent providing comments only. Two of the respondents who supported the original did not support the alternative on the basis that they did not agree that the solution should be limited to smaller shippers. They argued that significant offtake metering errors impact proportionately on shippers of all sizes. The respondent who offered only comments suggested that the reduced scope of the alternative proposal would limit the incentives upon GDNs to improve offtake meter accuracy, and therefore be of less benefit that the original proposal which they raised and continued to support.

In March 2012, we issued a letter[9] through the Joint Office seeking further views on our 'minded to' position to reject both UNC335 and UNC335A. There were two responses neither of which raised any substantive or new arguments in favour of either proposal.

We consider the views of respondents against the relevant objectives of the UNC below.

Objective a) – the coordinated, efficient and economic operation of the pipeline system to which the licence relates

We note that there was some support for the proposer's view that UNC335 would place a greater incentive on the GDNs to improve the accuracy of offtake meters, by redistributing the risk of any cash flow impacts from shippers to them. One respondent acknowledged that GDNs have gone some way to improve the meter accuracy validation routine, but suggested that there will be insufficient attention to the prevention of errors until there are appropriate financial incentives in place. They gave the example of an error at the Horndon offtake that had "*remained undetected for nearly two years*" and represented an "*under recording of over 160 GWh*".

Another respondent referred to the register of meter errors[10] maintained on the Joint Office website and suggested that there had been "*33 separate National Grid Offtake Meter errors"* in 2009 alone, and that 94% of such errors led to under-recording of gas.

We do agree that the incidence of offtake meter errors appears to be inordinately high given that there are fewer than two hundred meters to be monitored and maintained. It is also clear that this can lead to extremely high mis-recording of gas. For example, the version of the meter error register published on 23 December 2011 shows that in excess of 5500 GWh had been under-recorded, though, as pointed out in responses, over 80% of this was accounted for by just two significant errors at Braishfield B and Aberdeen.

We consider that the costs to GDNs of effectively providing short term funding for any energy reconciliation, as proposed by UNC335, would be significant. We note that, as an example, the proposer of UNC335A suggests that the costs of financing the Aberdeen error could run into several million pounds. Our analysis suggests that this is likely, as shown in Table 1 of our minded to letter.

[9] See: http://gasgovernance.co.uk/sites/default/files/UNC335-395-398wayforward(clean).pdf
[10] See: http://gasgovernance.co.uk/MER

Whilst our figures are currently only an approximation, they do suggest that the penalty associated with UNC335A is too low to provide an effective incentive, while, conversely under UNC335, the penalties could be material. A penalty approaching £3m for an error such as that which has occurred at the Aberdeen meter offtake point represents in excess of 1% of SGN's allowed revenues[11].

While we remain of the view that a cash-flow incentive such as that set out in UNC335 would provide an effective incentive for GDNs to make appropriate investment to avoid future offtake metering errors, we also consider that the GDNs liability must be proportionate and should be capped. Otherwise, this could have the inappropriate effect of diverting investment from elsewhere and potentially run counter to our duty to ensure that licence holders are able to finance their licensable activities.

Therefore, in the absence of any certainty over the level of any future liability, we remain unable to conclude that UNC335 or UNC335A would better facilitate the efficient and economic operation of the pipeline.

Objective d) –the securing of effective competition between [relevant shippers]

We are sympathetic to the problems that charging volatility has on shippers, particularly newer entrants and smaller parties who may not have the same access to finance as larger well established parties, or who may be more reliant upon and therefore relatively exposed to a specific sector of the market. It is therefore welcome that the proposer of UNC335A has taken account of this issue. We plan to consult on the issue of charging volatility in the near future as part of our further work on RIIO GD1.

We note that the alternative proposal relates only to those shippers with a portfolio of fewer than 100,000 Small Supply Points (SSPs) and whose code credit limit is less than £500,000. Several respondents suggested that the solution should be available to all shippers, with one suggesting that otherwise UNC335A may be discriminatory and distort competition between shippers either side of the 100,000 SSP threshold.

We do not consider that it is necessarily unduly discriminatory for gas transporters to have differing arrangements for shippers based on size. Indeed the applicability of the majority of credit rules will be determined from a shipper's size, based upon the level of their activity and the value they have at risk with the GT. However, we see no justification within the proposal or the FMR for this particular threshold being applied in these circumstances, without which we are unable to conclude whether it is unduly discriminatory.

We consider that significant meter errors are a relatively infrequent event and do not have a material impact upon competition. Whilst we acknowledge that any instance of a significant meter error reconciliation being invoiced may be detrimental to a shipper's immediate cash flow, to the extent that these are applied to all SSP shippers proportionately, we do not consider that the smoothing of these charges would do anything to facilitate competition between such parties, nor, as referred to by some of the respondents in favour of the proposals, encourage new entrants.

One of the two differences between UNC335 and the alternative 335A is that the latter would not have any retrospective effect, i.e. it would apply only to errors discovered following its implementation. As noted by the proposer of UNC335A, Ofgem generally holds the view that retrospective modifications should be avoided. This has been a

[11] SGN allowed revenues for Scotland Gas Networks = £200m p.a. (2005-06 prices) or c. 230m in 2010/11 prices. Inflator =226/193 Source: Gas Transporter Licence, Part E, E2, Annex A. http://epr.ofgem.gov.uk

consistent feature in our decisions[12] on proposals which have a retrospective element, and indeed in our published guidance on urgency criteria[13].

It is a general principle that rules ought not to change the character of past transactions, completed on the basis of the then existing rules. To do so may be considered unreasonable, or at best undermine market confidence. However, despite this general principle, we consider that there may be exceptional circumstances under which a modification with retrospective effect may be justified. As set out in the published guidance on urgency, these circumstances may include:

- a situation where the fault or error giving rise to additional costs or losses was directly attributable to central arrangements;
- combinations of circumstances that could not have been reasonably foreseen; or,
- where the possibility of a retrospective action had been clearly flagged to the participants in advance, allowing the detail and process of the change to be finalised with retrospective effect.

We also consider that, in any event, any cost/loss incurred due to the prevailing rules would need to be material in order to warrant a retrospective modification.

We do not consider that these circumstances can be applied in the case of offtake metering errors. Whilst we recognise that the scale of these errors can be significant, the impact upon shippers is entirely proportionate to the amount of energy that the shipper has initially been allocated, and more importantly, billed their customer for. Therefore, any invoice which follows the discovery of an offtake metering error is not an additional cost but simply a correction, with the shipper being exposed to no greater or less cost than they should have been initially invoiced had the meter been entirely accurate.

We recognise that these corrections can be unplanned and, to the extent they are generally a debit rather than a credit, therefore place a short term burden upon the cash flow of shippers. However, this also suggests that the shipper has been able to bill their customer for the full and accurate amount of gas and enjoy the benefit of that revenue until the gas is subsequently reconciled. We also note the point made by the proposer of UNC335A that the average period between a significant meter error being first notified to shippers and subsequently being invoiced is fifteen months, with cases such as the Aberdeen offtake error potentially being much longer. We therefore consider that while the uncertainty of when a particular error correction may fall due is unhelpful, it is not a genuinely unforeseen event and, subject to sufficient notice, should be budgeted for.

In conclusion, whilst we have some sympathy with the proposers' intent of allowing more flexible payment terms for unplanned charges, we consider that neither the original proposal nor the alternative would better facilitate the relevant objectives.

David Ashbourne
Partner, Legal - Smarter Grids and Governance
Signed on behalf of the Authority and authorised for that purpose

[12] For instance, UNC341: 'Manifest Errors in Entry Capacity Overruns' - http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/UNC341D.pdf
[13] See: www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=213&refer=Licensing/IndCodes/Governance