Modification proposal:	**Uniform Network Code (UNC) 341: Manifest Errors in Entry Capacity Overruns**		
Decision:	The Authority[1] has decided to reject this proposal		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	24 March 2011	Implementation Date:	N/A

Background to the modification proposal

If a user delivers gas onto the National Transmission System (NTS) over a gas flow day in excess of its NTS entry capacity holdings, then the user incurs a NTS entry capacity overrun charge. This charge is based on the quantity of gas by which the user has overrun (the overrun quantity) multiplied by an overrun price. The overrun charge is set at a rate to encourage users to purchase NTS entry capacity consistent with their flow requirements[2].

In April 2010, a user incurred a series of overrun charges which resulted in a multi-million pound overrun charge. It claims that this was the result of a manifest error on its part and has introduced this proposal in an effort to reclaim some of the NTS entry capacity overrun charges.

The modification proposal

This proposal seeks to introduce manifest error provisions into the Uniform Network Code (UNC) in instances where a user error in booking NTS entry capacity has led to NTS entry capacity overrun charges being incurred. Under this proposal, such a user could raise a claim for manifest error, and the UNC Committee (UNCC) would determine an appropriate adjustment to the NTS entry capacity overrun charges if it is agreed that there had been a manifest error.

The proposer considers that these arrangements should be effective from 1 April 2010. The proposal contains materiality thresholds and application fees included with a view to deterring claims for minor NTS entry capacity overrun charges.

UNC Panel[3] recommendation

At its meeting on 17 February 2011, the UNC Panel recommended (by majority) that the proposal should not be implemented. Of the 11 panel members, only one vote was cast in favour of implementing this modification.

[1] The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.
[2] UNC B2.12 provides the framework of how the NTS entry capacity regime operates.
[3] 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 proposal and the Final Modification Report (FMR) dated 17 February 2011. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR[4].

The Authority has concluded that implementation of the modification proposal will not better facilitate the achievement of the relevant objectives of the UNC[5]. The Authority has therefore decided to reject the proposal.

The Relevant Objectives:

The proposer submits that the proposal better facilitates the relevant objectives set out in Standard Special Condition A11(1) sub-paragraphs (d) and (f). We agree that these are the relevant objectives against which the proposal should be assessed. Our views on the merits of the proposal against these objectives are detailed below.

Assessment of the proposal against the relevant objective at Standard Special Condition A11(1)(d):

(d) …. 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;

The proposer believes that implementation would allow new users/ small users who have made a genuine error to be treated fairly and reasonably. In turn, the comfort this gives users should act to reduce barriers to entry and encourage greater participation in the industry (at both primary and secondary trading levels), thereby furthering effective competition.

The proposer has noted that historically Ofgem has been in favour of the introduction of manifest error provisions in gas. We still maintain the view that a robust manifest error process is desirable, and agree with the benefits that the proposer suggests could arise from such a process.

We consider that when compared with the current situation, the ability of a user to claim for manifest errors would be particularly beneficial for small users, who may not have sufficient financial resource to continue trading in the event of a genuine manifest error.

Accordingly, we are of the view that the reasonable objective of securing effective competition could potentially be met by the principles underlying the proposal. However, as drafted, we consider it to be ineffective.

We are concerned that the scope of what the proposal considers as a manifest error is too wide, which could lead to the process being abused. The proposal contends that events where the error is genuine and unintended and, the claimant is not seeking an unfair advantage, should be classed as manifest errors. Further, the guidance note

[4] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

[5] 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

associated with the proposal explicitly includes business process errors as coming under the remit of manifest errors[6].

We do not believe that business process errors should be included as within scope. A manifest error should be one that is clearly evident, and as such, should be detected by a reasonable and prudent operator in a short time and immediately be notified to the system operator. The proposal would allow errors to be raised up to three months after the error occurred; we consider this to be too long a period to allow for the detection of manifest errors.

As we noted in our decision letter for the Balancing and Settlement Code[7] (BSC) P9[8], "In most markets, the principle is that losses resulting from errors will lie where they fall. However, there may be very limited situations in which the rules of the market permit corrective action. Generally this must be initiated within a very short period from the error occurring". Notwithstanding the very different operational timescales between the gas and electricity markets (e.g. daily versus half-hourly balancing), we think this principle still applies. The difficulty in defining what constitutes a manifest error coupled with a lengthy notification period could act to create uncertainty around the process, and so would be unlikely to bring the comfort that would help secure effective competition.

We note that the proposed claims process includes a non-refundable fee to deter vexatious claims. But, given that several respondents commented that the UNCC might not feel competent to judge on whether a claim should be rejected, we feel that the manifest error definition needs to be much more specific before we could consider its approval.

A number of respondents had concerns about the retrospection element of the proposal. They considered that allowing retrospective adjustments introduces uncertainty and increases the perception of risk going forward. We agree that retrospective adjustment is generally undesirable and introduces uncertainty, which hinders effective competition.

The proposer argues that to allow the proposal to apply retrospectively from 1 April 2010 is a reasonable approach because it will be aligned the current financial year (2010/2011). The proposer indicated that the introduction of retrospectivity for this proposal met with the criteria for acceptable retrospection as detailed in our related decision letter P37[9] on manifest errors in the electricity trading regime. These criteria were:

- A situation where the fault or error occasioning the loss was directly attributable to central arrangements;
- Combinations of circumstances that could not have been reasonably foreseen; or
- Where the possibility of retrospective action has been clearly flagged to participants in advance and only the details and process were decided retrospectively.

[6] Manifest Errors In Relation to Entry Overrun Charges Guidance Document 5.4 (v)
[7] BSC description http://www.elexon.co.uk/pages/introductiontothebsc.aspx
[8] Decision letter for Modification Proposal Correction Of Technical Error In Respect Of The Energy Contract Volume Notifications Under Section P.2.3 And Adjustment Of Settlement Data Under Section U.2.5.Ofgem, 8 June 2001
[9] Decision letter for Modification Proposal P37,"To provide for the remedy of past errors in Energy Contract Volume Notifications and in Metered Volume Reallocation Notifications", Ofgem, 10 May 2002

We further stated that for a retrospective change to be justified, the loss sustained would need to be material.

However, P37 was introduced to address the consequences of introducing both new arrangements and new systems that were unfamiliar to the industry; Ofgem indicated that "even prudent operators may have made material errors as a consequence of their inexperience in dealing with the new systems" and therefore the proposal was applied retrospectively to the Go-live date for NETA.

In contrast the NTS entry capacity overrun regime has been in place for a number of years and is a fundamental element of the gas regime. National Grid Gas (NGG) has confirmed that the Gemini central system (which facilitates gas nominations, energy balancing, exit and entry capacity booking) has been in place since 2005. Gemini contains a number of reports which may be used to infer a user's end-of-day position, and the system contains functionality to set warning limits in respect of capacity usage, so we do not think that it is possible to attribute blame to central arrangements. In our P37 decision, we stated that "Ofgem notes that participants have been continually gaining experience and understanding of the processes of NETA and any trading risks that the Parties may face in consequence of their decisions. Ofgem would therefore expect that the test for a reasonable and prudent Party would effectively become progressively more stringent in relation to notification errors occurring later in time. As such, it is Ofgem's view that it would only be in relation to notification errors which occurred during the early days of NETA that it could be sensibly argued that a reasonable and prudent operator could not have either foreseen or been expected to bear the risk of alleged errors and their consequences". The same is true for the gas regime. There were no significant changes to the gas capacity overrun regime implemented from 1 April 2010 which would justify this modification being applied with retrospective effect. Any such adjustment would run counter to the incentive on participants to balance their capacity holdings and send appropriate signals to the system operator.

Assessment of the proposal against the relevant objective at Standard Special Condition A11(1)(f):

(f) ……..the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

The proposer believes that UNC 0341 will provide an appropriate mechanism for the consideration and resolution of possible manifest error circumstances in relation to NTS entry capacity overruns. In addition, the proposer believes it would reduce the risk of contractual disputes arising from unreasonable/ unintended consequences associated with the existing arrangements.

The proposal allows for the aggregation of several consecutive small claims into one large claim on the grounds of efficiency. We believe that this may introduce a perverse incentive for users who are just below the claim threshold to purposely repeat an error in order to pass the threshold.

Furthermore, a number of stakeholders expressed concern that the proposed UNCC may not be an appropriate forum for the assessment of the merits of manifest error claims. In view of the broad definition of what constitutes a manifest error, the UNCC may not be confident in determining a claim. We acknowledge the concerns around this issue and do not believe that it will promote efficiency in the implementation and administration of the UNC.

Summary

We are of the view that the relevant objective of securing effective competition could potentially be met by the principles underlying the proposal.

However, we have concerns that the current proposal's definition of what constitutes a manifest error is too broad in its scope and may undermine the commercial incentives to operate in a reasonable and prudent manner. We are also not convinced that it would be appropriate for the proposal to apply retrospectively from April 2010.

As such, we do not consider that the proposal as it stands is guaranteed to improve securing effective competition neither do we consider that it better facilitates the relevant objective of promoting efficiency in the implementation and administration of the uniform network code.

Ofgem, however, welcomes the discussion that has arisen from the development of UNC 0341. Ofgem shares the proposer's and industry's concerns regarding the lack of provision for manifest errors and, notwithstanding our rejection of this proposal as it stands, we believe that it would be in the industry's interests to introduce an appropriate and robust manifest error provision into the UNC at the earliest opportunity.

Hannah Nixon

Partner, Transmission

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