

Modification proposal:	Uniform Network Code (UNC) 395: 'Limitation on Retrospective Invoicing and Invoice Correction' and 398: 'Limitation on Retrospective Invoicing and Invoice Correction (3 to 4 year solution)'		
Decision:	The Authority ¹ directs that modification proposal UNC398 be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	1 March 2013	Implementation Date:	1 April 2014

Background to the modification proposals

The UNC sets out the rules by which gas is allocated to Gas Shippers, subsequently reconciled against the consumption at individual sites Registered to those Gas Shippers and finally settled through energy invoices. Traditionally, those settlement arrangements did not seek to reach a final position as such, with further reconciliations taking place as and when new information came to light, potentially dating as far back as the introduction of the network code arrangements (now set out in the UNC).

Following the implementation of UNC152V³ in April 2008, the UNC now contains a 'Code Cut Off Date' which limits the retrospective reconciliation to a period of between 4 years to 4 years and 364 days, with the 1 April of the outlying year acting as the fixed cut off date and incremented each year to the following 1 April. The limit will cover all retrospective transactions governed by the UNC between Gas Transporters (GTs) and Gas Shippers, but is of most significance for energy invoicing given the number of variables as compared to use of system charges. It also applies irrespective of whether these reconciliations would have resulted in debits or credits.

The billing position for any date beyond this Cut Code Off Date is considered to be crystallised; i.e. any error that is subsequently discovered will not be further reconciled.

The modification proposals

Modification proposals UNC395 and UNC398 propose to reduce the Code Cut Off Date to a period of 2 years to 2 years and 364 days (the '2-3 year solution') or 3 years to 3 years and 364 days (the '3-4 year solution') respectively.

These proposals were not intended to be mutually exclusive; UNC398 was proposed as an interim solution, allowing for the settlement window to be reduced by one year at a time if both are implemented in the intended sequence.

It is further proposed under UNC395 that 6 months prior to its implementation, the User Suppressed Reconciliation Volumes (USRVs) resolution date is amended⁴. This would require that all USRVs greater than 20 months old are passed to the GT to resolve, rather than after 30 months as now. These obligations upon the GT were introduced following

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

³ See www.ofgem.gov.uk/LICENSING/GASCODES/UNC/MODS/Documents1/UNC152D.pdf

⁴ See UNC Section E8.1.1.

the implementation of UNC152V in order to ensure that the USRVs did not become 'timed out'.⁵

UNC Panel recommendation and representations⁶

On 19 January 2012, the UNC Panel recommended implementation of UNC 398, with 6 votes in favour and 4 against.

At its subsequent meeting of 16 February 2012, the UNC Panel voted not to recommend implementation of UNC 395, by a majority of 8 votes to 2.

Following the further assessment requested by Ofgem in its letter of 15 March 2012⁷ (the 'March letter') the UNC Panel reconsidered the proposals in light of the new information provided by the workgroup. At its meeting of 16 August 2012 the UNC Panel again voted in favour in of implementing UNC398, this time by a majority of 7 votes to 3. The UNC Panel recommendation to reject UNC395 also remained the same, though this time by a slimmer majority of 6 votes to 4.

The views put forward by Panel members including, where appropriate, reasons why they changed their opinion between the first and second votes are set out in the Final Modification Reports (FMRs).

The Authority's decision

The Authority has considered the issues raised by the modification proposals and the FMRs, the latest versions of which are dated 28 August 2012. The Authority has also considered and taken into account the responses to the Joint Office's consultations on the modification proposals which are attached to the FMR⁸, and to the subsequent Ofgem consultation⁹ on its position of being minded to accept UNC395, in preference to UNC398. The Authority has concluded that:

1. implementation of either modification proposal is capable of further facilitating the achievement of the relevant objectives of the UNC¹⁰;
2. the net benefits of implementing UNC398 are more certain at this time than those of UNC395; and
3. directing that modification UNC398 be made is consistent with the Authority's principal objective and statutory duties¹¹.

⁵ See UNC192: 'Introduction of DNO Obligations to facilitate resolution of unresolved USRVs'

⁶ All responses to the Joint Office consultation and to our 'send-back' letter can be found at www.gasgovernance.co.uk

⁷ See: [www.gasgovernance.co.uk/sites/default/files/UNC335-395-398wayforward\(clean\).pdf](http://www.gasgovernance.co.uk/sites/default/files/UNC335-395-398wayforward(clean).pdf)

⁸ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁹ See: www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=414&refer=Licensing/GasCodes/UNC/Mods

¹⁰ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: <http://epr.ofgem.gov.uk/Pages/EPRIInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRIFiles%2fStandard+Special+Condition+PART+A+-+Consolidated+-+Current+Version.pdf>

¹¹The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

Reasons for the Authority's decision

Given the issues raised by these modification proposals we agree with the UNC Panel that they be assessed primarily against relevant objective d) and to a lesser extent f). We consider that the proposals are neutral in respect of the other relevant objectives.

Relevant Objective d) securing effective competition between shippers

Timely and accurate settlements facilitate competition insofar as they allow for the accurate allocation of costs and efficient use of capital. It is clearly undesirable for a commercial organisation to be unable to fully close out its accounts for several years, pending confirmation of an as yet unquantified liability (or credit).

Whilst the shorter settlement window proposed under UNC395 would seem to offer greater benefits than UNC398 in terms of reducing uncertainty, data provided by xoserve¹² suggests that there is not a significant decrease in unallocated gas between the 2-3 years and 3-4 years periods covered by these proposals. There is also a risk that this improved timeliness comes at the expense of settlement accuracy. We therefore consider that UNC398 strikes the better balance in the current circumstances. This is further explored below.

Timeliness of settlements

Whilst the Code Cut Off Date relates to all GT to Gas Shipper invoices, we are particularly concerned that the reconciliation of energy invoices will be at a higher 'cash out' cost than had the Gas Shipper been able to efficiently purchase that gas themselves. Whilst this may be a bigger issue for the accuracy of initial estimates than the timeliness of subsequent reconciliations, to the extent that a Gas Shipper may seek to hedge this risk and its other outstanding liabilities, they will incur ongoing costs. In seeking to reduce the current settlement window both proposals would be expected to reduce this uncertainty and the potentially inefficient costs associated with it.

In our consultation letter we provided the view that as UNC395 would reduce the period of uncertainty by the greatest extent, it offered greater potential benefits than UNC398. This view is supported by several respondents to both the Joint Office and Ofgem consultations. However, it is disappointing that despite several requests for information that would enable us to quantify this benefit, very little has been forthcoming.

We also noted in the consultation letter that the anticipated improvement either proposal may make to the timeliness of reaching a final settlement position must be balanced against the possible impacts upon accurate cost allocation. We note that there are currently volumes of gas being reconciled for the periods that would be excluded from further reconciliation under either proposal. This could result in a less accurate allocation of those historic costs and a degree of socialisation through the Reconciliation by Difference ('RbD') mechanism.

Shipper performance

We remain of the view that this reconciliation activity and the quality of data it relies upon are largely within Gas Shippers' control, either directly or indirectly. We are encouraged by the observation that the implementation of UNC152V did not lead to the

¹²[www.gasgovernance.co.uk/sites/default/files/Unreconciled%20Update%20\(provided%20by%20Xoserve\).pdf](http://www.gasgovernance.co.uk/sites/default/files/Unreconciled%20Update%20(provided%20by%20Xoserve).pdf)

increase in unallocated gas, but instead triggered an improvement in the timeliness of reconciliation activity. We consider it likely that the implementation of either UNC395 or UNC398 would have a similar effect.

However, we are concerned by the number and scale of issues associated with the quality of industry data and performance against key processes that are critical to the accuracy and timeliness of the gas settlements regime. For instance, we note from the information provided to the Annual Quantity ('AQ')¹³ Operational Review Group that nearly 1.8 million Smaller Supply Points ('SSPs') and 55,000 Larger Supply Points ('LSPs') that are known to be live and registered to a Gas Shipper nonetheless received a 'warning' of Xoserve being unable to carry out a revised AQ calculation¹⁴. There can be myriad reasons for this, but it appears to be most commonly due to Xoserve not receiving sufficient consumption data. Where Xoserve is unable to carry out an AQ revision the existing AQ calculation is carried forward, building up the scale of reconciliations into future years.

We note that the re-occurrence of warnings (and number of sites with an older AQ age profile) drops significantly after 3 years in both the SSP and LSP sectors. This suggests that there is little risk of UNC398 contributing further to unallocated gas. However, the limitations of current industry processes and associated shipper performance may impose such a risk if they cannot readily improve to meet the timescales proposed under 395.

Reconciliation in exceptional circumstances

Several respondents raised concerns about the impact UNC395 or UNC398 may have on the accurate reconciliation of Significant Meter Errors ('SMEs'), particularly in relation to an NTS-LDZ¹⁵ offtake meter given the length of time that an error may go undiscovered and subsequently take to resolve. Such errors impact not only upon those Gas Shippers who have sites registered in the relevant LDZ, but all those who utilise the NTS, to the extent that the error will signify an over or under recovery of NTS transportation charges and shrinkage. National Grid National Transmission System ('NG NTS') noted the outstanding reconciliation of around £35m for an SME first notified in August 2010.

We acknowledge that the reconciliation of meter errors can be a lengthy process and is a significant contributor to retrospective settlement. When requesting further assessment of UNC395 and UNC398 in the March letter we identified the relationship between those proposals and UNC335¹⁶. However, we consider that it would be preferable to address the causes of SMEs rather than retain inefficient costs of an extended settlement window upon Gas Shippers in anticipation of further errors.

Although the timescales associated with the SME process are not within scope of either UNC395 or UNC398, we consider that it should be possible to identify, quantify and subsequently reconcile an offtake meter error within 3 years and certainly within 4 years. As noted by NG NTS, the SME process is governed by the industry parties themselves through the application of the 'Measurement Error Notification Guidelines for NTS to LDZ

¹³ As defined in Section G1.6.7 of the UNC

¹⁴ Xoserve presentation to the AQ Operation Review Group, 28 November 2012: www.xoserve.com/index.php/our-services/aq-review/aq-review-2012/

¹⁵ The meter at the offtake point between the National Transmission System and the Local Distribution Zone

¹⁶ UNC335: 'Offtake Metering Error - Payment Timescales'

and LDZ to LDZ measurement installations¹⁷. It would be reasonable to expect that document to be reviewed in light of any modification to the Code Cut Off Date.

We also remain open to the possibility that there may be some exceptional circumstances that require a resolution extending beyond the Code Cut Off Date. For instance our consultation letter referred to the ongoing development of UNC429¹⁸ which seeks to allow Gas Shippers to claim back the costs of settling a historic error in customer billing. Without prejudice to any decision we may take on UNC429 or any other modification proposal, we recognise the concerns raised by some respondents about reducing the settlement window without further safeguards and conversely, those who feel this would lead to an inappropriate socialisation of costs. We remain open minded on this and will assess each case on an individual basis.

Given the above, we consider that UNC398 strikes a better balance than UNC395 between the more timely settlement of charges and the accuracy that can reasonably be expected by industry processes and performance in the near term.

Relevant Objective f) promotion of efficiency in the implementation and administration of the UNC

We consider that both UNC395 and UNC398 would lead to efficiency gains, both directly in reducing the number of iterative reconciliations for earlier years, and indirectly by driving further improvements to the settlements regime. However, we recognise that this may, in the short term, impose administrative costs in terms of data cleansing and reconciliation of periods before they time out. To the extent these activities relate to existing obligations which could have been discharged earlier, we do not consider this to be unreasonable.

As mentioned above, the existing age profile of AQs shows the vast majority to have been revised by year 3, suggesting the impact of UNC398 would be limited to relatively few sites. However, as UNC rules allow for a period of up to two years between the submission of reads for an 'Annual read' meter¹⁹ and the subsequent lead times before those reads result in an AQ revision, even sites that have been reconciled within existing rules could be captured by UNC395. Whilst this risk may be manageable, it may not be the most efficient way to administer the prevailing UNC rules.

We consider that UNC398 would better facilitate the promotion of this objective but, without further information on the additional costs to shippers of exceeding existing UNC requirements, we cannot conclude that this is the case for UNC395.

Conclusion

Given the impact that meter read performance and other feeder processes have upon the accuracy of AQs and gas settlement more generally, we welcome the recent formation of the Performance Assurance workgroup, which we understand may focus upon this area. We particularly look forward to seeing any recommendations that group may make on improvements that can be made to the timeliness and accuracy of settlements, and the premium that Parties may be willing to place on the ongoing assurance of that accuracy.

¹⁷ As referenced in the UNC section V12 – 'General Provisions Relating to UNC Related Documents' and OAD section D3.1.5.3

¹⁸ UNC429: "Customer Settlement Error Claims Process"

¹⁹ See Section M3.1.7 of the UNC

Current settlement procedures have to an extent been reverse engineered owing to historic system constraints around the availability and handling of meter readings, etc. With the replacement in large part of Xoserve's existing systems under Project Nexus, we would encourage UNC Parties to further explore the optimum final settlement period as represented by the Code Cut Off Date, particularly in the event that UNC432 is accepted²⁰.

We recognise that UNC398 was intended an interim solution, potentially being in place for one year only before being replaced by UNC395. However, the period that has elapsed since these proposals were first raised seems to have negated some of the most serious concerns which related to the initially proposed implementation date of April 2012. We are also cognisant of the anticipated 2015 implementation of Project Nexus and the potential step change this may represent in terms of the process for gas settlements.

Given the above, we have concluded that we should direct the implementation of UNC398 and not UNC395. Whilst we remain sympathetic to a further shortening of the settlement window, we consider that there may be further opportunity for the industry to explore the optimum settlements process and associated lead times in light of the anticipated improvements that may result from both Project Nexus and the work of the Performance Assurance workgroup.

Notwithstanding the points made above about the ongoing costs associated with an extended settlement window, we consider that any future review should further explore the costs of compliance with such standards and any dependencies, such as the reliance that can reasonably be placed on data from third party agents. We consider that any further modification to the Code Cut Off Date should be a natural back stop, derived from optimum settlement arrangements, rather than vice versa. With the anticipated implementation of Project Nexus already providing a catalyst for this further work and having regard to the Principles of Better Regulation, we do not consider that it would be appropriate to pre-empt this further work by also directing the implementation of UNC395.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority hereby directs that modification proposal UNC398: 'Limitation on Retrospective Invoicing and Invoice Correction (3 to 4 year solution)' be made.

Colin Sausman
Partner, Retail Markets & Research

²⁰ UNC432: 'Project Nexus – gas settlement reform'