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Modification proposal:	**Uniform Network Code (UNC) 429: Customer Settlement Error Claims Process (UNC429)**		
Decision:	The Authority[1] directs that this proposal be made[2]		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	18 July 2013	Implementation date:	1 April 2014

Background to the modification proposal

The UNC sets out the rules by which gas is allocated to Gas Shippers ('Shippers'), subsequently reconciled against the consumption at sites registered to those 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).

UNC152V[3] introduced a 'Code Cut Off Date' which limits the retrospective reconciliation to a period of between 4 to 5 years, with 1 April of the relevant year acting as the fixed cut off date and incremented by one year upon its fifth anniversary.

The Code Cut Off Date covers all retrospective transactions governed by the UNC between Gas Transporters (GTs) and 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 Code Cut Off Date is considered to be 'crystallised'; i.e. any error that is subsequently discovered will not be further reconciled.

On 1 March 2013 we approved UNC398[4], which will further reduce the reconciliation window to a period of 3 to 4 years. UNC398 comes into effect on 1 April 2014.

The modification proposal

UNC429 seeks to establish a process for Shippers to use when seeking to back off a customer claim for an invoice adjustment that extends beyond the prevailing Code Cut Off Date. This may extend as far as the six years allowed for such customer claims under the Limitations Act (1980). Shippers may otherwise be exposed to any shortfall (or if a customer debit, receive a windfall gain) relating to the crystallised period.

The proposer considers that this modification furthers relevant objective d) as it will allow Shippers to correct material settlement errors that would have otherwise resulted in an inaccurate allocation of costs and a cross-subsidy between Shippers. It considers that this improved cost targeting will benefit effective competition.

UNC Panel[5] recommendation

At the 20 June 2013 meeting of the UNC Modification Panel, four of the voting members were in favour of UNC429 being implemented; as the proposal was not supported by the majority of the Panel, the recommendation is that it not be implemented.

[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] UNC152V: 'Limitation on Retrospective Invoicing and Invoice Correction'
[4] UNC398: 'Limitation on Retrospective Invoicing and Invoice Correction (3 to 4 year solution)'
[5] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

The Authority's decision

The Authority has considered its statutory duties and functions in reaching its decision. The Authority has considered the issues raised by the modification proposal, the Final Modification Report ('FMR') dated 20 June 2013[6] and responses to the Joint Office's consultation. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC[7]; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties[8].

Reasons for the Authority's decision

Opinion on UNC429 was divided amongst the twelve respondents to the Joint Office consultation, with four being in favour and seven opposed. National Grid National Transmission System ('NG NTS') did not explicitly support or oppose UNC429, though it did raise some concerns with it. We agree with the proposer, the UNC Panel and respondents that this proposal should be considered against relevant objective d). We consider that it is neutral with respect to all other relevant objectives.

Relevant Objective d): the securing of effective competition between relevant Shippers

Several respondents suggested that allowing for a customer claims process would have a detrimental impact upon the accuracy of settlements and lead to an increase in the volumes of unreconciled gas. Some suggested that these historical settlement costs should remain crystallised rather than creating further uncertainty and risk. Some also went on to suggest that the gas industry should instead be working towards a further reduction in the reconciliation window and/or addressing the issues that may lead to customer claims in the first place.

However, others suggested that allowing Shippers to claim for material settlement inaccuracies would reduce the risk and associated costs to those Shippers and benefit competition overall. One respondent drew parallels between the process proposed under UNC429 and the Gross Volume Correction ('GVC') process used to correct errors in the 'crystallised' period under the electricity Balancing and Settlement Code ('BSC').

We agree that there are some similarities between the procedure proposed under UNC429, the GVC process and, perhaps to a greater extent, that of BSC Trading Disputes. The GVC process was itself the subject of the recent BSC modification proposal P274[9], which initially sought to remove the use of GVC, but was subsequently revised to simply restrict its use. In our decision to reject P274 we noted the impact that inappropriate use of the GVC process could have upon allocation of costs and therefore upon competition. However, we also recognised the strong support for retaining its use (subject to greater scrutiny) on the basis there may be reconciliation errors which suppliers may not reasonably be able to address within normal settlement timescales.

Whilst the UNC currently has a longer reconciliation window than the BSC, suppliers will nonetheless face similar issues in obtaining the correct meter reads required under each

[6] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com
[7] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/index.php?pk=folder590301
[8] 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.
[9] P274: 'Cessation of compensatory adjustment'

code in order to ensure accurate reconciliations and subsequent settlement. It is notable that each of the Shipper respondents opposed to UNC429 had, in their capacity as electricity suppliers, earlier responded to P274 supporting the retention of post-reconciliation compensation for errors through GVC, making similar arguments to those Shippers now in support of UNC429. Until such time as these issues may be addressed through, for instance, greater use of smart meter data, we consider that an appropriate balance must be found between timeliness in reaching a final reconciliation position and the accuracy of cost allocation. A mechanism which allows individual circumstances to be re-examined and if appropriate allow for the adjustment of previously misallocated costs may help provide this balance.

Tackling settlement errors at source

Some respondents considered that UNC429 could dilute Shippers' incentive to settle in a timely and accurate manner, allowing them to instead pass on increased risk and cost to the rest of the industry which is not in a position to control them. They considered that this was inappropriate as the variables that could lead to an adjustment are within the control of the Shipper, e.g. that regular asset checks and energy reconciliations will mitigate the risk of an unidentified error.

One respondent suggested that while it understands that delays can on occasion occur in the identification of issues, for instance relating to meter standing data, Suppliers and customers should make adequate provisions within their commercial metering contracts to back off any potential liabilities that may arise.

However, a further respondent suggested that Shippers do not have it in their power to prevent all such errors from occurring. It suggested that many such errors are caused by the slow degradation of metering equipment or pipe work and can only be detected during extensive maintenance which may only happen once every several years.

We agree that the existence of a customer settlement claims process should not be allowed to dilute the incentives on Shippers to do all that would be expected of a reasonable and prudent operator to manage the risk of errors occurring in the first place. We consider that the assessment of any claim must be subject to high degree of rigour and in no way seen as an easy option. This is discussed further below.

The claims process

Several respondents raised concerns with the robustness of the claims process set out in UNC429. For instance, one commented that there are not enough controls or suitable criteria in place to accurately validate these potentially significant adjustments and that any disputes process needs to be more transparent in order to work properly. Another suggested that claims would become out of control with no validation in place.

We agree that it may be appropriate for some aspects of the prescribed procedure to be further strengthened and are disappointed that these issues were not identified and fully addressed through the workgroup. For instance, a GT respondent suggested that it was sympathetic to the principle of UNC429 but was concerned that the GTs would become unduly responsible for settling the claims process based upon data submitted by Shippers. It noted that although UNC429 specifies a requirement to submit evidence in support of a Shipper's claim, it does not specify the details of the nature of this evidence or what it must contain. It suggested that an in depth framework needs to be developed which would detail the level of evidence required to justify a valid a claim. We have sympathy with this view.

Although the legal text specifies that the GT shall be entitled to reject a claim that it considers to be clearly erroneous, it is currently silent on what criteria it should apply in

considering whether to accept the claim. Nor does it require the GT to accept the claim in all circumstances where it does not determine that the information provided is erroneous. We therefore understand that UNC429 gives the GT a large degree of discretion to refuse claims and agree that there may be scope for a more detailed framework to be developed. Such a framework may establish the terms of reference under which an expert may determine any subsequent dispute, as discussed below.

We note that a Shipper who is refused their claim has the right to appeal the GTs decision to a third party expert under the existing UNC dispute mechanism. Given the wider interest in the claim, as recognised by the requirement for claims in excess of £1million to be notified to other Shippers, it may have been appropriate for the right of appeal to extend to those contributing Shippers if they wish to dispute an award. We can find no evidence that this has been considered by the workgroup.

One respondent suggested that the £50,000 minimum materiality threshold may constitute a barrier to entry and/or be discriminatory as it would allow only established Larger Supply Point ('LSP') Shippers to make a claim. It is not clear from the FMR or supporting papers why the £50,000 materiality threshold was chosen, though we do not consider that the claims process would be limited to LSP Shippers as this threshold could apply to a group of supply points if an error may have been caused by the same root cause, e.g. an error with a class of meters. The process could therefore be used by both LSP and Smaller Supply Point ('SSP') Shippers. However, we acknowledge that it may be used primarily by LSP Shippers given the greater likelihood of consumers at an LSP site triggering the initial claim

We consider it is appropriate for the UNC429 process to contain a materiality threshold as this, combined with other measures such as the requirement on Shippers to pay the GT's administration costs, should prevent trivial or vexatious claims. Whilst we note that the £50,000 proposed under UNC429 is markedly higher than, for example, the £3,000 threshold for BSC Parties to raise a trading dispute, in the absence of contrary evidence or an alternative proposal we cannot conclude that this would be an inappropriate threshold for the UNC429 process. To the extent that there are any remaining concerns with this limit, this may best be assessed in light of practical experience.

Some respondents suggested that using the Balancing Neutrality[10] mechanism in the manner suggested by UNC429 could also create a barrier to entry. Firstly, it may expose the new entrant to up to six years of unreconciled energy smear. Secondly, the Shipper's contribution would be based on current market share, rather than that at the time of the error. We disagree with the first part of this assessment as the socialised cost would be only for that part of any claim that extended beyond the Code Cut Off Date. However we do agree that all Shippers, including new entrants, would be required to contribute to these costs. We also agree that it would be preferable to recover costs commensurate with market share at the time of the error, rather than at the time the claim is settled. We have previously accepted modifications which adopt this principle, such as UNC171[11], which required the reconciliation of historic errors to be based on the AQ distribution at the time the error occurred, rather than at the time of its discovery.

We further consider that UNC429 may remove, rather than impose, a barrier to entry to the extent that it reduces the potential exposure to a large scale claim which a small Shipper may otherwise be particularly impacted by. As noted by some respondents, smaller Shippers may not have the portfolio size to efficiently hedge against such risks or effectively manage them through their agent contracts. In the extreme, this may deter small Shippers from competing at sites which may expose them to such risks.

[10] As defined under UNC Section F
[11] UNC171: 'Amendment of 'User SP Aggregate Reconciliation Proportion' to incorporate historical AQ proportions'

Limitations Act (1980)

Respondents' views were mixed on the extent to which the Limitation Act (1980) is relevant to settlements under the UNC. Some suggested that as gas industry parties have entered into a contract (the UNC) which specifically limits the period in which any adjustment to settlements can be brought (i.e. the Code Cut Off Date) they are agreeing that these statutory limits do not apply.

We agree that the Limitations Act does not prevent the UNC from stipulating a shorter period for settlements and have previously set out our views on this in relation to both UNC152 and UNC398. However, it is our understanding that the proposer and supporters of UNC429 are not questioning the ability of the UNC to impose a settlement window that is shorter than six years. Rather, they are seeking to address an issue arising as the end consumer is not similarly bound by these UNC timeframes and may legitimately make a claim relating to a longer period. The statutory time limit may therefore be relevant to UNC429, but only insofar as it provides an age limit for any claim that a Shipper may bring, commensurate with their exposure to an initial customer claim for an invoice adjustment.

Conclusion

We agree with those respondents who suggested that the gas industry should be working towards further reducing the reconciliation window as the accurate allocation of costs and more efficient use of capital will lead to more effective competition between Shippers. However, we do not consider that the availability of a customer settlement error claims process is contrary to this aim; indeed it may facilitate it.

As noted above, we consider that there will be a need for further guidance and possibly assessment criteria against which the GTs may assess the validity of the claim. This may require evidence not only on the scale and duration of the error, but to demonstrate that the Shipper has done all that would be expected of a reasonable and prudent operator to prevent and/or subsequently mitigate that error. This should give a degree of certainty to Shippers on what may be expected of them in making a claim. Their peers should also be assured that the error was, under the circumstances, not reasonably avoidable and that it is therefore appropriate to socialise those costs rather than expose an individual Shipper. This should also help to expedite the settlement of the consumer's initial claim with the Shipper.

Therefore, whilst there may be further work to be done to strengthen the claims process to ensure that it is both fully effective and robust, we consider than on balance, these concerns do not outweigh the potential benefits of its implementation. We also recognise that much of this work may be achieved outside of the UNC modification process, with the 1 April 2014 implementation date of UNC429 appearing to offer sufficient time to complete it. For the reasons set out above we consider that UNC429 will further relevant objective d).

Decision notice

In accordance with Standard Special Condition A11 of the GT Licence, the Authority, hereby directs that modification proposal UNC429: 'Customer Settlement Error Claims Process' be made.

Maxine Frerk
Partner, Retail Markets and Research
Signed on behalf of the Authority and authorised for that purpose.