

Modification Report
URGENT Modification Reference Number 0202a

Additional Incentive Structure relating to Implementation of Reconciliation by Difference.

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.12.4.

1. Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.2(a) Ofgas has agreed that this Modification Proposal should be treated as Urgent in order to develop the incentive structure that is appropriate from the date of implementation of Reconciliation by Difference.

2. Procedures Followed:

Transco agreed with Ofgas (and has followed) the following procedures for this Proposal;

Modification Proposal to Ofgas for consideration.	9th December 1997
Ofgas direction for Urgent Procedures to apply.	11th December 1997
Modification Proposal circulated to Modification Panel, members, Shippers and Non-Network Code parties seeking representation.	11th December 1997
Close out for representations.	21st January 1998
Modification Report to Ofgas.	29th January 1998
Ofgas Decision anticipated	31st January 1998

3. The Modification Proposal:

A paper entitled RbD -Detailed Incentive Regime (V0.3), together with a "letter of intent", was published to all Shippers 16th January 1998. These have then formed the basis for further debate. It is appropriate, therefore, at this time that Sections 2 and Section 3 are implemented. The revised version of these two sections (see below) forms the basis of this proposal that will be implemented on the 1st February 1998 :

Accurate and robust I & C AQs

- a) Transco will process an average of 3,000 AQ appeals per week. The number of AQ appeals processed will be averaged over 4 weeks or part thereof. The Standards of Service will be applicable from 19th January until less than 3,000 AQ appeals remain. It should be noted that AQ appeals must be submitted to Transco prior to the 31st January 1998.
- b) For each failure Transco will pay £10 to be apportioned to Shippers on the basis of their NDM reconciliation neutrality "smear".

- c) When the residual number of AQ appeals is less than 3000, Transco will process that residual balance in one further week. For each failure Transco will pay £10 per additional week (to be apportioned as in (b) above).
- d) All AQ appeals received by Transco prior to 31st December 1997 will be processed and returned to Shippers prior to 23rd January 1998.
- e) For each failure Transco will pay £20 to the Shipper who raised the appeal.
- f) AQ appeals should be raised together with supporting data as defined in the Network Code Section G1.6.8. However, where this supporting data is not available, Transco will consider any relevant supporting data submitted and try to process the appeal if possible.

Application of Meter Reads to Reconciliation

- a) If, following the processing of a Valid Meter Read, Transco take action to "suppress" the resultant Reconciliation Value, the "Suppressed Item" will be within the scope of this Standard of Service.

Note : the Reconciliation Value would have been destined to be used in the calculation of reconciliation charges on the Reconciliation Invoice at approximately M+15.

- b) If, following the processing of a DM Meter Read, Transco take action to "suppress" the resultant Reconciliation Value, the "Suppressed Item" will be within scope of this Standard of Service.

Note : the Reconciliation Value would have been destined to be used in the calculation of reconciliation charges on the Reconciliation Invoice at approximately M + 15.

- c) Transco will pay £20 for any Suppressed Item related to a NDM Reconciliation Value and pay £40 for any Suppressed Item related to a DM Reconciliation Value, below a planned performance level of 100%, that has not been released to the Reconciliation Invoice within two months following the one for which it was originally destined.

From 1st August 1998 this standard will change to:

Transco will pay £20 for any Suppressed Item related to a NDM Reconciliation Value and pay £40 for any Suppressed Item related to a DM Reconciliation Value, below a planned performance level of 95%, that has not been released to the Reconciliation Invoice within one month following the one for which it was originally destined.

- d) Transco will pay £30 for each further month that a NDM Suppressed item remains in the Suppressed Pot.

Transco will pay £60 for each further month that a DM Suppressed item remains in the Suppressed Pot.

- e) With the introduction of RbD it has been recognised that the risk of the reconciliation process has increased for RbD Shippers. Therefore the incentive payments will be aggregated into a RbD Incentive Pot and be apportioned amongst the RbD Shippers. It should be noted that I & C Shippers will benefit from the commitment to increased performance levels.

Apportionment will be on the basis of the RbD Market Share as defined by the "RbD Monthly sector".

- f) The Standard of Service does not apply to Reconciliation Values derived from :
- Smaller Supply Points;
 - unbundled Meter Readings.
- g) The Standard of Service applies to Reconciliation Values generated after RbD Day D.

4. Transco's opinion:

The implementation of RbD reduces the risk associated with the reconciliation process and changes the profile of the remaining risk between the I&C shippers and Domestic Shippers. Transco accepts that incentives are appropriate as attention is focused on the I&C reconciliation processes. Transco supports the view that the areas targeted and the level of liability are reasonable and appropriate if considered to be within the previously agreed caps on liabilities. To increase the level of the caps to accommodate this modification would, in Transco's view, represent an unjustifiable increase in contractual risk as RbD reduces the overall costs to the industry.

Transco believes a transition period is required whilst the systems for DCIII are fully implemented. The absolute figures proposed are therefore the Transco numbers moving to the Shipper figures on 1st August 1998.

Transco does not support the application, at this time, of an Incentives regime to the query management process. Transco has committed to develop (through Review Group 122) standards of service, to provide query management information and to then review the incentives regime at the appropriate time.

Transco does not support the proposal that interest should accrue on the size of the RbD sectors. Transco believes incentives should be targeted at the core issue (application of meter reads to reconciliation) rather than the resultant charges and should not be applied in areas where there is little direct influence on the outcome. To add an incentive in the form of interest would in effect create a double liability for Transco.

5. **Extent to which the proposed modification would better facilitate the relevant objectives:**

The proposed Modification has been developed to ensure that resources are focused on performance improvements in those areas identified as important to the ongoing reconciliation processes.

6. **The implications for Transco of implementing the Modification Proposal, including:**

a) **implications for the operation of the System and any BG Storage Facility:**

None.

b) **development and capital cost and operating cost implications:**

Some changes to existing Manual and IT systems are required to provide reporting information to the proposed Incentive regime. Any additional costs will be managed within existing budget provisions.

c) **extent to which it is appropriate for Transco to recover the costs, and proposal for the most appropriate way for Transco to recover the costs:**

No Impact

d) **analysis of the consequences (if any) this proposal would have on price regulation:**

No Impact

7. **The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal:**

This Modification Proposal will result in an increased level of contractual risk for Transco. Obviously, the greater the areas of the business subject to performance incentives then the greater the probability that incentive payments will be made.

The application of RbD would reduce the total level of risk in the market by reducing the potentially unsustainable cost of raising and processing invoice queries. The existing risk that all shippers are exposed to through the reconciliation neutrality process would, under an RbD regime, be borne by domestic shippers only. These domestic shippers benefit through the reduction in processing and administration costs that would be associated with domestic reconciliation. Thus the whole market benefits from the introduction of RbD.

8. **The development implications and other implications for computer systems of Transco and related computer systems of Relevant Shippers:**

Changes to Transco systems to create additional reports are required. Transco are not aware of any changes required for shipper systems to monitor incentive payments.

9. **The implications of implementing the Modification Proposal for Relevant Shippers:**

Shippers are more likely to receive the appropriate level of service required. Should this service performance fall below the expected level then the appropriate liability payments will be made.

10. **The implications of implementing the Modification Proposal for terminal operators, suppliers, producers and, any Non-Network Code Party:**

Improvements to the reconciliation process provide shippers with the opportunity to similarly improve their services to the end user.

11. **Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each Relevant Shipper and Non-Network Code Party of implementing the Modification Proposal:**

None.

12. **Analysis of any advantages or disadvantages of the implementation of the Modification Proposal:**

Advantages : provides incentives on performance thus increasing shipper confidence in the reconciliation process.

Disadvantages : Places increased risks on Transco.

13. **Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in the Modification Report):**

10 Shippers have made representations on this Modification Proposal, overall the Shipper representations are supportive of the proposals and the principles set out in Modification 202a. One shipper has provided the only representation against the proposal as, in their view, it is not close enough to the original Shipper proposals in Modification 202.

In general, the Shippers accepted the framework of incentives to coincide with the introduction of RbD, supported by a performance monitoring regime.

The Shippers made specific comments regarding the proposals in Version 0.3 :

Accurate and robust I&C AQs

Shipper Comments -

Shippers supported both the framework and the scale of the incentives.

The proposals appear to place no incentive on the residual AQ appeals once the 3000 per week target is exhausted.

The proposals do not explain how capacity rebates will be treated if Transco fail to process the pre 31st December 1997 AQ appeals by 23rd January 1998.

Transco comment -

Transco have clarified the proposal in this modification. Any residual appeals (<3000) will be cleared within one further week, or will attract a liability at the rate of £10 per outstanding appeal per week.

The capacity rebate will need to be discussed further. The most likely venue for discussion will be within the SPA/Metering Workstream.

Application of Meter Reads to Reconciliation

Shipper comments -

Shippers tended to support the framework, with some structural comments. Three Shippers stated that they preferred the Shipper incentive values.

Two Shippers were against the incentives creating an initial two month clearance period, although two Shippers were supportive of two months provided that it reduced to one month by 1st August 1998.

Some Shippers commented on the inappropriateness of deadbands.

One Shipper commented on the fact that this incentive payment will be made exclusively to domestic Shippers. They agreed with the principle.

Transco comments -

Transco believe that an initial two month clearance period provides incentives, whilst also recognising that it needs a transitional period in which to implement, test and establish the processes for managing the quality control aspects of suppressing and clearing reconciliation items.

The deadband concept is consistent with principles established within Review Group 072. The deadband for the transitional period is set at 100% reducing to 95% by the 1st August 1998.

Transco believe that a transition period better reflects the balance of costs and incentives.

Performance Monitoring

Shipper comments -

A number of Shippers commented on the need for financial values within the monitoring information.

A number of Shippers commented that the proposals did not represent sufficient commitment from Transco to the development of incentives for query management by a specific date.

One Shipper has asked that Transco consider what contingency rules should apply if the monitoring of the RbD Sectors indicates that unacceptably high or low reconciliation variances are flowing through to RbD reconciliation.

Transco comments -

Transco is fully committed to providing monitoring information, and to the ongoing development of industry standards in the management of queries.

Transco will include financial values within the suppressed pot and query management monitoring, and will work towards the timescales for query management incentives that Shippers suggest. However, Transco are unable to give a firm date for the introduction of query management incentives until the Industry (through Review Group 0122) develop a framework for managing queries against standards of service and appropriate incentives.

Transco believe that Review Group 174 should convene in February to discuss a number of post implementation issues. One of which should be the business rules that should apply if exceptional reconciliation values flow through to the RbD reconciliation process.

Interest on RbD Sectors

Shipper comments -

One Shipper was strongly in favour of the application of interest in order to indirectly incentivise Transco to manage the factors that influence the size of the reconciliation variances that flow into the RbD reconciliation process. Three Shippers were sympathetic to or supportive of this view.

Two Shippers supported Transcos view that the incentive was inappropriate. One of these recognised that the monitoring information will provide Transco and Shippers with evidence on the performance of reconciliation against which action can be taken by the industry.

Transco comments -

Transco are strongly against this incentive, and believe it to be inappropriate and inconsistent with the principles established within Review Group 072. Transco have no allowance in the formula for cost of capital.

Transco recognise that Review Group 0174 will need to agree a framework for reviewing the reconciliation performance measures following RbD implementation and as such it is not part of this modification.

Caps

Shipper comments -

Three Shippers supported the view that the incentives should be additional to the current incentive caps. A total cap of £10m was suggested.

Transco comments -

This question is wider than Modification 202a and should be considered within the framework of the total incentives package. Transco are opposed to any additional cap for these incentives, (referred to within section 3 and 7 above).

Letter of Intent

Shipper comments -

A number of Shippers believed that the commitments expressed in the letter were not strong enough. They particularly questioned Transcos stance on the caps and query management.

Further comments referred to ..

- * Transco acknowledging it's role as an AQ policeman in any future AQ process;
- * commitment to agreeing the 1998 AQ process by 1st March 1998;
- * incentives on the clearance of the suppressed pot prior to RbD;
- * review process to monitor RbD.

One Shipper asked that a revised letter of intent be sent prior to Ofgas signing Modification 194.

Transco comments -

The letter of intent does establish firm commitments from Transco.

The role of Transco in the management of AQs and the development of the AQ rules will be taken forward by the appropriate Review Group. Transco would also like to see a timely resolution of a manageable process but will look to the Review Group to agree the timescales.

Any clearance of the suppressed pot prior to RbD is linked to the adjustment of IQR and transitional issues that have been discussed in other forum. However, Transco do not believe that incentives are appropriate to this suppressed pot. Instead the Industry should consider mechanisms to facilitate the settlement process.

Review Group 0174 should consider future monitoring and review of RbD

Transco Response:

14. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation:

This Modification is not required to facilitate compliance with safety or other legislation.

15. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the Licence:

None.

16. Programme of works required as a consequence of implementing the Modification Proposal:

The appropriate processes and systems will be implemented.

17. Proposed implementation timetable (inc. timetable for any necessary information systems changes):

Modification report to Ofgas : 29th January 1998

Ofgas decision anticipated : 31st January 1998

Implementation : 1st February 1998

N.B. the proposal agrees to implement incentives related to AQs from the 19th January.

18. Recommendation concerning the implementation of the Modification Proposal:

Transco recommend that the Modification is implemented in accordance with the above timescales.

19. Restrictive Trade Practices Act:

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

20. Transco's Proposal:

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Director General in accordance with this report.

21. Text provided pursuant to Rule 9:

STANDARDS OF SERVICE 'SUPPRESSED' RECONCILIATION AND 1997/98 APPEALS¹

Add new Section E8:

"8. SUPPRESSED RECONCILIATION

8.1 General

8.1.1 In relation to Larger Supply Points with effect from the Reconciliation by Difference Date Transco shall investigate Suppressed Reconciliation Values following Individual NDM Reconciliation and DM Reconciliation where such was undertaken pursuant to a Meter Reading obtained by Transco pursuant to Section M3.6 and M4.1.

8.1.2 Those Reconciliation Values in respect of which this paragraph 8 will apply ("**Suppressed**" Reconciliation Values) shall be identified in the "**Network Code Reconciliation Suppression Guidelines**", the document so entitled prepared and revised from time to time by Transco (in consultation with Users).

8.1.3 For the purposes of this paragraph 8:

- (a) "**investigate**" means an investigation by Transco of the accuracy of a Suppressed Reconciliation Value;
- (b) "**relevant Reconciliation Billing Period**" is the Reconciliation Billing Period in respect of which an Reconciliation Invoice would have contained an Invoice Item derived from a Suppressed Reconciliation Value had not paragraph 8.1.4 applied;
- (c) for each LDZ for each Reconciliation Billing Period the "**User LDZ Suppressed Reconciliation Proportion**" shall be the User's User Aggregate Reconciliation Proportion for Monthly Individual Reconciliation calculated in accordance with paragraph 7.2.2.²

8.1.4 Where as a result of carrying out Individual NDM Reconciliation or DM Reconciliation a Reconciliation Value is Suppressed, the Suppressed Reconciliation Value will not be used for the purposes of calculating the relevant Invoice Items in a Reconciliation for the relevant Reconciliation Billing Period (Reconciliation Billing Period 'p').

¹ In the Modification Report Transco has reserved it's position as regards additional incentive payments.

² This is the User's share in the LDZ based solely on the 'monthly' pot calculated for RBD purposes.

8.2 [Suppressed] Reconciliation Values

8.2.1 In respect of each LDZ of each Reconciliation Billing period Transco will pay to the User the User's LDZ Suppressed Reconciliation Proportion of the amount (provided such amount is positive) calculated as the aggregate of:

(a)

$$((0.95 * A) - B) * £20 + (C * £30))$$

where following Individual NDM Reconciliation in Reconciliation Billing Period 'p'

- A is the number of Reconciliation Values Suppressed in Reconciliation Billing Period 'p - 1';
- B is the number of Reconciliation Value Suppressed in Reconciliation Billing Period 'p - 1' which are not Suppressed in Reconciliation Billing Period 'p';
- C is the number of Reconciliation Values Suppressed in any Reconciliation Billing Period before Reconciliation Billing Period 'p - 1' and which remain Suppressed in Reconciliation Billing Period 'p'.

(b)

$$((0.95 * D) - E) * £40 + (F * £60))$$

where following DM Reconciliation in Reconciliation Billing Period 'p - 0'

- D is the number of Reconciliation Values Suppressed in Reconciliation Billing Period 'p - 1';
- E is the number of Reconciliation Values Suppressed in Reconciliation Billing Period 'p - 1' which are not Suppressed in Reconciliation Billing Period 'p';
- F is the number of Reconciliation Values Suppressed in any Reconciliation Billing Period before Reconciliation Billing Period 'p - 1' and which remains Suppressed in Reconciliation Billing Period 'p'.

8.2.2 Amounts payable by Transco under paragraph 8 will be invoiced and payable in accordance with Section S.

TRANSITION DOCUMENT PART II

PARAGRAPH 7

Add new paragraph 7.10:

"7.10 1997/98 Appeals

"7.10.1 A **"1997/98 Appeal** is a notification (in respect of the Gas Year 1997/98) made by Users in respect of an NDM Supply Meter Point under Section G1.6.8(a) received by Transco prior to 31st January 1998.

7.10.2 For the purposes of this paragraph 7.10, Transco **"responds"** to a 1997/98 Appeal by either rejecting such appeal (on the grounds that the User has not complied with Section G1.6.8(b)(i) or notifying the User of the outcome under Section G1.6.8(b)(ii).

7.10.3 During each week, commencing from 19th January 1998 Transco will respond (in aggregate to all Users) to on average not less than 3,000 1997/98 Appeals (for which purposes such average will be determined over each consecutive period of four weeks commencing on 19th January 1998).

7.10.4 Without prejudice to paragraphs 7.10.5 and 7.10.6 until the beginning of the Day (Day 'd') on which there remain fewer than 3,000 1997/98 Appeals in respect of which Transco has not responded, where in any four week period Transco does not comply with the requirement in paragraph 7.10.3, Transco shall pay each User an amount calculated as follows:

$$UP * (N * (3,000 - AR) * £10)$$

where:

UP is the User's Reconciliation Neutrality Proportion;

N is 4 except in relation to the four week period in which Day 'd' falls where it shall be the number of weeks in the four week period prior to Day 'd';

AR is the average number of 1997/98 Appeals responded to in each week in each four week period.

7.10.5 Where, at the end of each consecutive week commencing on Day d, there remain any 1997/98 Appeals in respect of which Transco has not responded, Transco shall pay each User an amount calculated as follows :

$$UP * (£10 * RA)$$

where :

UP is the User's Reconciliation Neutrality Proportion;

RA is the number of 1997/98 Appeals in respect of which Transco has not responded at the end of such week.

- 7.10.6 Where Transco has not responded by 31st January 1998 to a 1997/98 Appeal notified to Transco prior to 31st December 1997 Transco will pay the User who submitted such 1997/98 Appeal £20.
- 7.10.7 A User's "Reconciliation Neutrality Proportion" shall be that proportion of the Reconciliation Neutrality Charges attributable to the user (whether payable by Transco or the User) in accordance with Section F6 in respect of the calendar month in which the end of the relevant four week, or weekly, period falls.
- 7.10.8 Amounts payable by Transco under paragraph 7.10 will be invoiced and payable in accordance with Section S."

PARAGRAPH 8

Section E : DAILY QUANTITIES, IMBALANCE AND NDM RECONCILIATION

Add :

- "E8.2.1 In respect of each LDZ for each Reconciliation Billing Period commencing prior to 1st August 1998 (Reconciliation Billing Period 'p') Transco will pay to the User the User's LDZ Suppressed Reconciliation Proportion of the amount (provided such amount is positive calculated as :

$$(((£20 * A) + (£40 * C)) + ((£30 * B) + (£60 * D)))$$

where:

following Individual NDM Reconciliation in Reconciliation Billing Period 'p'

- A is the number of Reconciliation Values Suppressed in any Reconciliation Billing Period 'p-2' which remain Suppressed in Reconciliation Billing Period 'p';
- B is the number of Reconciliation Values Suppressed in any Reconciliation Billing Period before Reconciliation Period 'p-2' and which remain Suppressed in Reconciliation Billing Period 'p';

following DM reconciliation in Reconciliation Billing Period 'p'

- C is the number of Reconciliation Values Suppressed in Reconciliation Billing Period 'p-2' which remain Suppressed in Reconciliation Billing Periods 'p';
- D is the number of Reconciliation Values Suppressed in Reconciliation Billing Period 'p-2' which remain Suppressed in Reconciliation Billing Period 'p';

Signed for and on behalf of Transco.

Signature:

John Lockett
Manager, Network Code

Date:

Director General of Gas Supply Response:

In accordance with Condition 7 (10) (b) of the Standard Conditions of Public Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference 0202a, version 1.4 dated 29/01/98), be made as a modification to the Network Code.

Signed for and on behalf of the Director General of Gas Supply.

Signature:

Kyran Hanks
Director of Transportation Regulation

Date:

The Network Code is hereby modified, with effect from _____, in accordance with the proposal as set out in this Modification Report, version 1.4

Signature:

Process Manager - Network Code
Transco

Date:

ANNEX

Restrictive Trade Practices Act - Suspense Clause

For the purposes of the Restrictive Trade Practices Act 1976, this document forms part of the Agreement relating to the Network Code which has been exempted from the Act pursuant to the provisions of the Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996. Additional information inserted into the document since the previous version constitutes a variation of the Agreement and as such, this document must contain the following suspense clause.

1. Suspense Clause:

- 1.1 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 shall not come into effect:
- (i) if a copy of the Agreement is not provided to the Director General of Gas Supply (the "Director") within 28 days of the date on which the Agreement is made; or
 - (ii) if, within 28 days of the provision of the copy, the Director gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraph 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996.

provided that if the Director does not so approve the Agreement then Clause 1.2 shall apply.

- 1.2 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 shall not come into effect until the day following the date on which particulars of this Agreement and of any such arrangement have been furnished to the Office of Fair Trading under Section 24 of the Act (or on such later date as may be provided for in relation to any such provision) and the parties hereto agree to furnish such particulars within three months of the date of this Agreement.