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UNC Modification Proposal 0122
“Restriction of the Invoicing Billing Period to Price Control ”

Dear Julian,

Thank you for your invitation seeking representation with respect to the above Modification Proposal.

General

As drafted we understand that this revised Urgent Modification Proposal seeks to implement a fixed 1st April 2002 backstop to all invoices and initiate a Review Group to consider more *‘sophisticated reconciliation closure mechanisms’*.

National Grid NTS is unable to support the implementation of this Modification Proposal and provides details of the following key concerns, within this response:-

- **Ex-post nature of the Proposal.**
- **Undue discrimination in favour of a sub-set of Users to the detriment of other Users and therefore to competition between Users.**
- **Movement away from current rules applying to LDZ Meter error reconciliations before current outstanding reconciliations are completed.**
- **Consideration of the Invoicing Query Resolution (IQR) processes.**
- **Potential implementation issues (operational and systems).**

Ex-post nature of the Proposal

We are concerned that the sub-text of the Proposal seeks, not only to address invoice processes into the future, but also to amend the outcome of a notified and pending invoice reconciliation (SE LDZ meter error) through the implementation of fundamental changes to

the UNC Invoicing processes. Under current UNC rules this notified invoice is being held back solely to comply with the industry agreed “0643” process.

We consider that the proposed changes have been raised in the absence of sufficient evidence that the consequences and effects such a change may have on perceived improvements to invoicing and any perceived improvements to meter validation have been fully considered.

We therefore can only assume that the primary, objective of *this* Proposal is to address the SE LDZ meter error.

The Proposer states that the, *“Fixed date of the 1 April 2002 will be the basis for resolution of the Farningham issue.”* We question whether it is appropriate that the proposed introduction of limits, to invoicing of retrospective billing periods can relate to an event which has already occurred; the process for their resolution is clearly stated in the UNC, the risks from which should have been factored into Shippers’ contract prices. It is our opinion that it is not appropriate to reduce materialised contractual risks through a Modification to the UNC in this manner.

We are concerned that the intent of this Proposal is to use the UNC Modification process to address a specific and known dispute. We believe that capturing a currently known and disputed error through the introduction of a proposed revision of the close-out date is not consistent with the intent and purpose of the UNC Modification process and would be inconsistent with previous regime changes.

Undue discrimination in favour of a sub-set of Users to the detrimental impact of other participants

We believe that if implemented this Proposal would introduce undue discrimination in favour of a sub-set of Users (i.e. those with a current NDM portfolio within the SE LDZ), in that the change ensures settlement to those affected Users in the absence of quantifying the affects such a revision may have on the rest of the industry. We consider that initiating change to the UNC for retrospective events may increase industry risk resulting from uncertainty regarding whether changes may be made after the fact.

Consideration of IQR processes

We are concerned that whilst this Proposal suggests that this change will affect all invoices, the proposer is only addressing the issue relating to the recent SE LDZ meter error and fails to consider any other issues which may need to be resolved prior to the implementation of any revision to the ‘line in the sand’. We note that the introduction of the current ‘line in the sand’ Reconciliation By Difference Date (1st February 1998) was achieved only after extensive industry engagement and agreement on all issues identified through the Invoice Quality Review (IQR) process, this taking approximately 3 years through to completion. This IQR process also ensured that any pending and notified invoicing issues were resolved before the changes were made.

Ex-post changes to the UNC

We continue to support the principle of introducing an efficient and economic limit to invoicing for retrospective billing periods and have maintained the position that agreement on an appropriate period must be reached through industry-wide discussion. However the primary objective of the Proposal is little to do with arrangements going forward and that the urgency request is based on seeking change to events and procedures, which have already taken place and are being processed through previously agreed contractual processes and licence obligations. We are concerned that, if implemented, 0122 may create a precedent, in respect of allowing ex-post changes that might introduce a new risk dimension to Transporters, that should be reflected in upwards pressure on any cost of capital allowed in future price control periods.

Previous LDZ meter error reconciliations

We note that over the last 4 years there have been two prior occasions where the LDZ Meter Error Reconciliation process described in the UNC has been completed (E.R.S.T offtake where the error covered a period of 01/02/1998 to 26/11/2002 and Blackrod where the error covered a period of 09/02/2004 to 26/04/2004), on both occasions these errors resulted in invoicing net credits to Users. One of these reconciliations also spanned the most recent two price control periods. We note that on both occasions, the reconciliation was processed in the absence of any challenge from the Users.

NTS Shrinkage Incentive Allowance

BGT states that its proposed approach *'recognises that each Price Control period is discrete and sums of allowed revenue within each Price Control are effectively agreed and closed out.'* We agree that arrangements regarding each Price Control, and agreements made between the Transporter and the Authority regarding relevant Allowed Revenues, are discrete. We also agree that it is not appropriate that UNC changes to affect the amount of Allowed Revenue previously agreed between the Regulator and Licensee through licence and Price Controls arrangements.

For the purposes of clarity we note that, during the pre-incentive period relevant to the SE LDZ Meter Error (1997 – 2002) the Shrinkage Provider accounted for the cost of Shrinkage as an actual operating cost. Therefore correcting for a misallocation of cost in the past, as a result of errors, does not affect the Allowed Revenue of the Transporter and is actually a correction to the 'bottom line' cost incurred by the Transporter. Such costs may legitimately, be recovered through contractual arrangements provided for in the UNC and the GT Licence. We believe it is inappropriate that a change to the UNC should impact agreed contractual and licence arrangements for a previous Price Control. Therefore, to the extent that costs were incurred by the Shrinkage Manager that should not have been incurred, then these costs should be recovered from those parties that are the present beneficiaries of such an incorrect allocation of costs.

With the initiation of the Shrinkage Incentive in 2002, the Shrinkage Provider was incentivised to minimise the costs of the provision of Shrinkage. The actual costs incurred are 'passed through' the NTS SO Price Control to customers, albeit adjusted for aggregate performance under that incentive. Therefore, Users would benefit fully from a correction of previously misallocated costs for errors enduring post 2002. The mechanism for passing through these adjustments is the SO Commodity Charge.

Restricting the invoice billing period does not create any additional incentives for Transporters to seek out meter errors in a more timely fashion under the present price control frameworks; this is because the majority of the costs are made up of the energy component of the volume incorrectly measured. The present price control framework passes these costs through to Users (subject to an adjustment arising from aggregate performance under the incentive).

Therefore, this Modification Proposal must be ineffective in changing Transporter behaviour as it cannot, on its own, materially increase the cost risk to the Transporters or meter asset owners. Consequently, this gives further weight to our argument that this change only seeks to opportunistically benefit a small group of Shippers in respect of legitimate costs arising under the present UNC arrangements.

Meter Ownership

Through the Shrinkage Incentive, the Shrinkage Provider is incentivised to reduce all aspects of Shrinkage, one of these aspects is reducing the amount of shrinkage resulting from meter error. This has been achieved through improving the quality of meter validation. Prior to DN sales it is true to say that the Shrinkage Provider, through the Shrinkage Incentive, was appropriately incentivised to improve meter validation. However under the current regime, with the DN adopting meter ownership at the NTS DN boundary, we believe that there may be merit in reviewing meter validation requirements. We suggest that these would benefit from industry discussion to determine the best way forward.

Recognising DN LDZ meter ownership, and therefore that meter validation is predominantly the responsibility of the DNs, that are not directly affected by the Shrinkage Incentive we fail to see how the proposed introduction of a revised 'line in the sand', from the current 1st February 1998 backstop to 1st April 2002, would provide any greater improvement to quality and timeliness of meter validation and assurance. We do not believe that putting a line in the sand would provide any greater incentive than the current Shrinkage Incentive.

Potential implementation issues (operational and systems)

We note that the Proposer seeks to implement the revised 'line in the sand' date by the 13th December 2006. We are concerned that the introduction of a change of this magnitude, affecting all invoices which relate to retrospective periods, in the timescales proposed will either not be possible or would involve significant risk to the current invoicing processes. Additionally we believe that prior to any revision of the 'line in the sand' date it may be necessary and appropriate to undertake a similar level of work, as achieved through IQR, to

ensure settlement of all issues that have already been notified. Furthermore, the Modification Proposal has provided no indication of the level of cost that might be incurred in carrying the change proposed across all invoicing processes so that a proper cost benefit analysis can be performed to inform any decision making process. The raising of this Proposal on an urgent timescale has meant that we have been unable to provide costs in this area.

Further Industry Debate

We believe that the introduction of any revised limits relating to the invoicing of retrospective billing periods within the UNC invoicing regime would benefit from detailed industry wide discussion and development lead by those parties most directly affected by changes in this area. Any such developments should consider an appropriate and achievable implementation plan, accounting for any necessary system, operational, asset and UNC changes to determine whether the benefits outweigh the cost. Additionally any change should consider all the parties and assets that contribute to the invoicing processes.

The proposer addresses only those consequences that such a change would have in respect of LDZ reconciliation, and in particular the recent SE LDZ meter error. These concerns regarding the implementation of this Proposal are similar to the concerns previously stated in our response to Urgent Modification Proposal UNC0117 – ‘Amendment to Invoice Billing Period’. We believe that if implemented the proposed changes to the UNC billing regime would affect numerous existing processes and systems, and entails much greater implications than those currently identified by the proposer. Additionally we are concerned that the implementation of this Proposal within the proposed timescales is, potentially undeliverable and as a result carries greater risk than the perceived benefits which may be achieved only for a subset Users. Unfortunately given the timetable of this proposal’s development and consultation it has not been possible to establish to full effects on current systems and processes and therefore the above comments are based on the experience of previous changes in this area.

We would welcome further clarification, from the proposer, as to which invoices would be limited by this change. In the absence of greater clarity we presume that this Proposal as drafted affects all UNC invoices in a similar manner to the intent of Modification Proposal UNC0117.

We welcome the proposer’s stated intent to raise a UNC Review Group to consider further ‘*arrangements for reconciliation in a wider context*’. NGG would seek to play an active and full role in such a review. However we believe that such discussion should take place prior to the implementation of the changes proposed within this Proposal for the reasons detailed above.

Extent to which implementation of the proposed modification would better facilitate the relevant objectives

In respect of SSC A11.1 (a) – We do not believe that this Proposal demonstrates improvements in the economic and efficient operation of the system. The proposer suggests

that the proposed changes will increase incentives on Transporters to improve meter validation. We fail to see how such a proposed change to the UNC would create any greater incentive on Transporters, to improve meter validation, than current arrangements. Transporter incentives are set through the Price Control. Any adjustment to such incentives could only be achieved through a revision to the GT Licence Section 22. We do not believe that a UNC revision as proposed would affect these incentives. The majority of the financial adjustment related to the SE LDZ meter error is related to the energy component of the error. As such there is a far greater incentive on Users to improve gas measurement accuracy and this relationship is reflected in the current Shrinkage Manager incentives.

In respect of SCC A11.1 (b) – We do not believe that the proposed introduction of fixed 1st April 2002 backstop limit to retrospective billing periods provides any discernable improvement to the timely provision of accurate meter validation, than currently required under prevailing arrangements. Given that that the Proposal may not mitigate the cause (improvements in meter validation), we question whether it would improve the symptoms (reducing reconciliation invoicing) either. Although, we are not responsible for the validation of meter readings, we do have a licence obligation to ensure that charges reflect costs and that such costs are economic and efficient. We believe that a 1st April 2002 backstop compromises our ability to appropriately allocate and target costs. We therefore do not believe that, as drafted, this Proposal demonstrates an improvement to the co-ordinated, economic and efficient operation of the combined pipe-line systems.

In response to the proposer's assertion that the Proposal would improve the System Operators role, as previously stated, and in response to Modification Proposal 0117, we do not believe that this Proposal would have any discernable affect on the Management of the System.

In respect of SSC A11.1 (c) – We believe that this Proposal compromises our ability to efficiently discharge this licence obligation. The introduction of an April 2002 fixed backstop to invoicing of retrospective billing periods may curtail the ability to appropriately target costs and benefits in an economic and efficient manner across all appropriate parties.

In respect of SSC A11.1 (d) – The Proposer suggests that improvements in respect of *'accurate information around volumes transported through the network is essential to shipping function'*. We agree with this statement; however we do not believe that this Proposal, as currently drafted, achieves this, in that it does not introduce any greater incentive on meter asset owner or Users, to provide accurate, timely meter validation, than is required under prevailing UNC obligations.

We believe that the principle of introducing an efficient and economic limit to invoicing of retrospective billing periods may better facilitate effective competition between relevant Shippers, Suppliers and meter asset owners, as such a change may reduce User exposure to the uncertainty of financial risk associated with retrospective billing periods. However we do not believe that, as proposed, an April 2002 backstop, would achieve this in an appropriate and non-unduly discriminatory manner. We consider that the change proposed could have the potential of unduly discriminating in favour of NDM portfolio Users within the SE LDZ at the expense of all other market participants, including potential system and

operational costs for implementing such a change, therefore we do not believe that this better facilitates effective competition between Users.

The Proposal indicates that any further '*sophisticated reconciliation mechanisms*' could be achieved through a proposed Review Group. This corroborates our view that simply moving a close out date from Feb 1998 to 1st April 2002 does not better facilitate the relevant objectives as no additional sophistication is suggested in the Modification Proposal. The assertion that this modification reduces future adverse risk for Shippers is only true for those Shippers that suffer reconciliations that are to their detriment. In practice once the risks across the whole spectrum of market participants is considered the net effect must by definition be zero as those that benefit will do so to exactly the same degree as those that are adversely affected.

We note that in its decision letter to Network Code Modification Proposal 642 – 'Withholding of energy charge where LDZ reconciliation has been disputed' – Ofgem stated that, "*Whilst significant and unforeseen energy reconciliations can reduce certainty for both the GT and Users, it is correct that energy balancing revenues be adjusted in light of better information about the actual off-take of gas. Ofgem also agrees with Transco, that such reconciliations may result in a credit to users, rather than a debit as in this case. It would be unreasonable to deprive any party of monies they were due by introducing an inappropriate point of cessation.*" We believe that our concerns set out here demonstrate that this Proposal is not consistent with the above statement.

The implications of implementing the Modification Proposal on Security of Supply, operation of the Total System and industry fragmentation

We do not believe that this Proposal, if implemented, would have a beneficial effect on our licence obligations in respect of Security of Supply (SoS), as suggested by the proposer.

The proposer suggests that if implemented, this change would incentivise improved meter read accuracy and thus consequently improve Security of Supply and Balancing decisions taken within-day. We do not believe that this Proposal if implemented would facilitate any improvement to the meter validation. Also, for the same reasons as detailed in our recent response to UNC Modification Proposal 117, we do not consider that this proposal will have any discernable effect on the decision making process relating to system balancing.

The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

Whilst not directly related to the operation of the System, we are concerned that, if implemented, this Proposal will have implications on the operation of UNC Billing systems. We do not believe that all such implications and risks have been fully rationalised or considered within this Proposal. And due to the timescales of this proposal we have not had sufficient time to complete our own assessment of these systems impacts.

We do not believe that this Proposal, if implemented, would provide any improvement in respect of System Operation, as has been suggested by the proposer and would again point to our response to UNC Modification Proposal 117 in this area.

b) development and capital cost and operating cost implications:

We consider, from experience of previous changes in this area, that IS systems development costs will be high.

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

Recover through current Internal costs incentive

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

No such consequences identified.

The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

Whilst this Proposal in itself does not increase contractual risk, the consequences of implementing such a change may be seen to set a precedent in which further disputes are addressed through retrospective changes to the UNC, this may increase contractual risk to Transporters.

The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

We are concerned that if directed to implement this Proposal, within the prescribed timescales, there is a risk that the IS systems and operational billing process changes, required to support such a change, may not be deliverable without compromising the integrity of the UNC Billing systems. We currently believe, based on past experience in this area of change, that such risks outweigh the benefits perceived by the proposer.

The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

Although this Proposal in itself does not increase contractual risk, the consequences of implementing such a change may be seen to set a precedent in which further disputes are addressed through retrospective changes to the UNC, this may increase contractual risk to Users.

Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

No such consequences identified

Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Disadvantages

- Will curtail the ability of NG NTS to maximise the efficient and economic targeting of costs.
- Positively and unduly discriminates in favour of a sub-group of Users to the detriment of other Users and therefore to competition between Users.
- Unlike previous industry changes in this area the Proposal does not seek the settlement of all existing notified invoices or other billing issues prior to changing the close out period the billing process.
- Undermines the principals of the UNC change process relating to retrospectivity of change, setting a precedent which would increase the perceived risk for all parties from the application of retrospective changes.

The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

No such implications have been identified.

The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

No such implications have been identified.

Please let me know if you require any further information to enable preparation of the Final Modification Report.

Yours sincerely

Ritchard Hewitt