

## Stage 02: Workgroup Report

# 0429: Customer Settlement Error Claims Process

At what stage is this document in the process?

- 01 Modification
- 02 Workgroup Report
- 03 Draft Modification Report
- 04 Final Modification Report

This modification creates a claims process that will allow Shippers to correct settlement errors for the period after the close out of reconciliation up to the statute of limitations.



The Workgroup recommends that this modification should proceed to Consultation.



High Impact: Suppliers, Shippers, Customers



Medium Impact: -



Low Impact: -

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## About this document:

The purpose of this report is make a recommendation to the Panel, to be held on 15 November 2012, on whether Modification 0429 should proceed to Consultation and to submit any further recommendations in respect of the assessment of this modification.



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# 1 Summary

## Is this a Self-Governance Modification?

The Modification Panel determined that this is not a self-governance modification.

## Why Change?

At present the UNC limits all retrospective invoices to a period between 4-5 years, depending on when the invoice is triggered. This creates a mismatch between the current reconciliation window and the Limitation Act that governs all contracts, allowing invoices to be queried and adjusted if necessary for a period up to 6 years from the time of action. This means that any energy invoices between Shippers and Customers that are adjusted for the full period allowed under the Limitation Act cannot be fully reflected in energy allocation in settlement under the current UNC processes. On a case-by-case basis, this could also lead to legal action between Shippers and Transporters where a Shipper has been charged for energy and transportation that it has not used.

## Solution

The solution to the problems identified above has two main components:

- Creation of a claims process for Shippers to use when major loss is incurred in the gap between the end of the reconciliation window and the Limitation Act.
- Related adjustment of the AUGE process to address the impact of a shorter reconciliation process than the Limitation Act.

## Impacts and Costs

The AUGE assessment of any mismatch between the reconciliation period and the Limitation Act will provide increased certainty that costs are being allocated correctly. Providing a settlement error claims process up to the Limitation Act period will reduce the financial risk exposure currently facing Shippers. In particular this would give added protection to smaller Shippers that could otherwise be made financially unviable by a mismatch between the Limitation Act and the reconciliation period.

It is envisaged that, if central systems changes are required to support this modification, this will be a User Pays Modification.

## Implementation

- **01 April 2013 if a decision is received prior to 01 December 2012**
- 01 April 2014 if a decision is received after 30 November 2012 and prior to 01 December 2013
- If a decision is received after 30 November 2013 implementation should be on the following 01 April that is at least 6 months after the decision date.

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## The Case for Change

The current processes do not recognise the mismatch between the Limitation Act and the UNC reconciliation period. Recognising this mismatch through a claims process and the annual AUGE assessment will, first, reduce the risk that Shippers have no option but to take legal action against the Transporters in order to recover unavoidable losses incurred outside of the reconciliation period and, second, will ensure that costs are more accurately targeted.

As the risks from the mismatch in periods are often unpredictable and beyond a Shipper's control, but with potentially large financial consequences, the inclusion of a claims process will help ensure that smaller Suppliers and Shippers that are least able to manage such large and unpredictable risks are not unduly disadvantaged, thereby helping to reduce barriers to entry and facilitate effective competition (*Relevant Objective (d)*).

## Recommendations

The Workgroup recommends that this modification should now proceed to Consultation.

## 2 Why Change?

### ***Mismatch between Limitation Act and UNC reconciliation window***

The Limitation Act 1980 limits the enforcement of commercial debt to a period of six years. Furthermore, the effect of Unfair Contract Terms Act 1977 is such that it will prevent Shippers from contractually aligning their and their customer's cost exposure to the timescales of the UNC process when a clear settlement error has occurred. Standard contracts are usually used which means any ability to limit a customer's time to pursue a claim will always be subject to a test of reasonableness which by its very nature will depend on the circumstances in each case. This means that there is currently a gap between the period for which a Shipper or customer can claim back costs incurred under their commercial arrangements, and the period for which settlement accommodates this correction.

In the event that an over-recording of customer consumption is identified, this mismatch in time limits leaves Shippers exposed to repayment of costs to their customers that they are unable to back off in settlement, with the full amount of gas initially, and inappropriately, allocated to that Shipper remaining unchanged. Conversely, when a customer's energy consumption is found to have been under-recorded, then the Shipper is unable to reflect this in settlement, so potentially gaining a windfall since the industry is not compensated for the gas that was inappropriately allocated to each Shipper.

The current reconciliation window is mismatched to the Limitations Act by one to two years for a period four to five years ago. This creates a small amount of risk that any adjustment made to a large meter or a large number of smaller meters in the period of the mismatch may create a significant loss. This risk is relatively low for many Suppliers due to the size of the mismatch, the length of time in the past that this exists and the nature of their portfolios. For a few niche Suppliers, with many larger meters, this risk may be more significant since the scale of any adjustment is potentially large.

Were the industry to consider any further shortening of the current reconciliation window then this would have significant impacts on the settlement process and the market in general. For example, if a reduction to a 2-3 year reconciliation time limit were proposed, the amount of energy that will not be reconciled as a consequence would be in the region of 2.5-3.5% of total throughput. This would represent a significant increase over the current 1.5-2.5%<sup>1</sup> that the current 4-5 year time limit results in.

The impact this may have on the LSP NDM market has been shown by the analysis undertaken by Xoserve on UNC Modification 0395/0398 and presented to the industry on 26 April 2012. The following data shows (as of 31 December

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<sup>1</sup>Source: Xoserve presentation to UNC distribution workgroup 26 April 2012.

2011) shows an estimate for the amount of energy (kWh and £) that may be yet reconciled for those years.

Calendar Year	Historic Reconciliation Percentage	Unreconciled Estimate of Rec (mWhrs)	Unreconciled Estimate of Rec £000
2007	-4.62%	-187,084	-3,577
2008	-5.98%	-274,455	-5,247
2009	-4.59%	-202,738	-3,876
2010	-2.47%	-138,807	-2,654
2011	-1.85%	-361,009	-6,902

NB: these figures do not reflect potential adjustments for DM sites, which individually would be much greater.

These figures demonstrate that the current cut-off date creates a situation where a Supplier may be unable to easily correct significant, and for a smaller Supplier, potentially business ending errors in settlement.

A claims process would counter this risk as it would allow the Shipper to claim for significant energy and transportation costs where a consumer had made a claim against them for the period outside of the normal reconciliation process (under the Limitations Act) and would avoid the need for legal challenge to correct the error.

### **Impact on AUGÉ processes**

A key finding of the AUGÉ process has been that many aspects of Unidentified Gas are temporary in nature and will eventually be allocated back to an individual Shipper through the reconciliation process. The Customer Settlement Error Claims Process will not result in changes to reconciliation and so there seems to be a need to recognise, through the AUGÉ process, that some sources of Unidentified Gas would not be corrected owing to the current reconciliation backstop date.

### **Why there is a risk of legal challenge**

It has been noted above that the current backstop date impacts how Shippers can recover their costs for incorrect gas allocations that have been corrected with their customer. As we have noted the current reconciliation cut-off date limits how far a Shipper can currently undertake adjustments through system processes, but as acknowledged by Ofgem:

*"The reconciliation process is not in itself a remedy for contractual breach but a discrete operational process provided for and operated in accordance with the UNC contract. Where contractual obligations are imposed on parties breaches of these obligations may give rise to contractual claims and the Limitation Act provides that such claims would, as a general rule, have to be brought within six years. This is not affected by the length of time within which reconciliation can occur".*

11 October 2007: Ofgem Decision Letter 0152V/AV/VB

There is agreement with Ofgem's assessment that Shippers still have the right under contractual law to correct the cost allocation in the event that there has been a clear error. In this case the billing error would sit with the organisation

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that has undertaken the energy allocation or transportation activity. At present however there is no clear mechanism for this to occur and a Shipper will have to rely on a legal process to correct any significant cost error.

### 3 Solution

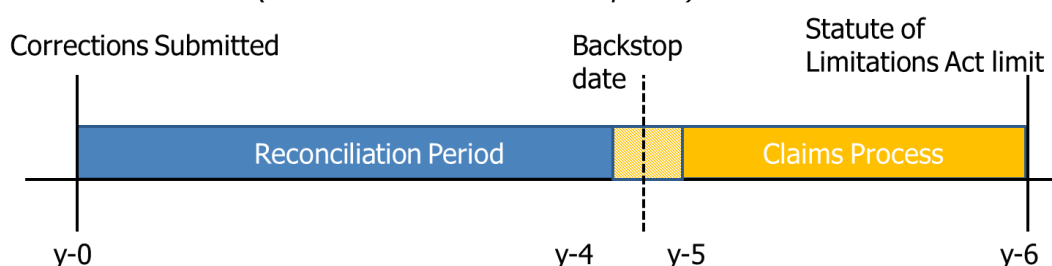
The solution to the problems identified above has two main components:

- Creation of a claims process for Shippers to use when major loss is incurred in the gap between the end of the reconciliation window and the Limitations Act.
- Related adjustment of the AUGE process to address the impact of a shorter reconciliation process than the Limitations Act.

#### Settlement Claims Process

To remove the financial exposure that Shippers face as a result of this misalignment, it is proposed that a Customer Settlement Error Claims Process is developed. This process will allow Shippers, when customer bills are adjusted, to correct Settlement Errors for periods between the closeout of the settlement window and up to the maximum time permitted by the Limitations Act, as illustrated below.

*Illustration of Process (current reconciliation backstop date)*



It is intended that this process will be used relatively rarely to correct material errors and will only be used where the nature and materiality of the error can be clearly demonstrated. It therefore will be a relatively manual process with the Shipper expected to submit the claim and evidence supporting the claim to the Transporter's for validation. For the avoidance of doubt, the Customer Settlement Error Claims Process will not impact the period covered by the reconciliation process, concerning itself with the period after reconciliation has closed out.

#### *Initiation of Customer Settlement Error Claims Process*

It is intended that this process will be triggered by the Shipper submitting a Customer Settlement Error Claim to the Transporter's Agent. It is proposed that there is a limit of total materiality of the error that cannot be corrected by the normal reconciliation processes of [£50,000] as determined below. The materiality criteria would be applied to an individual Supply Point or a group of Supply Points. In the latter case the error would have to be caused by the same root cause (e.g. error identified with a class of meters or systemic errors with correction factors for a class of customer). These customers can be connected to different networks as the claim is against the system as a whole.

#### *Content of Settlement Error Claim*

In addition to this materiality threshold, customer agreement would need to be obtained for any correction (which may mean multiple agreements if a group of customers are impacted). If the error meets the eligibility criteria, the Shipper would be expected to provide to the Transporter's Agent the following:

- Detail on the nature and duration of the error, detailing its materiality in terms of volume of gas as well as an estimate of its financial impact in terms of energy and transportation costs. When determining the cost of the error with regard to energy, it is expected that the Shipper would reference the monthly average of the System Average Prices for the period in the claim. When determining the transportation cost, the Shipper would reference the relevant Transportation charges in effect at the time of the claim.
- The dates for which the Customer Settlement Error Claim will apply. This will only cover the period after which normal settlement reconciliation closes out, up the limit under the Limitations Act.
- Written confirmation from the customer(s) that they agree with the Shipper that an error has taken place and the overall materiality of the error, as well as the timescales that the error covers.
- Evidence of the Shipper and customer bills relating to the Supply Point to demonstrate loss.

#### *Processing of Settlement Error Claim*

Once received, the relevant Transporters would have 28 days to evaluate the claim and either approve or reject it. During that time the Transporter's Agent would have the ability to ask for additional information to clarify the Customer Settlement Error Claim.

Prior to any legal action, if the Transporter's Agent rejects the claim then the Shipper or Transporter has 14 days to appeal to a suitable arbitration body. In line with normal commercial practices, the party seeking arbitration will supply three suitable arbitration bodies in event of a dispute, with the other party choosing one of the three bodies. Reasonable costs will be borne by the side that the arbitration body rules against unless otherwise directed by the arbitration body.

#### *Resolution of Settlement Error Claim - Energy Correction.*

In order to preserve the integrity of the settlement process, it is proposed that any energy financial adjustment shall be included in Balancing Neutrality as part of the Monthly Adjustment Neutrality Amount. For the purposes of this process, the value of the Customer Settlement Error Claim will be determined by multiplying the average SAP for the period that the Monthly Adjustment Neutrality Amount will apply by the volume of the Customer Settlement Error Claim. The Shipper will either then pay or be paid this amount as appropriate. Where any charges above £1million are to be applied, the Transporter's agent will issue a notification to Shippers. In such cases the charges will be applied two months after the Customer Settlement Error Claim is approved.

#### *Resolution of Settlement Error Claim - Transportation Correction.*

The relevant Transporter(s) will determine the value of the Customer Settlement Error Claim by multiplying the volume of the Customer Settlement Error Claim by the relevant transportation charges, with the Shipper being paid or paying that amount as appropriate. Any financial adjustment would be incorporated into 'k' by the Transporter.

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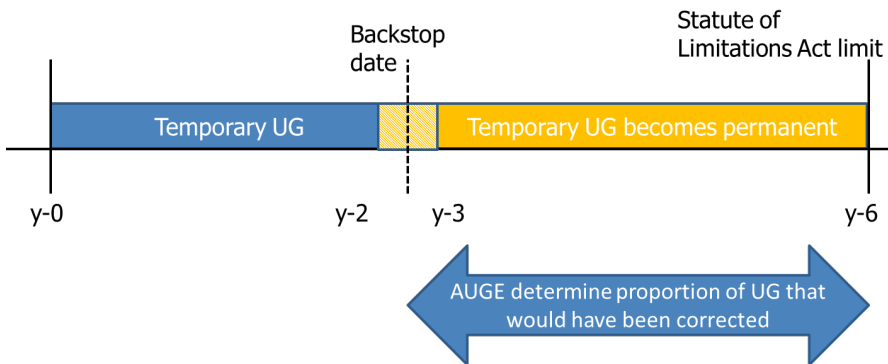
### AUGE Process Adjustment

The current AUGE process attempts to determine the scale of Unidentified Gas that is present in the settlements process. A key factor in determining the amount of Unidentified Gas that exists is determining which sources of unidentified gas are permanent (i.e. will never be allocated to an individual Supply Point) or temporary (i.e. will eventually be corrected at some point and allocated to an individual Supply Point).

Shortening the current reconciliation time period will shorten the period in which settlement errors are corrected. It will therefore increase the amount of Unidentified Gas and other energy in the system that cannot be corrected through the reconciliation process and so be classified as permanent Unidentified Gas. The Settlement Error Claim process above will allow for a process to correct settlement errors beyond the reconciliation window, which may include corrections for sources of gas use which would have been originally classified as Unidentified Gas.

It is therefore proposed that the AUGE be required to make an assessment of the amount of energy that would have been corrected (and so be classed as temporary Unidentified Gas) were it not for the close out of the reconciliation window.

*Illustration of Proposed AUGE process adjustment.*



The AUGE would detail the materiality of this "fossilized" Unidentified Gas and adjust the resulting Unidentified Gas volumes accordingly.

## 4 Relevant Objectives

Impact of the modification on the <b>Relevant Objectives:</b>	
Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	None
c) Efficient discharge of the licensee's obligations.	None
d) 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.	Positive
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code.	None
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

*Relevant Objective (d) 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 proposed process allows Shippers to claim for material settlement inaccuracies that cover the period between the closeout of reconciliation and the Limitations Act. Reducing risk to Shippers will reduce costs to the industry overall and reduce a barrier to entry, and so benefit competition.

Allowing the AUGÉ to assess any inconsistencies between the reconciliation period and the Limitations Act will ensure that costs are allocated more accurately, with parties facing the costs they impose helping to avoid market distortions and thereby promoting effective competition.

## 5 Impacts and Costs

### Consideration of Wider Industry Impacts

No wider industry impacts identified.

### Costs

Indicative industry costs – User Pays	
Classification of the modification as User Pays or not and justification for classification	
Minor costs in operating the claims process are expected, but no systems implications. Any costs for the AUGE should be minor and should follow the existing methodology for the AUGE costs. Since no systems changes are involved this is not classified as a User Pays Modification.	
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification	
N/A	
Proposed charge(s) for application of Users Pays charges to Shippers	
N/A	
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from Xoserve	
N/A	

### Impacts

Impact on Transporters' Systems and Process	
Transporters' System/Process	Potential impact
UK Link	<ul style="list-style-type: none"> <li>None</li> </ul>
Operational Processes	<ul style="list-style-type: none"> <li>Minor changes for the Transporter Agency to assess claims.</li> </ul>
User Pays implications	<ul style="list-style-type: none"> <li>None</li> </ul>

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	<ul style="list-style-type: none"> <li>Those wishing to claim would need to establish a process for doing so.</li> </ul>

## Where can I find details of the UNC Standards of Service?

In the Revised FMR for Transco's Network Code Modification

### **0565 Transco Proposal for Revision of Network Code Standards of Service**

at the following location:

<http://www.gasgovernance.co.uk/sites/default/files/0565.zip>

Impact on Users	
Development, capital and operating costs	<ul style="list-style-type: none"> <li>• None</li> </ul>
Contractual risks	<ul style="list-style-type: none"> <li>• This process will remove the potential for Shippers to be exposed to costs from customer invoice corrections that could not be backed off by settlement corrections.</li> </ul>
Legislative, regulatory and contractual obligations and relationships	<ul style="list-style-type: none"> <li>• None</li> </ul>

Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	<ul style="list-style-type: none"> <li>• None</li> </ul>
Development, capital and operating costs	<ul style="list-style-type: none"> <li>• None</li> </ul>
Recovery of costs	<ul style="list-style-type: none"> <li>• None</li> </ul>
Price regulation	<ul style="list-style-type: none"> <li>• None</li> </ul>
Contractual risks	<ul style="list-style-type: none"> <li>• Reduction in risk of legal action under Limitations Act if no corrections are made.</li> </ul>
Legislative, regulatory and contractual obligations and relationships	<ul style="list-style-type: none"> <li>• None</li> </ul>
Standards of service	<ul style="list-style-type: none"> <li>• None</li> </ul>

Impact on Code Administration	
Area of Code Administration	Potential impact
Modification Rules	<ul style="list-style-type: none"> <li>• None</li> </ul>
UNC Committees	<ul style="list-style-type: none"> <li>• None</li> </ul>
General administration	<ul style="list-style-type: none"> <li>• None</li> </ul>

Impact on Code	
Code section	Potential impact
To be determined by Transporters	<ul style="list-style-type: none"> <li>•</li> </ul>

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact

Impact on UNC Related Documents and Other Referenced Documents	
Network Entry Agreement (TPD I1.3)	• None
Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4)	• None
Storage Connection Agreement (TPD R1.3.1)	• None
UK Link Manual (TPD U1.4)	• None
Network Code Operations Reporting Manual (TPD V12)	• None
Network Code Validation Rules (TPD V12)	• None
ECQ Methodology (TPD V12)	• None
Measurement Error Notification Guidelines (TPD V12)	• None
Energy Balancing Credit Rules (TPD X2.1)	• None
Uniform Network Code Standards of Service (Various)	• None

Impact on Core Industry Documents and other documents	
Document	Potential impact
Safety Case or other document under Gas Safety (Management) Regulations	• None
Gas Transporter Licence	• None

Other Impacts	
Item impacted	Potential impact
Security of Supply	• None
Operation of the Total System	• None
Industry fragmentation	• None
Terminal operators, consumers, connected system operators, suppliers, producers and other non code parties	• None

## 6 Implementation

- 01 April 2013 if a decision is received prior to 01 December 2012
- 01 April 2014 if a decision is received after 30 November 2012 and prior to 01 December 2013
- If a decision is received after 30 November 2013 implementation should be on the following 01 April that is at least 6 months after the decision date.

These dates are proposed since the reconciliation period runs from 01 April each year, and the new processes need to be aligned with this period rather than come into force midway through the period, but also to allow Shippers, the AUGÉ and the Transporter Agency sufficient time to be prepared for the new processes.

## 7 The Case for Change

Nothing in addition to that identified above.

## 8 Legal Text

### Text

*[The following Legal Text was prepared by X, and no issues were raised by the Workgroup regarding its content.]*

## 9 Recommendation

The Workgroup invites the Panel to:

- AGREE that this modification should be submitted for Consultation.