51 Homer Road
Solihull
West Midlands
B91 3QJ
www.xoserve.com

Ms Ndidi Njoku
Industry Codes
Ofgem
9 Millbank
London
SW1P 3GE

Nick Salter
e: Nicholas.j.salter@xoserve.com
t: +44 (0) 121 713 5625

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Dear Ndidi

Review of Reconciliation by Difference (RbD) – Ref 57/06

I have pleasure in attaching xoserve's response to the RbD consultation.

Our response has been formulated in agreement with the major Gas Transporters, on whose behalf xoserve operates the RbD processes and systems.

The response concentrates on providing factual assessments against the specific questions raised in the consultation document and limited commentary based on xoserve's experience. We understand that each Transporter will also be submitting their own response.

The response can be treated as non-confidential. If you have any questions on the issues raised then please don't hesitate to contact me.

Yours sincerely

Not signed – sent by e-mail

Nick Salter
Regulatory Affairs Manager

Review of Reconciliation by Difference (RbD)

xoserve response to Consultation Ref: 57/06

Introduction

Please note: There is a glossary of abbreviations at the end of this document.

xoserve's response has been formulated in agreement with the major Gas Transporters, on whose behalf xoserve operates the RbD processes and systems. xoserve understands that each Transporter will also be submitting their own response.

Background

xoserve was created during the network sales process to act as a service provider to the five major Gas Transporters (GTs) and is owned jointly by National Grid, Scotland Gas Networks, Northern Gas Networks, Wales and West Utilities and Southern Gas Networks.

xoserve provides transactional services, information system support and change management on behalf of the eight gas distribution networks and the National Transmission System. The primary recipients of xoserve's services are the GTs' customers, the gas shippers. By providing centralised services across the industry, xoserve enables gas supply competition to operate efficiently in Britain.

As service provider to the GTs, xoserve operates the RbD process and provides expert input into the associated industry work groups. This response is based on xoserve's experience of managing RbD processes over the eight years since the mechanism was introduced. During this period as xoserve and its predecessor Shipper Services, we have operated the core RbD processes, managed the interfaces with key data providers, regularly liaised with the RbD Auditor and conducted extensive reviews, risk modelling and ongoing verification of the RbD processes and outputs. xoserve's role has included chairing operational and contractual industry forums, such as the RbD Audit Sub Committee and the RbD Sub Group, and working with the industry on a number of refinements to RbD and associated processes.

Chapter One – Introduction

1. Given the original rationale and benefits of RbD, do you consider it remains valid under the current GB Gas arrangements?

There were a range of drivers for the introduction of RbD and there were also a number of key principles fundamental to the robust operation of RbD.

Part of the original rationale for the introduction of the RbD methodology was that the value of reconciliations for each SSP was very low, meaning that the average costs of processing meter point reconciliations, including failures and queries, would be disproportionately high compared to the amount of money being re-distributed, particularly as some of the value of each individual meter point reconciliation would be funded by or returned to the primary party through Reconciliation Neutrality.

Experience of reconciliation of a relatively small number of meter points had highlighted concerns around the potential for inaccurate reconciliation values arising from erroneous meter reading and meter asset data. Both these attributes are dependent on human intervention and even if the percentage errors are very low, the absolute number of errors is likely to give rise to high levels of queries and rejections Reconciliation Charges.

RbD is based on the principle that the energy in an LDZ is whole. This principle remains valid and is supported by mechanisms to process LDZ reconciliations in the event of errors in the LDZ input quantities.

The fairness of the apportionment of values amongst shippers with SSP portfolios is partly reliant on the AQ of supply points within each shippers' SSP portfolio being representative. In recent years there have been a number of refinements to the AQ review process and contractual framework.

Meter point reconciliation in the LSP market needs to be timely. At the last analysis, average duration of reconciliation within the monthly RbD sector was 1.6 months, within the six monthly sector 5.7 months, and 7.7 months for the annual sector.

RbD was the industry response to the potential system and manpower impacts of replicating individual meter point reconciliation across 21 million supply points. Evidence from administering individual supply point reconciliation for 400,000 supply points over the past ten years has shown significant issues which would still support the original RbD rationale.

Current meter point reconciliation for the larger supply points is processed and reconciliation that appears in 'error' will be filtered out prior to invoicing. These User Suppressed

Reconciliation Values (USRV) then require industry action before being invoiced. Despite a new liability regime for USRV there is a significant backlog of 20,400 USRV waiting for action. This reconciliation energy has not yet been invoiced. If individual reconciliation were processed for an additional 20,600,000 supply points, the USRV process would likely not withstand the volume of data involved. This is just one measurable instance of how the system would not be sufficient to process the data involved. In just this one area both transporters and shippers would require a significant increase in manpower and computational capacity without a financial benefit from the changes.

2. Are the costs and benefits of the RbD process transparent to the industry, and if not how can transparency be improved?

At the time RbD was approved, the cost of implementing the RbD process was estimated at approximately £3 million. This was based on an increase in clerical staff to implement and maintain the system plus IT costs related to development of the operating mechanism. This was weighed against the perceived cost of full meter point reconciliation including a large number of staff (700+) to manage the Reconciliation charge validation and suppression process and the much increased system infrastructure costs required to cover data processing and storage. These costs were estimated at nearly four times the RbD implementation cost in 1997, comparable with the costs of developing the electricity equivalent a short time later. These costs are likely to be greatly increased if development were to take place now.

Since 1997 there have been a number of major initiatives that have impacted the base used to derive these costs. These include meter read unbundling and RGMA. As a result an up to date estimate of the cost and benefit of RbD across the entire industry would prove difficult to ascertain. Although the overall benefits of administrative savings, IT cost reduction, simplification of the process and improved control are all present, the costs are now distributed throughout the industry. While xoserve undertakes a small number of suppressed reconciliations from the Must Read process the bulk of the USRVs are shipper responsibility, leading to costs being distributed through Shipper organisations, making cost benefit calculations more complex and full transparency difficult to achieve. xoserve is committed to operating RbD efficiently and has requested suggestions from the Regulator and industry participants on a number of occasions over how greater transparency can be achieved in an increasingly fragmented industry.

At the time RbD was implemented two of the main aims were to reduce the complexity of systems required for new entrants, thus lowering market entry costs, and to simplify processes, lowering transaction costs. The number of market entrants has grown over the lifetime of RbD and transaction costs have reduced steadily over the same period, demonstrating the successful achievement of these aims.

3. Do the various RbD related industry workgroups provide sufficient governance and transparency of the RbD arrangements?

Every effort is made to ensure the RbD process is as transparent as possible. There are a number of regular forums to discuss RbD matters, including the Billing Operations Forum, the RbD Sub Group and the RbD Audit Sub Committee. In addition RbD matters are often discussed through the AQ Sub Group and the Demand Estimation Sub Committee (DESC).

The workgroups cover the full scope of RbD from data input through calculation, invoice and audit. In addition of the regular information provided, a number of specific projects have been run at the request of shippers to assess specific areas impacting RbD. These have, over the eight year span, led to a number of modifications to improve the operating mechanism, including threshold crosser reconciliation (Mod 640) and USRV liability regime (Mod 637).

xoserve believes that industry participants have ample opportunity to raise questions or concerns through the various forums.

4. Is there sufficient transparency of the data or the information xoserve provides to the industry?

RbD is an element of the Reconciliation Invoice. On this invoice shippers receive details of all their larger supply point reconciliations that have contributed to the RbD charges. Information is also given, in aggregate, of the total volume of larger supply point (LSP) reconciliations forming the base of the RbD charges and both the shipper aggregate AQ and LDZ aggregate AQ for the small supply point (SSP) market. Thus the proportion of charges that a shipper experiences can be validated.

Large individual charges that contribute to the RbD aggregate are published on the Shipper Information Service (SIS).

Whilst a shipper can validate their proportion of SSP charges, each shipper has insufficient information to directly validate the total volume of LSP reconciliation energy driving the RbD charges. To provide assurance, a number of activities are conducted, for example RbD supporting information, including verification, risk modelling and allocation accuracy monitors such as Scaling Factor analysis are made available on a regular basis to industry participants to provide assurance over charges. Publication of this information on a regular basis provides assurance and transparency of charging without breaching confidentiality of individual charges.

The RbD Audit confirms that aggregate energy from meter point reconciliations flows into RbD correctly.

Historically xoserve has worked with the industry to investigate any issues and provide further information if necessary. A number of processes that are supported by xoserve, such as scaling factor monitoring, AQ review processes, suppression and liability calculations, have all been developed and enhanced over the life of RbD without any formal obligation to do so and xoserve is fully committed to continuing to support the process in the future.

5. Is the scope of the current RbD audit appropriate?

The scope of the RbD audit is defined within UNC. This was agreed as part of the implementation of RbD and has had an unqualified opinion every successive year. As part of the process the independent auditor outlines to the RbD Audit Sub Committee (RbD ASC) the approach they will take for each audit.

In recognising the requirements of shippers expressed through the RbD ASC it was agreed to extend the audit to include an assessment of a key feeder process to RbD, the process in question to be selected by the RbD ASC participants. To help the decision on which area to focus on, xoserve provided a full assessment of controls and risks for each feeder process.

In addition to the RbD audit there are industry consultation processes around the bulk of the feeder processes. This provides a further level of assurance and information provision on top of the Audit itself.

Given that industry participants have visibility of their element of many of the feeder processes and the governance framework that operates around the various feeder processes and numerous avenues for industry involvement in the process, the scope would seem appropriate.

6. Are there sufficient incentives on all parties to limit the size of RbD?

RbD charges currently account for less than 3% of the commodity invoicing and energy settlement. The level of RbD charges is directly related to the size of reconciliation energy, which is influenced by a number of factors that are the responsibility of the industry in general.

Meter read provision drives both the number of reconciliations processed and also accuracy of AQ values, thus impacting initial allocation accuracy.

Timeliness of reconciliation is influenced by read provision and USRV clearance rates. Both these areas have incentive mechanisms through the must read process and the USRV liability charging.

Accuracy of AQ has been subject to a number of industry initiatives over the years, the most recent being Mod 640 charges. These provide an incentive for shippers to amend AQ out of the SSP market where the supply point consumption has increased above 73,200KWh per annum. There may still be potential for measures to improve Shipper incentives to maintain accurate AQ values.

As the size of reconciliation is related to meter read history, changes in end user behaviour and timeliness of read provision, there is no reason to expect that reconciliation size would decrease over time. What is of greater importance is the speed of processing reconciliation from read to invoice. The mechanisms mentioned above provide contractual obligations, but, in most cases, without "hard" incentives.

Chapter 2 – RbD Issues

7. Do you consider there is sufficient transparency in the operation and accuracy of industry processes such as the AQ review and shrinkage calculations?

Both processes operate to published methodologies and timeframes. In the case of AQ the definitions are specified in UNC and an online calculator is available for shippers to replicate exactly the calculations that are performed. In addition, the full AQ process is supported by an industry group and relies on information provided by the market participants themselves. The process is fully transparent, enabling each shipper to replicate the calculation of an AQ exactly.

There have been concerns about manipulation of read information by specific shippers in the past, resulting in a number of Network Code modifications to prevent selective amendments. As AQ is the building block for much of the gas allocation, balancing and invoicing processes it is obviously a key variable. As such the impacts of inappropriate AQ would be much wider than the RbD process and any gaming would impact the whole demand management and settlement process, irrespective of whether RbD operated or not. In addition a number of monitoring processes are in place, including through DESC and RbD verification, which would highlight AQ data errors. These are shared with the industry including the data used to derive allocation parameters, allowing shippers to build an understanding of the link between allocation and reconciliation themselves.

LDZ Shrinkage derivation is the responsibility of each DN Transporter. However the wider industry has involvement through the Shrinkage Forum. LDZ Shrinkage is based on three main elements, leakage, theft and own use (gas used for operational purposes). Leakage is by far the main contribution to any LDZ shrinkage value, being over 90% of the total, and has been derived by an independent consultant based on a national leakage survey that had full involvement of the shipping community.

Own use is a subjective figure but is based on firm temperature and plant efficiency information. However, theft of gas is certainly far more subjective and could be argued to be less accurate than the other contributing elements. Current theft figures are based on historical theft levels and information from investigations registered with xoserve. This limited information supports Transporter responsibility as no more than the 10% allowed, possibly lower, but provides limited support for overall levels.

Lack of transparency in theft of gas would affect all market participants and is not specific to whether RbD operates or not. The impact of theft would be shipper responsibility, regardless of how the reconciliation process were to operate, and with wholly meter point reconciliation a mechanism would need to be developed to levy the cost of theft to shippers.

Ofgem highlights perception that industrial theft is not accounted for. While any potential theft in this market, over and above that included as Transporter responsibility within Shrinkage, will be included in RbD charges, there is no evidence that theft is prevalent in this market sector. xoserve would encourage any evidence of theft within the industrial and commercial sector to be raised for investigation.

8. Do you consider the existing governance arrangements around these processes to be appropriate?

Both AQ review and Shrinkage are managed through transparent processes within an industry framework. In both processes shippers and the regulator are informed and able to influence the process.

AQ review operates to a set of controls outlined within UNC. The outcome of each AQ review and amendment process is monitored and results sent to the Regulator for information and potential action. Although there are no specific financial incentives around the process, results from the monitoring exercise and pressure from other participants have led to a number of code modifications reducing the scope for possible gaming. In a competitive industry it would be surprising if companies did not attempt to gain competitive advantage where possible and the action and reaction suggests a healthy environment.

While significant AQ amendment may be seen as gaining an advantage, AQ is being used as an estimate for future consumption. Customer consumption has been shown to vary year on year by at least 5%, excluding weather impacts. This suggests that any perceived advantage may be hard to judge. Although the incentive for Shippers to minimise their AQ is still present that would also be the case for meter point reconciliation. One of the benefits of RbD is that it provides an environment where it is easier to monitor and assess data issues.

LDZ shrinkage values are submitted to the Regulator for agreement. Governance around this area allows for industry participants to make representation following which the Regulator has the final authorisation to allow the changes. This governance is common in other areas of the UNC and appears to be effective.

Monitoring of factors such as scaling factor would highlight significant issues for both AQ and LDZ shrinkage values. This monitoring is reviewed regularly by DESC and is a further level of control and governance around the process.

Confirmation of sites onto the UK Link Sites and Meters database could be improved, the incentives here are weak and incentives through the NExA on IGTs would also be useful.

9. Do you consider that there are appropriate incentives in place on relevant parties to ensure the timeliness and accuracy of these processes?

Both AQ and shrinkage processes have clear timescales specified within UNC.

For shrinkage there is a perceived incentive to wish to decrease values as a Transporter and increase values as a shipper. This cross incentive acts as an effective balancing mechanism.

Implementation of modification 640 provided additional incentive on shippers to act in a timely manner to amend AQ for sites that are likely to move from the SSP to LSP markets at the next review. Although this concentrated on one key aspect, it is important to recognise that under RbD the impact of any AQ issue will only be felt if a shipper has a disproportionate number of supply points with that specific issue.

Ofgem raised the issue of IGT AQ reviews and in particular the impact of the WAALP adjustment during the 2005 review. There has been concern about the accuracy of the IGT AQ review and while the proportion of energy flowing into CSEPs has been relatively small, it is not insignificant and is increasing. Given the level of obligation covering AQ derivation within the UNC, it would seem appropriate to ensure all parties, including IGTs, have similar obligations. xoserve understands that a number of Code modifications are being considered in this area and we would welcome additional controls around the accuracy of data flowing from iGT systems.

The WAALP adjustment was the first adjustment required as a result of changes to the seasonal normal temperature that had been processed since network code began. However, not having inappropriately high AQ provided sufficient incentive for the adjustment to be included in the derivation of AQ.

RbD provides a noticeable benefit in timeliness of reconciliation that is important to highlight. For meter points subject to individual meter point reconciliation, individual shippers are in control of when meter points within their portfolio are reconciled, transporters aggregate position and SSP shippers are reliant on RbD for their energy position to be reconciled. If meter point reconciliation were to be extended the shipper community would continue to be reliant, through Reconciliation Neutrality, upon all other shippers for their energy position to close out, but the reliance would be upon an increased number of meter point reconciliations; with the RbD mechanism over half the total reconciliation is processed the next month with some processed within the month.

10. Do you consider the timing and scope of the AQ review is appropriate?

The possibility of a mid-year review or rolling AQ calculations is raised. The current AQ process takes four to five months to process and amend data before the AQ goes live. AQ

mid year review would require significant resources from xoserve and shipper organisations without any obvious benefit in allocation accuracy.

Indeed, one of the main causes of inaccurate AQ values and the basis for a significant proportion of amendments during the current AQ review, is incorrect read or meter asset information. Implementing AQ changes with every read or asset change would increase the number of AQs that were incorrect. Were these used to derive commodity charges, the result would be an increase in reconciliation. RbD charges would increase substantially and any perceived inequalities between shippers would be magnified.

Both the above options suggest that shippers may require additional opportunities to change AQ values. As it stands any larger supply point AQ and any potential threshold crosser can be changed, at any time through the year, within the current regime. The fact that most shippers choose not to use this ability enforces the opinion that the timing and scope of the review is appropriate.

Chapter 3 - Wider Considerations

11. What would the likely costs and benefits be of introducing Meter Point reconciliation to all supply points?

A benefit of individual meter point reconciliation is that, following reconciliation, each supply meter point receives an accurate allocation of energy, providing that the read and meter asset data are correct.

However, reconciliation volumes for domestic sites are low value and require a disproportionate amount of resource to process. Changes are unlikely to provide any energy efficiency benefit as end consumers are already billed on meter reads and can see immediately the impact of their consumption levels.

A perceived benefit of meter point reconciliation is that each shipper would be in control of the magnitude and timing of their own reconciliation. However, even with meter point reconciliation, a mechanism to apportion reconciliation energy across the market would need to continue, to ensure that all energy is accounted for. Energy Balancing Neutrality charges are far more financially significant than transportation. Broadening the scope of meter point reconciliation would increase the risk of greater levels of error flowing into the Energy Balancing Neutrality "pot" than arising from meter point reconciliation at the 400,000 LSP. Global meter point reconciliation would therefore have the potential to reduce certainty of reconciliation energy flows compared to RbD.

Any reconciliation energy needs a counterparty to ensure completeness. Without RbD there would be an element of smearing that would continue, although this might also include the LSPs.

The costs stated against chapter 1, question 2, from 1997 are likely to be substantially understated in today's market. At the very least there would need to be major system enhancements to cater for universal meter point reconciliation, to include large invoice files and query handling.

In addition there would be a need to parallel run both processes for the foreseeable future to enable reconciliation through the RbD process to be closed. This redundancy of systems has an inherent risk and cost associated with it which does not appear to be outweighed by any potential benefit.

12. What conditions would need to be satisfied in order for meter point reconciliation to be practicable?

Current levels of queries and suppressed reconciliation for the 2% of the market subject to meter point reconciliation lend weight to the argument made in 1997 that system functionality to handle the data requirements, processing and query management plus the manpower required to deal with the query process would be significant.

Any move towards meter point reconciliation would require investment across the industry in new systems and functionality, staff numbers and training. In addition the historic backlog of outstanding reads, USRVs and queries would need closing. It would not seem practical to run both systems in parallel as this would at least double the industry costs leading to end user price rises.

The resources required to handle problems arising from inaccurate reconciliations could in theory be reduced by the introduction of meter reading that removed the dependency on human intervention and although such technology is beginning to be more prevalent, it still represents a very thin slice of the market. Even with automated meter reading, there would continue to be a reliance on accurate meter asset data and the satisfactory operation of the technology to avoid errors and resultant query management costs.

13. Would it be feasible for shippers to choose whether or not their supply point should be individually reconciled or processed through RbD?

Under current system functionality the only method for making this choice would be to artificially inflate the supply point AQ above 73,200 KWh per annum. This would increase capacity charges and raise allocation, albeit that the latter would be returned through reconciliation. An alternative would be amendment to the system to flag supply points in this situation. The system changes required to support such a change would be significant.

While this may have some advantage, any smearing of costs such as theft of gas, over and above that included within Shrinkage, would then be made across a smaller population with the remaining shippers bearing a consequential increase in risk and cost per supply point.

Conclusion

To conclude, xoserve supports Ofgem's initial view that existing industry mechanisms are sufficient to address, where appropriate, the issues identified within the consultation paper.

Abbreviations

AQ	Annual Quantity
CSEP	Connected System Exit Point
DESC	Demand Estimation Sub Committee
GT	Gas Transporter (major)
IGT	Independent smaller Gas Transporter
LDZ	Local Distribution Zone
LSP	Larger Supply Point (AQ over 73,200kWh)
NExA	Network Exit Agreement
RbD	Reconciliation by Difference
RGMA	Review of Gas Metering Arrangements
SSP	Smaller Supply Point (AQ up to 73,200kWh)
UKLink	The IT system comprising sites and meters and invoicing 95
UNC	Uniform Network Code
USRV	User Suppressed Reconciliation Value
WAALP	Weather Adjusted Annual Load Profile