



Ms Ndidi Njoku
Industry Codes
Office of Gas and Electricity Markets
9 Millbank
London, SW1P 3GE

E.ON UK plc
Griffin Court
Colliers Way
Nottingham
NG8 6AT
eon-uk.com

Alex Travell
0870 419 1464
0115 8767321
alex.travell@powergen.co.uk

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Review of Reconciliation by Difference

Dear Ndidi,

Thank you for the opportunity to respond to your recent consultation regarding the Reconciliation by Difference (RbD) process in the gas market.

We welcome the opportunity to comment upon some of the issues that exist with RbD. The underlying rationale for the introduction of RbD remains relevant today and has not greatly changed since competition in the sub 73,200 kWh usage market (defined within the Uniform Network Code as Smaller Supply Points) was introduced in 1996.

We therefore believe that continuation of the RbD process is currently justified until the issues regarding xoserve's systems capability and metering data quality have been suitably addressed.

As requested we have responded to the specific questions that were raised in the consultation:

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

We believe the underlying rationale for the implementation of RbD continues to remain valid.

The introduction of competition into the domestic sector exposed a number of key problems with the systems and processes that had been successfully implemented for reconciliation of predominantly non-domestic consumers using over 73,200 kWh of gas per year (defined within the Uniform Network Code as Larger Supply Points). The systems originally developed and implemented by Transco and now utilized by xoserve have not significantly changed since the introduction of RbD.

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No 2366970

Registered Office:
Westwood Way
Westwood Business Park
Coventry CV4 8LG

There is little evidence therefore that these systems could manage meter point reconciliation of all gas meters any more satisfactory today than they could prior to the introduction of RbD. Therefore the conclusions of the Network Code review group 174 continue to remain valid.

Another key problem that was initially encountered with the introduction of domestic competition was the impact of poor data quality concerning gas metering.

Accurate information concerning the physical attribute of a gas meter is important when attempting to calculate gas volumes for reconciliation. The quality of metering data concerning domestic customers was found to be particularly poor at the outset of competition and significantly contributed to the problems that led to the introduction of RbD.

There have been several initiatives since then to improve the quality of metering data in the industry. However the implementation of competition in metering services is widely believed to have introduced a recent degradation of data quality.

To give reassurance to the shipping community that this issue would not prevent meter point reconciliation from being implemented we would suggest that a review of the impact of metering competition on data quality is undertaken by xoserve to determine whether this remains a barrier to the replacement of RbD.

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

The costs to the industry of the RbD process are not totally clear.

The cost of xoserve's central systems that manage RbD are bundled together with the other services that they provide to the industry and are therefore not clear to industry participants.

There are clear administrative benefits of validating and paying RbD invoices by shippers compared to meter point reconciliation. What is less clear to each party however is the added level of risk that the inaccuracies of the process brings compared to meter point reconciliation. This can only be calculated at an aggregate portfolio level and may disguise individual

types of customer who are significantly disadvantaged by the process.

The work carried out previously by Transco (now xoserve) to validate the accuracy of RbD was useful in demonstrating the issues that exist with the process and the implications for the overall shipping community.

To date this work has suggested that the RbD process has systematically over billed Smaller Supply Points. It would appear that this level of inaccuracy is reducing and that it appears to have a regional bias. Evidence to date suggests that this overcharge affects all shippers operating in the Smaller Supply Point market to a similar extent and therefore RbD should not be seen as an inhibitor to competition.

The underlying risk and cost of RbD therefore presents itself as higher costs for Smaller Supply Point customers than they would incur if meter point reconciliation were utilized.

The benefit of RbD is that it allows Smaller Supply Point competition to exist within the current constraints of xoserve's systems and the level of metering data quality in the industry. Considering the cost savings that competition in retail gas has brought to the Smaller Supply Point market we believe that the decision to implement RbD was justified.

The ongoing validation of the accuracy of the RbD process should be an obligation made upon gas transporters and their agent xoserve. If RbD can not continue to be proven to have a relatively minor impact upon the costs to the Smaller Supply Point market then justifying its continued use will be difficult.

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

We are comfortable with the transparency of the current governance arrangements of the Uniform Network Code. However the current governance structure relies heavily upon the relevant objectives of the gas transporter's relating to their network code.

An accurate and equitable gas settlement process is crucial to ensuring that retail gas shipping and supply activities can operate. It would improve the existing governance processes for RbD if this was more clearly defined within the relevant objectives of all gas transporters (GT).

There is currently a lack of transparency and appropriate governance regarding the interface of information between Independent Gas Transporters (IGT) and larger GT in relation to RbD and gas settlements in general. There is no common obligation on all GT to operate in a collective manner to ensure that the retail market is able function and this presents a clear problem for the accurate functioning of RbD.

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

There is now a greater risk that the transparency and availability of information crucial to the understanding of RbD will reduce following the fragmentation of network ownership. There should be a requirement placed upon the GT and consequently their agent, xoserve, to provide transparent information to shippers that gives comfort that the RbD process and the underlying information that it relies upon is accurate.

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

The current RbD Audit has a very limited scope to ensure that the systems used by gas transporters agent, xoserve, function correctly. The current audit concentrates on determining whether the 'black box' calculations are performed by xoserve accurately. This task is important and useful as no one individual shipper would be able to verify the accuracy of this function.

The RbD Audit does fail however to truly give comfort to shippers that the information that supports RbD is accurate. We would prefer the scope of the RbD Audit to be extended to include greater emphasis on ensuring the accuracy of the processes and data that undermines and supports RbD such as the AQ Review process and the determination of load profiles.

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

The mechanism of reconciling energy introduces uncertainty and therefore financial risk to gas shippers and to lesser extent gas transporters. This should act as an appropriate incentive to limit the size and impact of RbD.

It could be argued that for shippers with predominantly Larger Supply Point portfolio there may not be a sufficient incentive to reduce the size of RbD. This could be addressed by limiting the RbD process to customers

defined as domestic rather than to Smaller Supply Points defined within the Uniform Network Code.

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

Improvements to the transparency of the AQ Review and Shrinkage calculations would be helpful to all parties particular since the fragmentation of network ownership has led to a differing set of commercial interests.

One of the key issues identified with RbD and the AQ Review process is the impact of I&C consumers who are included within the Smaller Supply Point RbD process. Some action has been instigated to mitigate the risk that these customers present via the implementation of processes specifically designed at sites that cross the threshold between Smaller Supply Points and Larger Supply Points.

It would considerably help both RbD and the AQ Review process if the definition between non-domestic and domestic supply points was used as the basis for determining whether meter point reconciliation or RbD was used.

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

The potential for gaming around the AQ review process is an area for concern as it could undermine the benefits that RbD presents to the industry. Sufficient safeguards exist within the Gas Shippers Licence Condition 3 to enforce the current governance regime. These should be more rigorously monitored and enforced by Ofgem.

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

There are no incentives on iGTs and larger GT to operate together to ensure timely and accurate information is passed regarding RbD and gas allocations for shippers in general.

This presents a considerable risk to the correct functioning of RbD

especially now that the size of the IGT market is significant. To mitigate this we believe an obligation upon all transporters (IGT and larger GT) to utilize a common agent and therefore systems for managing Supply Point Administration services for shippers is required.

RbD operates on the assumption that AQ values are accurate. The process for reviewing and updating AQ values was not devised with consideration to the impact that it may have upon the RbD processes. Improvements have occurred over time to the process to ensure that parties act in an appropriate manner. However RbD operates using the principle of general allocation at a portfolio level that will never be 100% accurate and will always be vulnerable to the potential of inappropriate action during the AQ review process by shippers.

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

The annual review of domestic gas consumers AQ is appropriate considering the current RbD process.

The recalculation of AQ for Larger Supply Points on an annual basis should be reviewed as there is potential merit for RbD, I&C shippers and consumers of introducing a process whereby AQ's are recalculated more frequently. It would be beneficial to allow shippers to control the AQ for Larger Supply Points and propose amendments at any time.

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

There would be considerable benefits in introducing meter point reconciliation to all supply points as it would remove the uncertainty that shippers and therefore suppliers face when contracting with customers whose supply is classified as being a Smaller Supply Point.

However until the underlying issues of systems capability and data quality are addressed then it must be assumed that costs to the industry as a whole of removing RbD will be prohibitive.

12. What conditions would need to be satisfied in order for individual Meter Point reconciliation to be practicable, and to what timescale?

The introduction of widespread Smart Metering could act as a catalyst for the removal of data quality issues that originally hampered the introduction of meter point reconciliation for Smaller Supply Points.

The enhanced accuracy that meter point reconciliation would afford to the gas settlements process could also act as an incentive for all suppliers to install Smart Metering.

The ability of xoserve's systems to robustly manage the meter point reconciliation of a considerably larger number of supply points would need to be verified. Any improvements would need to be delivered in a cost effective, transparent and timely manner.

13. Would it be feasible for shippers to choose whether their supply point should be individually reconciled or processed through RbD?

This option would be particularly welcome should Smart Metering be introduced on a wide scale in the domestic gas market. As new Smart Meters were installed a scenario could be envisaged whereby these sites transfer to a regime of meter point reconciliation.

In this scenario even a relatively low percentage of domestic supply points adopting Smart Metering would substantially increase the number of supply points subject to individual meter point reconciliation and therefore this option would require the capabilities of xoserve's systems to be determined from the outset.

Yours sincerely

A handwritten signature in black ink, appearing to read 'AGT Travell', with a stylized flourish at the end.

Alex Travell
Industry Development Manager
Retail Regulation
E.ON UK