

Modification proposal:	Uniform Network Code (UNC): Revision to the User Suppressed Reconciliation Values financial incentives arrangements (UNC141 and 141A)		
Decision:	The Authority ¹ directs that UNC141 be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	11 September 2007	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

The UNC and the Network Code Reconciliation Guidelines contain provisions for the validation and, where necessary, suppression of Non Daily Metered (NDM) and Daily Metered (DM) Reconciliation Values. They further set out processes and performance standards for managing the investigation and resolution of values which fail the prescribed tolerances.

Transporters are responsible for the investigation, resolution and subsequent release of suppressed Reconciliation Values generated from Daily Reads and Must Reads except where it is identified that these have arisen as a result of the Meter Information held on the Supply Point Register being incomplete, out of date or otherwise incorrect. Users are responsible for the investigation of all other suppressed Individual Meter Point Reconciliation Values. These are known as User Suppressed Reconciliation Values (USRVs).

The resolution of USRVs ensures the correct allocation of energy to supply points within the associated shipper's portfolio. This in turn reduces the incorrect allocation of energy and related transportation charges to other shippers via the RbD processes.

Network Code mod 637 brought in a regime that sought to provide a financial incentive for the prompt resolution of USRVs by applying defined charges where they had not been resolved within prescribed timescales, commencing with a £20 charge after two months, with subsequent £30 monthly charges from four months onwards. This change was considered necessary to put in place more robust contractual obligations with respect to USRVs and promote the timely resolution of suppressed NDM reconciliations.

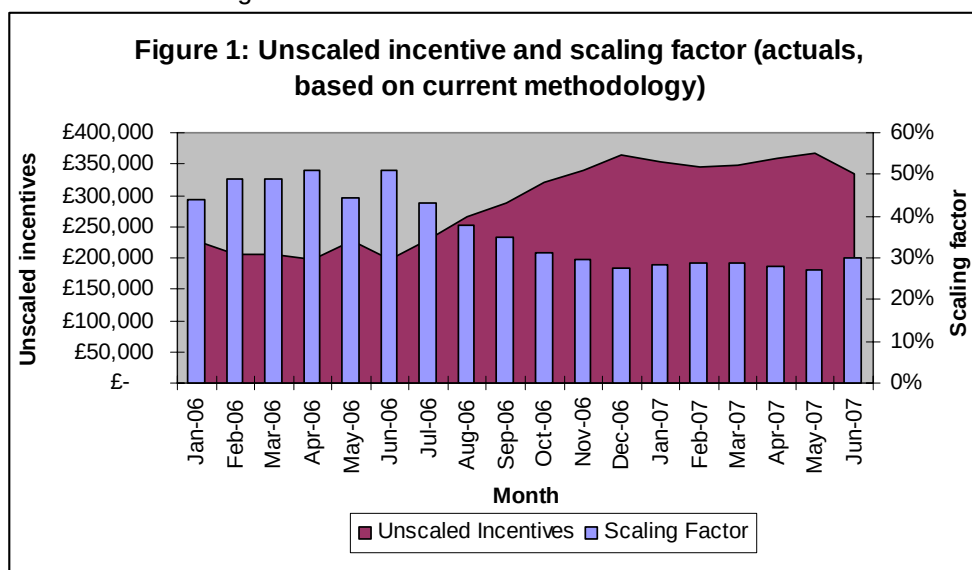
The overall volume of charges that may be applied is subject to a monthly cap of £100,000. Where necessary, the defined charges are scaled back to ensure that this cap is not exceeded. Transporters are entitled to keep 2% of all amounts received to cover the cost of administering the scheme. On a quarterly basis the remainder is aggregated by LDZ and apportioned to all RbD shippers in each LDZ on the basis of their Small Supply Point (SSP) market share for that quarter.

Evidence presented by Xoserve to the Distribution Workstream on 22 March 2007 (and appended to both UNC141 and 141A) suggested that the monthly cap was regularly being exceeded, sometimes by very significant margins, and that this trend had worsened during the latter half of 2006. This was resulting in the heavy scaling back of incentive charges: by December 2006 a scaling factor of 0.27 was being applied to scale

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

back uncapped incentives from £364k to £100k. This trend has stabilised but not improved in 2007 – see figure 1 below.



The modification proposal

UNC0141 seeks to increase the monthly cap on the current USRV incentive regime from £100,000 to £500,000. In addition, it would alter the proportion of this amount that Transporters are entitled to keep for administering the scheme from 2% to 0.5% (effectively increasing the cap on the administration levy from £2,000 to £2,500 per month).

UNC0141A seeks to retain the current monthly cap of £100,000 on the USRV incentive, but create a sliding scale of monthly charges that increases the longer the USRV remains unresolved, escalating from £30 after four months³ to £500 after six years. It would also alter the proportion of the amount that Transporters are entitled to keep for administering the scheme from 2% to 2.5% (also effectively increasing the cap on the administration levy from £2,000 to £2,500 per month).

UNC Panel⁴ recommendation

At its meeting on 21 June 2007 the UNC Panel recommended by a majority that UNC0141 be made, and by majority that UNC0141A not be made.

³ We note that one respondent to the industry consultation stated that it was unclear whether the current £20 X+2 charge would remain under 141A, assuming that it did (an interpretation subsequently captured in the legal text submitted to us). We share the view that 141A was unhelpfully ambiguous on this point. Legal text was not available when 141A was consulted upon, and the proposal itself was self-contradictory in stating that *'the USRV would attract an initial £30 charge in month X+4 in line with the existing methodology'* (the existing methodology does not apply *initial* charges of that level in that month). We have assumed the proposal intended to commence charges at £30 in X+4 in our explanation given that these were the initial charges and timing explicitly stated by the proposer. We do not consider that our views of 141A would have been materially different had we assumed the £20 X+2 charge was retained, but we wish to highlight that it would be useful if any future proposals in this area could be clearer on intent.

⁴ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 21 June 2007. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR⁵. The Authority has concluded that:

1. implementation of UNC0141 will better facilitate the achievement of the relevant objectives of the UNC⁶; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties⁷.

Reasons for the Authority's decision

We consider that there is merit in some aspects of both of the proposals, but that on balance only UNC0141 better facilitates the code objectives and is consistent with our wider statutory duties.

Applicable objective (d) – the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation with other relevant gas transporters) and relevant shippers

Almost none of the consultation respondents made any direct reference to the code objectives when framing their arguments for or against these proposals, but those that did cited this objective. The issues raised by other respondents appear to us to be most directly relevant to this objective and so have been considered against it.

Responses to the consultation on these proposals highlighted a broad consensus for the view that changes to the current regime are required, although this consensus did not extend to which of these approaches to adopt.

Ten respondents supported UNC0141. Supporters suggested that the statistical evidence brought forward by Xoserve had demonstrated that industry performance to resolve USRVs was worsening under a regime that capped incentive charges at £100,000 per month and that this provided clear evidence that the current incentives were insufficient. It was highlighted that errors caused by USRVs escalated risk to RbD shippers and the likelihood that costs will be incorrectly targeted on the wrong Users where USRVs remain unresolved. In particular, it was highlighted that Shippers may lack adequate incentives to resolve USRVs that have been under deemed, with RbD Shippers picking up the costs of this shortfall through the smearing mechanism. Those respondents who preferred UNC0141 over 0141A suggested that the latter would be ineffective because charges under that proposal would be extremely heavily scaled back with the £100,000 monthly cap retained.

One respondent (the Proposer) supported UNC0141A. They argued that when the majority of USRVs are resolved there is little movement of energy between the larger supply point market and the RbD market. The respondent suggested that commercial

⁵ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁶ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

⁷ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

incentives mean that the cases where there is a significant movement of energy are most likely to be in relation to large under-deemed USRVs. They considered that UNC0141A would provide a more targeted incentive because it would specifically target long-standing USRVs. They argued that the higher cap of UNC0141 would make the USRV mechanism penal in nature.

Two respondents considered that there are shortcomings with the current regime but supported neither proposal. Both essentially argued that these proposals failed to identify and appropriately address the causes of failures to resolve outstanding USRVs, suggesting that this situation may be driven by data problems or processing issues as well as, or rather than, commercial drivers. Whilst not supportive of either mod in their current forms, one respondent suggested that industry should give further consideration to a blended approach that sought to phase penalties (like UNC0141A) whilst also raising, or completely removing, monthly caps (the former of which is part of UNC0141).

We have some sympathies for both of these proposals and agree that there may be some value in considering a blended approach that focuses incentives on the most long-standing USRVs whilst incorporating a raised or removed cap.

Notwithstanding this view that these approaches could be seen as complementary rather than conflicting, we consider that taken in isolation – as they necessarily must be given that they have been raised as separate proposals – only UNC0141 better facilitates the code objectives.

UNC0141A is not without merit. We consider that its intent, to focus incentives most strongly on resolving the most long-standing USRVs, is sensible. The phased approach would mean that incentives are most clearly targeted on resolving long-standing under-deemed USRVs. These may be resulting in inappropriate cost targeting, to the detriment of RbD Shippers. But whilst this is the case, the evidence suggests that the monthly cap of £100,000 would, based on current levels of outstanding USRVs, be likely to be so substantially exceeded that the charges proposed by UNC141A would be extremely heavily scaled back (at least in the short term)⁸. This is likely to severely reduce the value, and predictability, of the incentive.

UNC141A would appear to offer little in the way of incentive to resolve long-standing USRVs above and beyond UNC141, whilst offering considerably reduced incentives to resolve recent USRVs than UNC141. Perversely this could simply encourage shippers not to address unresolved USRVs until they have been outstanding for a significant period when compared with both UNC141 and the baseline.

Whilst UNC141 does not provide the progressive step change in individual monthly charges that UNC141A does, it nonetheless does provide incentives to prevent unresolved USRVs becoming long-standing because of the cumulative nature of the monthly charges. In addition, the raising of the monthly cap to £500,000 would remove the issue of heavy scaling back of charges that exists under both the current and proposed UNC0141A baselines. The headroom allowed for in the new monthly cap should

⁸ Precise modelling of the levels of scale-back for 141A was not provided during the industry assessment process. However, there is some indicative evidence to suggest that the extent of scaleback under 141A would be significant. The Proposer of 141A cited Xoserve analysis in Appendix A of their proposal showing the level of scaleback were a sliding scale regime similar to that proposed by 141A (with uncapped charges at £30 in early months escalating to £500 after six years) to be implemented. This analysis shows that in March 2007 the uncapped charges would have to have been scaled back by in excess of 92% to meet the £100,000 cap, with the £500 charge actually levied at £39.32, and the £30 charge actually levied at £2.36.

also mean that there is greater consistency and transparency in the incentive that is applied to unresolved USRVs (i.e. that if a Shipper is liable for, say, a £30 charge at month X+4 that they will actually be charged £30, rather than an unpredictable lesser amount that will fluctuate from month to month dependent on other Shippers' performance).

We note the unsubstantiated view of the UNC0141A proposer that the charges levied under UNC0141 would be penal. The broad-ranging support for this proposal from most other respondents suggests that this is not a widely held view but, as highlighted in the preceding paragraphs, we do not discount the possibility that a more targeted approach to incentivising USRV resolution may still be possible. But whilst sympathetic to the view that UNC0141 may not be a perfect solution, we nonetheless consider that there is reasonable evidence to suggest it provides an improvement on the baseline.

On balance, we consider that UNC141 will provide stronger, and more predictable, incentives to resolve USRVs than either the baseline or UNC141A. This should help to facilitate the accurate targeting of costs on those that cause them and help mitigate risks that errors will be smeared on the RbD community. This should help reduce cross subsidies and increase market participants' confidence that they will be settled on correct energy volumes. For these reasons, we concur with the majority industry view that UNC141 will better facilitate the securing of effective competition between relevant shippers.

In considering this proposal we have noted with some concern the evidence suggesting that some USRVs remain unresolved for several years, in some cases stretching back to 2001. Suppliers are under licence obligations⁹ to read and inspect meters at least once every two years and we find it hard to understand how USRVs could remain unresolved significantly beyond this window. As the industry develops the USRV arrangements it may help to consider if there are legitimate reasons why some types of sites, or causes, of USRVs cannot be resolved in a timely manner.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC0141: *Revision to the 'User Suppressed Reconciliation Values' Financial incentives arrangements* be made.



Mark Feather,
Associate Director, Industry Codes & Licensing
Signed on behalf of the Authority and authorised for that purpose.

⁹ Pursuant to [Standard Condition 12 of the Gas Suppliers licence](#)