

Modification proposal:	Uniform Network Code (UNC) 0152V, 0152AV and 0152VB: Limitation on Retrospective Invoicing and Invoice Correction (UNC152)		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	10 October 2007	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

In both the gas and electricity markets the consumption or production of market participants are reconciled on an iterative basis, with initial data and calculation of credits/debits overwritten by subsequent reconciliations as better data becomes available. There are however significant differences between the two markets in regard to whether the iterative process is finite or open-ended.

Electricity reconciliation window

The Balancing and Settlement Code (BSC), sets out time caps for reconciliation and data retention.

It provides that '*no Settlement Run or Volume Allocation Run shall be carried out on any date which is more than 28 months after the Settlement Day to which such runs relate*³. An Extra-Settlement Determination⁴ may take place after that date⁵, but can only do so if there is data in place that would allow it to be enacted.

The BSC sets out requirements for the retention of settlement data by both signatories and the central BSC Agents. These provide that data must be readily available in a format that can go straight into a Settlement Run for 28 months, and then retrievable in archive or other form for a further 12 months⁶ in order to facilitate Extra-Settlement Determinations. When 40 months has lapsed from the relevant Settlement Day there is no requirement for either signatories or the central agents who run the BSC systems to retain settlement data. The BSC Panel can instruct Parties and BSC Agents to retain specific data beyond this window to enable an Extra-Settlement Determination to take place⁷, but in practical terms it would have needed to give this instruction by the 40 month mark in order to ensure that the relevant data had not already been destroyed. The BSC Panel has never issued such an instruction in the six and a half years the BSC has been in place⁸.

A consequence of these provisions is that a BSC signatory has certainty that its financial liabilities under the BSC are firm, or (should an instruction be received from the BSC

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.

³ BSC clause U2.2.4.

⁴ An Extra-Settlement Determination is an ad hoc correction of one or more signatories' position that stops short of the full recalculation of all signatories' positions that would take place with a Settlement Run.

⁵ BSC clause W1.2.6.

⁶ BSC clause U1.6.3.

⁷ BSC clause U1.6.4.

⁸ Source: ELEXON.

Panel) would know that a specific correction is pending, no later than 40 months after any given Settlement Day.

Gas reconciliation window

There are no equivalent provisions in the Uniform Network Code (UNC) that constrain the amendment of financial positions as better data becomes available.

In practice, this can mean that signatories' financial positions are altered by amendments to data relating to dates many years past. The consequences of such amendments may be significant: in December 2006 a correction was made as a result of a metering error at Farningham that went undetected from July 1999 to June 2005. The entire duration of the error was corrected, resulting in the reallocation of 2.4TWh of energy (approximately £25m in financial terms) between different signatories.

The Farningham incident prompted two urgent modification proposals, UNC117 and 122, which sought to introduce a restriction on how far back errors could be corrected (26 months in the case of 117, and to the commencement of the last price control in the case of 122) before the Farningham correction was invoiced. We rejected both whilst signalling that further consideration of the principles of introducing a historic limitation were merited.

British Gas raised a review proposal, UNC126 to consider the issues further. This highlighted a broad industry consensus for the introduction of a historic limitation on invoicing but differing views on what its duration should be. Three modification proposals were subsequently raised, all drawing on the findings of UNC126.

The modification proposal

Three modification proposals have been raised: UNC152V by British Gas; UNC152VB by Wales and West Utilities; and UNC152AV by Statoil.

All three would seek to introduce a 'rolling' cut-off date, with dates that fall before this cut-off considered to be 'timed-out' for the purposes of billing (i.e. if errors were subsequently discovered that related to those dates they could not be corrected). The cut-off date would be set to the 1 April of the year X many years before the current year. It would therefore roll forward by one year each time the 1 April is passed, and would increment in length by one day each day during the intervening year⁹.

All three proposals are essentially identical, bar that the value of X varies between them: 4 for UNC152V; 5 for UNC152VB; and 6 for UNC152AV.

Proposal	Value of X	Minimum period eligible for correction	Maximum period eligible for correction	Hereafter referred to as:
152V	4	4 years 1 day (on 1 April)	5 years (on 31 March)	'4-5 year model'
152VB	5	5 years 1 day (on 1 April)	6 years (on 31 March)	'5-6 year model'
152AV	6	6 years 1 day (on 1 April)	7 years (on 31 March)	'6-7 year model'

⁹ i.e. on 1 April each year the cut-off would be 1 April X years previously, with dates falling before that ineligible for further reconciliation. On 2 April the cut-off would still be set to 1 April X years previously – meaning the period eligible for reconciliation was one day longer than it had been the previous day. This period eligible for reconciliation would continue to expand by one day with each passing day until 1 April the following year. When that anniversary passed, the oldest date eligible for reconciliation would move forward by one year.

Business rules illustrating how the rolling window would be applied in practice can be found in the FMRs for the proposals.

UNC Panel¹⁰ recommendation

The UNC Panel considered the three proposals at its meeting on 16 August 2007. For each of the three proposals, the Panel voted by majority in favour of implementation. The Panel then considered which of the three proposals was optimal. The Panel reached a majority recommendation that UNC152V best facilitated the code objectives.

The Authority's decision

The Authority has considered the issues raised by the modification proposals and the Final Modification Report (FMR) dated 16 August 2007. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposals which are attached to the FMR¹¹. The Authority has concluded that:

1. implementation of any of the three modification proposals will better facilitate the achievement of the relevant objectives of the UNC¹²;
2. of the three modification proposals, we consider that 152V (the 4-5 year model) best facilitates the relevant objectives of the UNC; and
3. directing that the modification 152V be made is consistent with the Authority's principal objective and statutory duties¹³.

Reasons for the Authority's decision

In common with the Panel, we consider that each of the three proposals represents an incremental improvement on the baseline. There is comparatively little to choose between them, but of the three we consider that 152V, the 4-5 year model, is optimal.

In the remainder of this letter we set out our views in relation to how these apply to this proposal in the context of the code objectives and our statutory duties. We additionally explain our views regarding why our concerns with the (in many regards similar) rejected proposals UNC117/122 were addressed by these proposals.

We note that some industry respondents did not identify which code objectives were relevant to their arguments. Where this is the case, we have tried to incorporate their views under the objective that appears to us to be most relevant.

Applicable objective (a) – the efficient and economic operation of the pipe-line system to which the Gas Transporter's licence relates

A minority of respondents felt this objective was relevant, though there was little consensus on whether any impact was positive or neutral.

¹⁰ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

¹¹ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

¹² 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

¹³ 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.

One RbD¹⁴ Shipper suggested that this objective would be facilitated by increasing incentives on Transporters in respect of ensuring NTS and LDZ meter accuracy. It is argued that this would facilitate understanding of gas flows and therefore aid the economic and efficient operation of the pipeline system. Another RbD Shipper who did not explicitly cite this objective used a similar argument. Both considered that these incentives would be maximised by the shortest window (i.e. 4-5 year). Neither made clear how these incentives would work in practice or what the cash-flow impact might be on the Transporters.

The suggested incentive to improve meter accuracy was disputed by several Transporters, including by one who supported the 4-5 year option for other reasons. The suggested incentive was also disputed by one I&C Shipper who suggested that its existence was unclear.

We have not been able to identify any clear financial incentives on Transporters to improve meter accuracy from the evidence provided to us and from our understanding of how these proposals interact with Transporter cash-flows under both the UNC itself and their price controls.

On the evidence available, we consider that the three variants of UNC152 are essentially neutral in their impact on this objective.

Applicable objective (b) – the co-ordinated, 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

Again only a small minority of respondents felt this objective was relevant. Where this was the case, their arguments were essentially an extension of the logic they had applied to objective (a).

One RbD Shipper argued that the increased incentive on Transporters to achieve meter accuracy that it had suggested would result under objective (a) would have a knock-on effect in encouraging Transporters to co-ordinate their efforts with respect to meter accuracy verification, thereby facilitating this objective.

One Transporter highlighted that it did not agree that better co-ordination between pipeline operators would result from any of the variants of 152 because they did not agree that they contained any incentives on Transporters to improve the meter assurance regime.

As previously highlighted against objective (a), we have not been persuaded that any of the three variants of this proposal will increase incentives on Transporters to improve the meter assurance regime. Given that we are not convinced that such an incentive is introduced, by extension it would not be logical to conclude that Transporters would better co-ordinate their efforts to act upon it.

On the evidence available, we consider that the three variants of UNC152 are essentially neutral in their impact on this objective.

¹⁴ Reconciliation by Difference, or RbD for short, is the method of reconciling the difference between actual and deemed measurements of gas allocated to Small Supply Points.

Applicable objective (c) – the efficient discharge of the licensee’s obligations under this [Transporter] licence

One respondent considered that this objective would be better facilitated. Again this conclusion was founded on a view that incentives on Transporters to ensure accurate metering would be increased by this proposal. The respondent considered that accurate metering is essential to inform Transporter decisions in respect of efficient system investment, system balancing and security of supply. A causal link was therefore argued between implementing a time limit for reconciliation and facilitating the efficient discharge of licence obligations by the Transporters.

As previously noted against objectives (a) and (b) we have not been persuaded that any of the variants of 152 would increase incentives on Transporters to improve meter accuracy. In view of this, we consider that each of these proposals would have no material impact on this objective.

Applicable objective (d) – the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators and relevant shippers

Most arguments raised by respondents were either explicitly referenced against this objective, or appear most directly relevant to it.

These arguments can be broadly categorised into four broad themes:

- impacts relating to financial certainty of code liabilities;
- impacts relating to the socialisation of errors;
- interactions with non-code liabilities and the ability to back-off risk; and
- consequential impacts on data retention by market participants.

We will briefly explain respondents views on these themes before setting out our views on where the balance lies between them.

Financial certainty of code liabilities

There was a common consensus amongst both Shipper and Transporter respondents that the current regime poses financial risks to Shippers. The lack of any end-date on the reconciliation process may foster uncertainty amongst Shippers and creates the risk of significant financial adjustments relating to events long since past, with Farningham cited as an example. Several respondents suggested the presence of such risks both created barriers to entry and reduced the confidence of market participants in the arrangements.

Respondents’ views on the relative weight of this issue were divided dependent on the nature of their participation in the market.

RbD Shippers tended to adopt a ‘the shorter the better’ stance on the time limit for reconciliation, favouring the 4-5 year model. RbD Shippers acknowledged that a greater proportion of error correction would be timed out with this window, but considered this a price worth paying for increased financial certainty. Several RbD Shippers highlighted that the costs of meter errors may not be met by those responsible for them, creating an

asymmetric risk between RbD Shippers and other types of participant, with the former carrying most risk.

A minority of Shippers, predominately those with Industrial and Commercial ('I&C') customers portfolios favoured the 6-7 year model for reasons that we detail later in the section entitled 'Interactions with non-code liabilities and the ability to back-off risk'.

Transporter views varied. The distribution networks considered all of the variants better than the baseline, with the 4-5 year favoured where an opinion was expressed. National Grid NTS and the NTS Shrinkage Manager differed from this view in that they considered that the 4-5 year model might result in an inappropriate level of socialised error being uncorrected due to being timed out. Several network operators, including NTS, suggested that they were largely 'neutral' to the effects of any specific time constraint for reconciliation and that Shipper impacts were most relevant to determining a preferred variant.

The socialisation of errors

The introduction of a time constraint on reconciliation will mean that incorrect data 'timed-out' by this constraint may be incorrectly apportioned. There were divergent views on the level of acceptable socialisation, and indeed on whether unreconciled data was necessarily incorrect.

NTS noted that in its role as the Shrinkage Manager it is obliged and incentivised to ensure that costs for Shrinkage are appropriately targeted. They considered that reconciliation is a fundamental process in ensuring that costs are appropriately targeted, and suggested that the evidence brought forward in the UNC126 review group suggested that a more appropriate balance between socialising shrinkage costs and minimising contractual risks to Shippers would be found with the 5-6 year model than the 4-5 year one.

Other respondents also highlighted the issue of finding an appropriate balance between the socialisation of 'timed-out' unreconciled data and reducing Shippers contract risk and exposure. It was noted that energy cannot be reconciled for dates falling earlier than 1 February 1998 under the existing baseline, and that there is therefore an existing precedent for the existence of a time constraint on invoicing. More generally, it was noted that there is unreconciled energy stretching back to 1998 and that some tolerance of 'timed-out' uncorrected data was inherently necessary in order to realise the other benefits of the introduction of a time cap of any duration. One Transporter respondent suggested that some energy will never be reconciled under the current baseline, and further noted that some of this unreconciled energy may nonetheless have been allocated correctly (i.e. that one should not regard unreconciled energy as synonymous with incorrectly allocated energy).

It was noted that there had been considerable analysis conducted by the UNC126 review group into the volumes of unreconciled energy that would have been timed out from invoicing had either a 4-5 year, or 5-6 year, cut-off been in place. RbD Shippers strongly argued that this showed that volumes of energy outstanding after 4-5 years were sufficiently immaterial to be greatly outweighed by the benefits of adopting the shortest time-window for reconciliation.

Interactions with non-code liabilities and the ability to back-off risk

Several I&C Shippers suggested that it would be inappropriate to create a time limit for reconciliation that was shorter than six years, arguing that to do so would be inconsistent with the provisions of the Limitation Act. These Shippers essentially argued that they may be held liable by their customers for the correction of errors for up to six years as a consequence of the Act, and that a shorter reconciliation window would preclude their ability to back-off these corrections through the code. One highlighted that our decision letter on Network Code modification 642 had stated that 'it would be unreasonable to deprive any party of monies they were due by introducing an inappropriate point of cessation', and had gone on to highlight the Limitation Act set six years as a constraint for actions set on a simple contract.

Some RbD Shipper and Transporter respondents disputed the relevance of the Limitation Act to the reconciliation process. One Shipper suggested that contract law as it applies to energy supply contracts in the non-domestic sector permits parties to a contract to agree to any such period for invoice closure as they deem appropriate and argued that Shippers could therefore back off this correction risk through their supply contract terms and conditions.

Several RbD Shippers suggested that they were prevented from passing costs related to RbD adjustment on to domestic customers more than 12 months after an error that caused the adjustment occurred as a result of being signatories to the Energy Retail Association's Code of Practice for Accurate Bills¹⁵. They argued that the longer the time window for reconciliation in the UNC, the greater the risk this poses to them should they need to correct customer bills.

Impacts on data retention by market participants

There was a common consensus that introducing a time limit for reconciliation would reduce data retention and management demands on participants. One I&C Shipper who stated that they agreed with this principle nonetheless argued that the shorter the time limit, the greater the likelihood of an increase in resource requirements on participants in order to handle the processing of invoices and risks associated with invoices becoming unrecoverable.

Our views on these issues, and the relative balance between them

We consider that all three of the variants of 152 better facilitate this objective when compared to the baseline. The extent to which one is preferred over the others is dependent on the balance to be found between the benefits of decreasing participant risk of exposure to significant alteration of historic cash-flows, and the demands on them for data retention (which are both best facilitated by a shorter time limit) and avoiding the socialisation of unreconciled energy (which is best facilitated by a longer time limit).

Although the Limitation Act was raised as an objection to a limit of less than six years by some industry respondents, we consider that it is not of significant relevance to our decision. 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, albeit it may have the practical effect of rectifying some contractual breaches

¹⁵ Currently five of the 'big-6' energy suppliers are signatories to this code. For further information, see: <http://www.energy-retail.org.uk/customerbilling.html>

(depending on the circumstances that caused any corrected data to flow into the reconciliation process). 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. Given this we do not consider that it is necessary for the period within which reconciliation can be made to be equivalent to the six year period in which a contractual action would have to be brought under the Limitation Act.

Respondents who held the view that they may be subject to financial risk resulting from customer claims should the code reconciliation window be shorter than the contractual claims window allowed for by the Limitation Act have not explained how such a risk could arise in practice or provided any evidence to suggest the likely frequency or magnitude of any such 'shortfall' event. We have tried to identify potential scenarios where such 'shortfall' could occur and have concluded that this is likely to be a limited risk. In addition, the Shippers may be able to mitigate this risk through its contracts with the end customer. On balance, we consider that any detrimental impact resulting from such risk is likely to be significantly outweighed by the benefits in relation to financial certainty and reduced demands for data retention that we detail in the following paragraphs. For these reasons, we consider that 4-5 years is an appropriate point of cessation for reconciliation and that approving 152V would therefore be consistent with our decision on Network Code modification 642.

Regarding the other issues raised against this objective, we regard it as self-evident that the introduction of a time limit on reconciliation will reduce the risks, and potential costs, that code signatories will face significant alterations to their liabilities in relation to past events. These risks have been steadily increasing over time, as the window that has lapsed since the current backstop (1 February 1998) has widened. The reduction of these risks and their associated costs should significantly improve confidence in market participation, thereby helping to secure effective competition between Shippers and reducing barriers to entry. The benefits in this area are best facilitated by the 4-5 year option, because this is the shortest window.

Likewise, the introduction of a time constraint will ease demands on participants for data retention in relation to dates falling before the cut-off. The mitigation of inefficiencies associated with the current effectively open-ended requirement for data retention should aid participant efficiencies, thereby also helping to secure effective competition. Again, the benefits in this area are best facilitated by the 4-5 year option because this is the shortest window.

The introduction of a time limit for reconciliation inherently requires an acceptance that some energy volumes may never be correctly apportioned, as there is evidence of outstanding unreconciled energy volumes stretching back to the introduction of the current market arrangements. However, we note that the extensive analysis provided by the UNC126 review group suggests that the extent of unreconciled energy by the 4-5 year mark is comparatively small in the context of the size of the market.

In relation to within LDZ energy, the analysis suggested that approximately 1% (3TWh) of energy would be deemed but not reconciled with the 4-5 year model (in relation to unread meters and User Suppressed Reconciliation Values (USRVs)). As noted by one respondent, a proportion of these deemed volumes may not be inaccurate. In recent

weeks we have approved a modification proposal¹⁶ that seeks to increase the incentives on Shippers to resolve outstanding USRVs, and this should help to further mitigate the scale of long-standing USRVs.

In relation to NTS to LDZ reconciliations, the analysis suggested that approximately £19.5m of energy would not be correctly apportioned because of timing out under the 4-5 year model, reducing to £9.1m of energy for the 5-6 year model¹⁷. It should be noted that this analysis reflected historical performance at the time of the UNC126 review group process and may not be a realistic guide to future materiality. The data studied by the review group was heavily influenced by the presence of the Farningham incident¹⁸ within the data studied. When that incident was excluded from the data the volume of incorrectly apportioned energy under either the 4-5 or 5-6 year model was reduced by well over 50%.

The incorrect apportionment of any energy volumes is undesirable and may have a dilatory effect on cost targeting, but we consider that these volumes are tolerable in the context of the wider competitive benefits of reducing risks and costs of participation in the market through the introduction of a time limit on reconciliation.

We are also mindful that the electricity market has operated a 40-month limit on reconciliation for a number of years now without it causing significant difficulties. Even the 4-5 year model (equating to 48-60 months) envisaged by 152V is conservative in this context. We are not convinced by the suggestion that this is an aggressive window in which to resolve errors.

On balance we therefore consider that the mitigation of risk and data retention requirements should hold greater weight than avoiding the fairly limited timing-out of reconciliation volumes in our decision. Whilst we consider that all three variants represent an improvement on the baseline, the 4-5 year model maximises the benefits and therefore in our opinion best facilitates the securing of competition.

Applicable objective (f) - the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code

One respondent suggested that the introduction of a time limit will require Xoserve to hold less data, and this would result in central cost savings that would promote efficiency in the implementation and administration of the code.

Another respondent suggested that the introduction of a 4-5 year model will increase the risk to I&C Shippers who do not maintain accurate meters and suggested that 'if the proposal encourages greater meter accuracy within the I&C sector it could further facilitate [this objective]'.

We are in agreement that all three of these proposals would decrease the requirements for central data retention by Xoserve and its consequent costs. The 4-5 year model creates the biggest decrease, and therefore best facilitates the promotion of efficiency in the implementation and administration of the UNC.

¹⁶ UNC141, 'Revision to the User Suppressed Reconciliation Values Financial Incentives arrangements'.

¹⁷ No equivalent data was made available for the 6-7 year model as this duration was not supported within the 126 review group.

¹⁸ Farningham was an outlier both in terms of the lapsed time between errors occurring and reconciliation (at 7 years, over one year longer than the next nearest incident) and volume (at 2.4 TWh, nearly double the size of the second biggest correction and nearly three times the size of the third biggest correction).

We find the argument that improvements in I&C meter accuracy could be encouraged by the 4-5 year model somewhat weak and have not been convinced that such an incentive would be introduced.

Our wider statutory duties

In addition to better facilitating the code objectives, we also consider that approving 152V would be consistent with our wider statutory duties. In particular, we consider it would be consistent with our duties to promote effective competition and promote efficiency in the activities of licence holders.

The approval of UNC152 and the rejection of UNC117/122.

We note that time limits on reconciliation were previously envisaged by urgent modifications UNC117 and 122, both of which were rejected. This may prompt the question of what has changed since then to merit our now reaching a decision to introduce a time constraint on reconciliation. In short, at the time of 117/122 we were provided with very little evidence to enable us to understand the historic frequency, magnitude and duration of reconciliation corrections and therefore to have confidence that the potential impacts of this kind of change were fully understood and persuasive. This prompted us to suggest that further consideration of the implications of a time-cap should be considered by industry in order to *'to ensure that any solutions put forward are robust and enduring, rather than incident specific'*. This evidence has now been forthcoming, through 152 and the 126 review group, and a persuasive case for change has now been made.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC152V: 'Limitation on retrospective invoicing and invoice correction' be made.



Mark Feather

Associate Director, Industry Codes and Licensing

Signed on behalf of the Authority and authorised for that purpose.