

Modification proposal:	Uniform Network Code (UNC) 634: Revised estimation process for DM sites with D-7 zero consumption (UNC634)		
Decision:	The Authority ¹ directs this modification be made ²		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	10 November 2017	Implementation date:	To be confirmed by the Joint Office

Background

UNC432³, which was implemented with effect 1 June 2017 as part of Project Nexus, fundamentally changed the basis on which gas is allocated and subsequently reconciled and settled. Prior to this, any gas used within a Local Distribution Zone (LDZ) that was left over once allocations had been made for Daily Metered (DM) usage and shrinkage would be allocated to the Non-Daily Metered (NDM) sector. The amount of gas allocated to the NDM sector would be adjusted over time as meter readings came in, allowing for a reconciliation between the amount of gas initially allocated to individual sites and actual metered consumption. However, such reconciliation only took place for larger supply points. Smaller supply points, which typically include domestic premises, continued to be allocated an Annual Quantity (AQ) based proportion of whatever gas was left over once all other reconciliation had taken place. UNC432 removed this Reconciliation by Difference (RbD) process and required smaller supply points to be individually reconciled in the same way as larger supply points.

Further, under the new arrangements NDM consumption is no longer used as the balancing factor in each LDZ. Instead, a new NDM demand algorithm uses actual weather data to derive a bottom-up estimate. This estimate is subtracted from total LDZ throughput, along with DM measurements and an allowance for shrinkage, and the GTs own use of gas. Any residual unidentified gas (UIG) usage is now the balancing factor. This daily UIG is apportioned across all supply points, in accordance with a weighted scaling factor determined by an independent expert, the AUGE.⁴

Whilst the industry has become accustomed to permanent unidentified gas estimates (i.e. the amount of gas still unaccounted for once the 3-4 year UNC cut-off date for reconciliation has been reached), of around 1% of throughput, the daily UIG figures have been in excess of this. They have also been volatile. This unpredictability is making it more difficult for gas shippers to determine how much gas they should purchase in order to balance their daily positions, particularly for those who were previously exempt from any allocation through RbD.

Whilst the initial allocation of UIG is a temporary measure, with volumes being reduced as further meter reads come in which allow gas to be reconciled against individual supply points, this interim allocation of UIG will have cash flow implications for gas shippers. We were satisfied that these cash flow implications and the commercial impact that UIG was

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day-to-day work. This decision is made by or on behalf of GEMA.

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

³ UNC432: "[Project Nexus – Gas Demand Estimation, Allocation, Settlement and Reconciliation reform](#)"

⁴ The Allocation of Unidentified Gas Expert, see: www.gasgovernance.co.uk/augenex

having on gas shippers more generally, led us to agree that UNC634 should follow an urgent timetable.⁵

The modification proposal

One of the contributing factors to the current levels of UIG is the absence of Valid Meter Reads from a significant number of DM sites. This is at least in part due to meter read submissions failing the new validation rules, which form part of the new systems.

Currently, when it is not possible for whatever reason to procure a Valid Meter Reading from a DM site, the consumption from the equivalent day the week before, i.e. D-7, is used as an initial proxy of its consumption for settlement purposes. This process is intended to minimise the level of error between expected actual consumption and the amount of gas initially allocated to the site, in instances where there is a short disruption in the submission of actual reads. However, if the D-7 read was atypical of the site's consumption, for instance if it fell on a Bank Holiday, it could exacerbate any error. If the issues preventing an actual Valid Meter Reading continue, this could result in an ongoing distortion of UIG and error in gas settlements more generally.

UNC634 proposes to modify the current estimation process in instances where a Valid Meter Reading is not submitted for a DM site in accordance with UNC rules, and the prevailing D-7 consumption is zero. It was initially proposed that the estimate would instead be calculated to be a daily average of the sites consumption, i.e. AQ/365, in all instances. Following discussions at the Distribution workgroup a further two options were added, of either leaving the estimate at zero where Xoserve has reason to believe this is correct, or replacing it with an alternative consumption value agreed with the relevant shipper.

UNC Panel⁶ recommendation

At its meeting of 9 November 2017, the UNC Panel voted by a majority not to recommend implementation of UNC634.

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) version 2.0 dated 9 November 2017. We have considered and taken into account the responses to the industry consultation(s) on the modification proposal, which are summarised in the FMR and published in full on the Joint Office website⁷. We have concluded that:

- implementation of UNC634 will better facilitate the achievement of the relevant objectives of the UNC;⁸ and
- directing that the modification be made is consistent with our principal objective and statutory duties.⁹

⁵ See: www.gasgovernance.co.uk/sites/default/files/ggf/book/2017-10/Ofgem%20Decision%20Letter%20on%20Urgency%200634.pdf

⁶ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁷ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

⁸ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, available at: <https://epr.ofgem.gov.uk/Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

Reasons for our decision

There was a strong response to the consultation on this proposal, with the Joint Office receiving 18 responses. Of these, two were in favour of UNC634 being implemented with a further three offering qualified support. Eleven respondents were not in favour of UNC634 being implemented and the remaining two offered comments only.

We agree with the consultation respondents and the UNC Panel that UNC634 should be considered against relevant objectives (d) and (f), and that it would have a neutral impact on the other relevant objectives.

Relevant objective (d) - the securing of effective competition between relevant shippers;

The majority of respondents, whether they were in favour or opposed to the implementation of UNC634, recognised the current concerns around the volumes and volatility of UIG. However, views were mixed on the extent to which the existing rule of re-using the D-7 read in the absence of a Valid Meter Read contribute to the problem. There were also mixed views on whether UNC634 offered a better solution.

We acknowledge the point made in several responses that there are now relatively few instances of the default D-7 rule resulting in zero consumption being attributed to the supply point. We also note that Xoserve considers the majority of cases that do exist to be correct. However, the small number of instances that are erroneous may still account for a material amount of gas consumption given that DM sites typically have an AQ in excess of 58,600,000 kWh. Under the current circumstances of UIG volumes being higher and more volatile than expected, we consider it to be particularly important that all practicable measures are taken to remove any contributors to UIG. We also recognise respondents' concerns with this particular change to the default rules, and touch upon them further below, but consider that these are outweighed by the benefits of ensuring the UIG allocation and associated cost are as accurate as possible. We consider that accurate cost allocation is a fundamental principle of effective competition, allowing efficient operators to gain some competitive advantage over their rivals. Therefore, to the extent that UNC634 will contribute to the more accurate allocation of cost, we consider that it would better facilitate relevant objective (d).

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

One respondent raised a concern that the legal text may be open to interpretation over the extent to which the Central Data Services Provider (CDSP – Xoserve) has discretion to use a DM read despite it having failed validation, which could lead to disputes. Whilst this concern was also reflected in the UNC Panel discussion as reflected in the FMR, the respondent also notes that the legal text was not available at the time their response was written, being instead based on their understanding of the proposal at that time. It is therefore not clear to us whether this concern remains, though we note that the precise wording that the respondent refers to as being ambiguous does not appear in the published legal text.

⁹ 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 as amended.

We would agree that ambiguous legal text could reduce certainty and in some cases lead to disputes that may be time consuming to resolve, but have been unable to conclude whether that would be the case with UNC634. We therefore consider that UNC634 would have a neutral impact upon relevant objective (f).

Notwithstanding this, we do share the concerns of several respondents over this treatment of missing DM reads being an enduring solution, despite it being prompted by a transitional issue. We also note the concerns of several respondents that despite the extension to the originally requested timetable, there had still been little time for a robust assessment of the proposal. When asked to grant urgency to a modification proposal we must assess the trade-off between a full and rigorous assessment, and ensuring that the process completes in sufficient time to address the issue at hand, if appropriate. We remain of the view that it was appropriate to grant urgency to this proposal, given the ongoing issues around UIG. Whilst the failed validation of DM meter reads may constitute a relatively small component of UIG, we consider that all practicable steps should be taken to expediently reduce the problem.

We would also note that the UNC modification rules anticipate the situation where further consideration of an implemented modification proposal may be appropriate.¹⁰ For instance, the urgency of a situation may have necessitated a decision being made on the basis of incomplete or sub-optimal analysis. Any urgent modification proposal that is implemented should be placed on the agenda for the following UNC Panel, which should consider whether or not to refer the matter to the relevant workgroup, together with the Terms of Reference to be applicable. Whilst noting that this is a matter for the discretion of the UNC Panel, including the timeframe over which such a re-evaluation should occur, we consider that it may be appropriate to revisit the area covered by UNC634 once the greater and more immediate concerns over UIG have abated.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, we direct that modification proposal UNC634: *'Revised estimation process for DM sites with D-7 zero consumption'* be made.

Rob Salter-Church

Partner, Consumers and Competition

Signed on behalf of the Authority and authorised for that purpose

¹⁰ See rule 10.3: www.gasgovernance.co.uk/sites/default/files/ggf/page/2017-07/Modification%20Rules.pdf