

URGENT Modification Report
Changes to the 2003 Annual Quantity (AQ) Amendment Process
Modification Reference Number 0624
Version 1.0

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.9.3.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because it has established that Transco's AQ sub-group recognises that unless robust AQ Network Code rules governing AQ amendment activity are put in place, there is potential for significant commercial impact on Users.

Procedures Followed:

Transco agreed with Ofgem (and has followed) the following procedures for this Proposal:

Proposal agreed as Urgent	24 March 2003
Circulate Proposal to Users requesting representations	25 March 2003
Representation close-out	31 March 2003
Final Modification Report to Ofgem	02 April 2003
Ofgem decision expected	07 April 2003

1. The Modification Proposal

Modification of the Network Code is required to:

- Establish a tolerance limit within which proposed amendments to Smaller Supply Point Provisional AQ values would be rejected by Transco where such a request seeks an alteration of less than 20% of the Provisional value notified by Transco.
- Remove the existing tolerance threshold of 1000kWh per annum.
- Introduce reasons for Provisional AQ amendment. These should reflect that such amendments may only be made where the User is challenging the data that Transco has used in its calculation. The following conditions are proposed:
 - the Provisional AQ was calculated utilising inaccurate meter asset data; and/or
 - the Provisional AQ was calculated utilising inaccurate meter reading data; and/or
 - The shipper requested AQ was derived using an end reading that is more recent than the end reading used to derive the Transco proposed Provisional AQ and/or
 - Transco did not propose a Provisional AQ.
- Introduce provisions relating to the behaviour of Users during the amendment phase of the AQ review process which reflect that the focus of amendments should be balanced. (That amendment requests should reflect the true, seasonally adjusted, annual consumption anticipated at the Supply Meter Point requiring increases as well as reductions in the AQ).

2. Transco's Opinion

Transco believes that this Modification Proposal should be implemented.

The Annual Quantity (AQ) sub-group of the Supply Point & Billing Workstream has identified that a number of procedures within the Provisional AQ Amendment process have been actioned by some Users in a manner that has the potential to detrimentally affect other Users with Smaller Supply Meter Point (SSMP) portfolios. It is believed that a number of Users have manipulated their commercial position through the Annual Quantity (AQ) amendment process by focusing on reducing AQ values. The nature of the Network Code regime means that such AQ reductions have an adverse financial impact on other Users where such reductions do not in aggregate reflect the amount of gas likely to be consumed.

Given the basis of elements of SSMP charging to Users (based on aggregate LDZ AQ values), a series of measures have been identified by the AQ sub-group which are designed to better protect Users from the outcome of the yearly AQ review process.

Transco believes these afford further protection to Users having Smaller Supply Point portfolios which are subjected to Reconciliation by Difference (RbD).

3. Extent to which the proposed modification would better facilitate the relevant objectives

This Modification Proposal identifies measures which further refine the Annual Quantity (AQ) review process thereby providing greater certainty to all Users with respect to the impact of community AQ values. The proposed measures facilitate maintaining the accuracy of AQs and are therefore consistent with the efficient and economic operation by Transco of its pipeline system.

4. The implications for Transco of implementing the Modification Proposal , including

a) implications for the operation of the System:

No such implications have been identified.

b) development and capital cost and operating cost implications:

No such implications have been identified.

c) extent to which it is appropriate for Transco to recover the costs, and proposal for the most appropriate way for Transco to recover the costs:

Not applicable.

d) analysis of the consequences (if any) this proposal would have on price regulation:

No such consequences have been identified.

5. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal

Transco is not aware that any additional contractual risk would be introduced if this Modification Proposal were implemented.

6. The development implications and other implications for computer systems of Transco and related computer systems of Users

There are no such implications for Transco. It is possible that Users may need to alter their computer systems to accommodate implementation of this Modification Proposal.

7. The implications of implementing the Modification Proposal for Users

It is possible that Users would need to review relevant processes to accommodate implementation of this Modification Proposal. It should be noted, however, that the measures identified within this Modification Proposal are consistent with guidelines previously issued by Ofgem concerning submission of AQ amendments.

8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party

No such implications have been identified.

9. Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal

No such consequences have been identified.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- A reduced number of SSP AQ amendments would be sought thereby increasing certainty for Users in terms of their relevant User aggregate LDZ AQ positions.
- The commercial risk faced by Users subjected to Reconciliation by Difference (RbD) is reduced.
- Clear definitions of when an AQ amendment can be submitted are established.
- Establishes contractual reference to the operation of a consistent AQ amendment methodology identifying both upward and downward amendments.

Disadvantages

No disadvantages are identified.

11. Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Six representations were received with respect to this Modification Proposal. Five of these were supportive and one was opposed to its implementation.

TotalFinaElf Gas & Power Ltd, Scottish Power, Powergen, Innogy and British Gas believe that by introducing the measures identified within this Modification Proposal, a more balanced approach to AQ amendments can be reached and the potential for inappropriate behaviour is removed.

Innogy states "...The AQ review process should encourage shippers to provide AQs which are as accurate as possible. In our opinion setting the threshold at 20% will mean domestic shippers will not be able to achieve this for a significantly large part of their portfolio, and the collective effect of this might result in inefficiencies arising in Transco's pipeline system. Whilst we would not advocate dispensing with a threshold altogether, at least not for this year, in our opinion a 10% threshold would be more appropriate to use this year..."

Transco's response: Last years amendment activity was made up of approximately 20% of User portfolios. The revised tolerance is expected to decrease activity to approximately 10%. Transco does not therefore believe that this is a significant impact on User portfolios.

The AQ Sub-group has previously discussed in some detail the tolerance level which should be applied in association with AQ amendments. Modification Proposal 0454 'Amendment to the Small Supply Point AQ Process' originally introduced a tolerance of 1000kWh and in the light of recent AQ reviews was considered to be low. Extensive analysis undertaken within the AQ sub-group has suggested that a 'percentage' tolerance is preferable to an 'absolute' tolerance. Values of between 20% - 30% were discussed following which the AQ Sub-group identified that a 20% threshold would be optimal.

Powergen states "...It has become apparent that shippers can abuse the RbD process by requesting excessive AQ amendments, which results in other domestic shippers being forced to take defensive actions to protect their own commercial positions..."

Scottish Power comments "... in order to reduce the risk to RbD shippers manipulating AQ values to the detriment of other Users, the AQ sub group has identified a number of changes that if agreed would not only reduce the number and circumstances of permissible amendments but would also make legal the requirement within Network Code, for shippers to take a balanced approach when submitting amendments. Scottish Power therefore fully support the implementation of Modification Proposal 0624 and believe that the measures detailed within, will provide greater stability and reduce the risk to RbD..."

TotalFinaElf Gas & Power Ltd states "...We are in agreement that implementation of this proposal will strike a balance between reducing the overall number of AQ amendments generated for Smaller Supply Point, whilst ensuring that amendments can still be made to those Supply Points where the provisional AQ calculated by Transco is inappropriate..."

British Gas states "...We believe that this modification addresses issues in the AQ Review process that have led to distortions in Reconciliation by Difference (RbD) through some shippers submitting only amendments decreasing AQs. The principal change, requiring balanced activity, was one that the majority of the industry "believed" it was already operating to. However, when this principle was explicitly challenged during an Ofgem review of 2002 AQ amendment activity it was found that Network Code conditions were insufficiently explicit in this respect..."

Transco concurs with the view of the above respondents and believes that, if this Modification Proposal were implemented, the provisions within the Network Code would be sufficient to prevent future inappropriate behaviour.

British Gas further states "...we believe that the majority of shippers, including ourselves, will have applied AQ amendment processes in the past that would have satisfied the balanced activity requirement specified in the new paragraph 1.6.4(c). We similarly believe that this compliance includes the criteria specified in 1.6.4(b). However, we have not in the past recorded evidence to support 1.6.4(b) and 1.6.4(c) as specified in 1.6.5(c).

It would require a significant system change to provide such data as part of the live AQ amendment dataflow, and if required, this would not be a deliverable as part of the 2003 AQ review process. However, we have been given to understand that Transco will not be amending their dataflow requirements. Therefore retrospective analysis of shippers submissions, under "reasonable endeavours" to satisfy the requirements within the modification, should be sufficient to demonstrate compliance to the proposed clause 1.6.4...)."

Transco concurs with the view of the above respondent and confirms that no amendment to the current dataflow requirements is planned.

Scottish and Southern Energy notes that it raised Modification Proposal 0614 "Suspension of Smaller Supply Point AQ Amendments for 2003" and Review Proposal 0615 "Review of the Smaller Supply Point AQ Calculation Methodology", both on the 13 February 2003 and states "...We are deeply concerned that Transco has raised Modification Proposal 0624 at this late stage. We see no reason why Transco has not done so before. Indeed, we believe that Transco's action in this respect questions the governance of the Network Code. We firmly believe that Transco's actions represent an abuse of process..."

Transco's response: Following exhaustive discussion, the AQ sub-group requested Transco to raise an Urgent Modification Proposal to establish relevant Network Code provisions associated with governance of the AQ amendment phase of the AQ review. The AQ sub-group specifically requested that the legal drafting be shared and reviewed with Ofgem as a pre-requisite to Transco raising such a Proposal. Transco ensured that the requirements of the AQ sub-group were met prior

to raising this Modification Proposal. Transco does not therefore believe an abuse of the Modification Process has occurred.

Scottish & Southern Energy further states "...Our understanding of this proposal is that it aims to address the concerns that have been raised within the industry over the operation of the amendment phase of the AQ Review. It seeks to restrict shippers' activities within the amendment phase and impose certain behavioural patterns. However such activity is symptomatic and not causal. The underlying cause of concern would seem to lie within the Demand Estimation and RbD regimes. This Modification Proposal does nothing to address these concerns and, most inappropriately, it clearly represents a further transfer of the costs and risks associated with SSP reconciliation from Transco on to shippers, which totally defeats the point of the RbD process. To expand upon these points, within the domestic market, the industry signed on to certain perceived benefits that underpin RbD. In other words, the industry accepted the loss of accuracy at a meter point level in return for a much simplified and less costly settlement process that works at an aggregate portfolio level. As a result, focus shifted to the AQ (as it is the AQ, rather than metered consumption, that determines final demand allocations). At this time the AQ calculation methodology itself (part of Demand Estimation) was not reviewed, and is perhaps now an oversimplification given its increased importance. It appears to be volatile depending on the read history used, it may systematically bias certain customer groups and in general would seem a poor estimate of consumption for individual meter points. Furthermore, its accuracy at a portfolio level has yet to be determined..."

Transco's response: In furtherance of Review Proposal 0567 'Review of NDM demand forecasting methodology' raised by Scottish & Southern Energy, the industry spent considerable time and engaged significant Transco resources in reviewing all aspects of NDM demand forecasting. Its conclusion was that other than implementation of Modification Proposal 0590 'Provision of additional within day demand forecast and demand attribution run' no further investigation was required. Further to this, a consequence of Review Proposal 0615 is that many of SSE's claims described above will be investigated within appropriate Network Code fora to include the RbD and AQ sub-groups of the Supply Point & Billing Workstream.

It is worthy of note that Scottish & Southern Energy was asked to provide evidence relating to read history affecting the AQ calculation, within the AQ Sub-group. No such evidence was, however, forthcoming. Transco remain committed to ensuring the integrity of the RbD regime and welcomes any empirical evidence which challenges this.

Scottish & Southern Energy states "...by virtue of 1.6.4(d), the legitimacy of a shipper's action appears to be open to interpretation solely by Transco. We are concerned over their ability to reject amendments without notification or appeal, when the criteria for such a judgement has not clearly been defined. For example, if the 'true' level of amendments is 30% up and 70% down, will this be deemed as inconsistent and the amendments rejected? What is a balanced approach? How will Transco determine the true rate? What if the true rate is 70% up and 30% down, but the shipper submits amendments at a rate of 50/50 up/down?..."

Transco believes that the legal drafting establishes that a consistent approach must be taken for all Supply Points subjected to review by the User. It further identifies that the Users should not materially differentiate in their treatment of Supply Points irrespective of whether the Provisional AQ is increased or decreased. The drafting does not, however, suggest that amendments submission should necessarily be "balanced".

12. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation

Implementation of this Modification Proposal is not required to enable Transco to facilitate compliance with safety or other legislation.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence

Implementation of this Modification Proposal is not required to facilitate any such change.

14. Programme of works required as a consequence of implementing the Modification Proposal

No program of work is required as a result of implementing this Modification Proposal.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

Transco proposes that this Modification Proposal be implemented as soon as possible. This would allow Users sufficient time prior to commencement of the 2003 AQ Review process for any required system and/or process enhancements.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation of this Modification Proposal.

17. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

Section G, paragraph 1.6.4

Re-word paragraph 1.6.4(a) as follows:-

- (a) Following the notification of the Provisional Annual Quantity the Registered User may, subject to paragraph 1.6.4(c) and where the provisions of paragraph 1.6.4(b) apply:
- (i) in the case of a Smaller Supply Point where it considers that the Provisional Annual Quantity should be greater or lesser than the Provisional Annual Quantity notified by Transco by not less than 20%; or
 - (ii) in respect of any Larger Supply Point
- not later than 13th August in the preceding Gas Year notify Transco that it considers that the Provisional Annual Quantity does not satisfy the requirement in paragraph 1.6.6 (“**User Provisional Annual Quantity**”).

Insert as new paragraph 1.6.4(b):-

- “(b) The provisions referred to in paragraph 1.6.4(a) are:
- (i) that the Registered User reasonably considers that Transco’s calculation of the Provisional Annual Quantity is derived from:
 - (aa) Meter Readings that are incorrect or were taken prior to Meter Readings available to the Registered User and/or
 - (bb) materially incorrect details of the Supply Meter Installation for the relevant Supply Meter Point; or
 - (ii) where Transco has determined the Provisional Annual Quantity in accordance with paragraphs G1.6.2(a) or G1.6.2(d).”

Insert as new paragraph 1.6.4(c):-

- "(c) Where, in respect of any Supply Point, the Registered User notifies Transco of a User Provisional Annual Quantity in accordance with paragraph 1.6.4(a) it shall warrant that:
- (i) in reviewing the Provisional Annual Quantity it has applied a methodology that:
 - (aa) is consistent to all Supply Points for which it is the Registered User; and
 - (bb) does not materially differentiate in its treatment of Supply Points where the User Provisional Annual Quantity may be greater than the Provisional Annual Quantity notified by Transco and Supply Points where the User Provisional Annual Quantity may be less than the Provisional Annual Quantity notified by Transco; and
 - (ii) it has notified Transco of all User Provisional Annual Quantities resulting from the application of the methodology referred to in sub-paragraph (i) above that satisfy the requirements set out in paragraph 1.6.4(a)."

Re-number the existing paragraph 1.6.4(b) as 1.6.4(d) and amend as follows:-

- ~~"(b)~~(d) Transco will be entitled to reject without consideration, notice or liability any notification by a User which does not comply with the requirement in paragraph 1.6.4(a)~~(i)~~."

Re-number the existing paragraph 1.6.4(c) as 1.6.4(e).

Insert as a new paragraph 1.6.5(c):-

“(c) shall record evidence (and shall make such evidence available for inspection where reasonably requested) to support the applicable provision of paragraph 1.6.4(b) and the warranty given pursuant to paragraph 1.6.4(c).”

Signed for and on behalf of Transco.

Signature:

Debbie Dowling
Finance Manager

Support Services

Date:

Gas and Electricity Markets Authority Response:

In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0624**, version **1.0** dated **03/04/2003**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **1.0**.

Signature:

Process Manager - Network Code

Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:
 - (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or
 - (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriateprovided that if the Authority does not so approve the Agreement then Clause 3 shall apply.
2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.
3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.
4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.