

Final Modification Report
Reconciliation following AQ Amendment where an SSP becomes an LSP prior to
calculation of Provisional Annual Quantity
Modification Reference Number 0136
Version 1.0

This Modification Report is made pursuant to Rule 9.3.1 of the Modification Rules and follows the format required under Rule 9.4

1 The Modification Proposal

Modification Proposal 640 was implemented in June 2004 and introduced arrangements to reconcile the energy and transportation commodity charges, where the revision of the Annual Quantity (AQ) had caused a Supply Point to be re-classified as a Larger Supply Point (LSP). Modification Proposal 640 contained three specific exclusions in order to simplify the amendment. These exclusions were considered, at the time, to be of little significance and of low materiality.

However, from figures made available by xoserve at the Billing Operations Forum, it was made apparent that this was no longer the case.

In July 2006, Modification Proposals 094, 095 and 096 were raised seeking to remove each of the three exclusions which were at the time detailed within Section E 7.4.3 (a) (b) & (c) of the Transportation Principal Document.

The Authority subsequently approved Modification Proposals 094 & 095 on 30 October 2006, however Modification Proposal 096 was rejected.

Within the Authority's decision letter for Modification Proposal 096, dated 30th October 2006, the Authority made reference that *'the exclusion contained within UNC section E7.4.3 c) and the ability to avoid the revision charge provides an incentive on shippers to proactively monitor and pursue threshold crosser appeals.'* Further the decision letter stated *'in addition to correctly allocating costs to the individual LSP rather than the RbD sector at an earlier stage, we also consider that this should provide administrative efficiencies, encouraging appeals to be made throughout the year, rather than concentrated in the post-Provisional AQ window.'*

Whilst the proposer acknowledges that it can be argued that the remaining exclusion provides an incentive for parties to proactively monitor and pursue threshold crosser appeals, this same exclusion also provides a perverse incentive on Shippers to ensure that appeals are concluded prior to, and as close as possible to, the post-Provisional AQ window as all Supply Points which have had successful appeals will be excluded from the subsequent End of Year Reconciliation calculations and will not be subject to the resulting Annual Quantity Revision Difference Transportation Charges.

Approximately 80% of annual gas assumption takes place during the winter months within a window which begins at the commencement of the new Supply Point AQ

(1st October) and the date when Provisional Annual Quantity calculations are undertaken by the Transporters (normally at the end of March). Therefore all successful threshold crosser appeals, undertaken within the aforementioned window, will have a significant detrimental impact to the RbD sector, due to the profile of annual gas consumption. The impact is compounded where appeals are undertaken at the last possible moment, where reads are taken at the end of the winter consumption period.

The modification proposal seeks to maintain the incentives on Shippers to proactively monitor and pursue threshold crosser appeals, but also remove the perverse incentives on Shippers to ensure that appeals are concluded prior to, and as close as possible to, the post-Provisional AQ window.

It is proposed that where a successful threshold crosser appeal takes place, regardless of when the appeal is undertaken, either before or after the date when Provisional Annual Quantity calculations are undertaken by the Transporters, that the Supply Point will not be excluded from the End of Year Reconciliation calculations. However it is further proposed that the Supply Point will not be exposed to the full resulting Annual Quantity Revision Difference Transportation Charge, but instead will only be charged a proportion of the charge, this proportion being 90%.

Appendix 1 provides supplementary information relating to the Modification Proposal 640 Adjustments for the 2004/5 Gas Year and highlights the specific impact of AQ's appealed during the appeals window and therefore exempt from Annual Quantity Revision Difference Transportation Charges.

It further provides information relating to the Modification Proposal 640 Adjustment for the 2005/6 Gas Year, specifically in relation to the impact of AQ's appealed during the appeals window and therefore exempt from Annual Quantity Revision Difference Transportation Charges.

Consequences of not implementing this Proposal

The existing perverse incentives which are in place, will continue to exist and significant amounts of energy will continue to be allocated to the incorrect sector i.e. that this will be allocated in aggregate across SSP's, rather than being correctly applied to the LSP sector.

Appendix to Modification Proposal - Reconciliation following AQ Amendment

Modification Proposal 640 Adjustments - 2004/5 Gas Year

	(Mwh)
Initial Threshold Crosser Volume established	4,093,625
Less Exclusions Applied	
Shipper Transfers	989,372
Appealed during appeals window	205,916
Increases less than 15k and 20%	75,878
SSP to LSP after appeals window (no reconciliation)	341,787
Other Reasons (e.g. Duplicates)	149,098
Final Reconciliation Volume	2,331,574
Unreconciled Volume due to exclusions	1,271,166

Based on MOD640 Reconciliation invoices for the 2004/5 Gas Year, non-reconciliation of 'Appealed during appeals window' upward threshold crossers represents **£3M** of misallocated charges between the SSP and LSP markets.

Modification Proposal 640 Adjustments – 2005/6 Gas Year

	(MWh)
Appealed during appeals window	435,800

Based on MOD640 Reconciliation invoices for the 2005/6 Gas Year, non-reconciliation of 'Appealed during appeals window' upward threshold crossers represents **£10M** of misallocated charges between the SSP and LSP markets.

2 Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Standard Special Condition A11.1 (a): *the efficient and economic operation of the pipe-line system to which this licence relates;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (b): *so far as is consistent with sub-paragraph (a), the coordinated, 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;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (c): *so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (d): *so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;*

By incentivising actions which lead to a more accurate allocation of energy and transportation charges following revision of Annual Quantities, implementation would be expected to allocate costs more accurately and so facilitate the securing of effective competition between Shippers and between Suppliers.

Some respondents did not believe that appropriate incentives would be created and therefore concluded that implementation would not further facilitate this objective

Standard Special Condition A11.1 (e): *so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers' licences) are satisfied as respects the availability of gas to their domestic customers;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (f): *so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.*

Implementation would not be expected to better facilitate this relevant objective.

3 The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

4 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) implications for operation of the System:

No implications for operation of the system have been identified.

b) development and capital cost and operating cost implications:

Minor additional costs are anticipated as a result of implementation.

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

No additional cost recovery is proposed.

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

No consequence for price regulation has been identified.

5 The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

No such consequence is anticipated.

6 The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

Implementation would have a minimal impact upon systems and require little system development. The processes for the calculation of reconciliation is already in place and implementation of this Modification Proposal would create a modest amount of additional calculations and reconciliation to perform.

7 The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

Administrative and operational implications (including impact upon manual processes and procedures)

Implementation would have an impact upon Shipper systems and require some system development. The scale of this is dependent on each Shippers' existing system and processes.

Development and capital cost and operating cost implications

No such costs have been identified.

Consequence for the level of contractual risk of Users

No such consequence has been identified.

NG UKD argued that a User's level of contractual risk would increase as a consequence of subjecting all LSP AQ threshold crossers to a proportion of the end

0136: Reconciliation following AQ Amendment where an SSP becomes an LSP prior to calculation of Provisional Annual Quantity v1.0
of year reconciliation.

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

Additional User costs may be passed through to the Supplier who may incur costs from retrospectively billing the customer for the extra consumption. Suppliers, and ultimately consumers could therefore incur extra costs.

EDF Energy disagree that additional costs would be incurred as ultimately revenue is collected based on actual consumption.

9 Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non 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

- Ensures the correct allocation of energy and transportation commodity charges following revision of Annual Quantities
- Improves the incentives upon Shippers to ensure that threshold crosser appeals are undertaken in a timely manner.
- Reduces any perverse incentives upon Shippers to undertake Threshold Crosser appeals as late as possible in the AQ revision process.
- Improves arrangements to ensure that costs are not inappropriately borne by SSP Shippers.
- Increase in the number of AQ revisions submitted by Shippers

Disadvantages

- Additional calculations and reconciliations to perform
- In order to minimise the User Annual Quantity Revision Difference incurred, the work undertaken by some Shippers in monitoring threshold crossers will increase

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

Representations were received from the following parties:

Organisation		Position
British Gas Trading	BGT	Support
Corona Energy	Corona	Not in Support
EdF energy	EDF	Support
E.ON UK	EON	Support
Gaz de France	GDF	Not in Support
National Grid Distribution	NG UKD	Not in Support
RWE npower	RWE	Not in Support
Scotia Gas Networks	SGN	Support
Scottish Power	SP	Support
Total Gas and Power	TGP	Not in support (0096 response)
Wales & West Utilities	WWU	Not in Support

Some representations questioned the rationale for the proposed 90% Annual Quantity Revision Difference Transportation Charge and the incentives that this would create.

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

No such requirement has been identified.

13 The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

No such requirement has been identified.

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

No programme for works has been identified.

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

It is proposed that the Modification is implemented no later than 30 September 2007 for application to the 2006/07 Gas Year End of Year Reconciliation.

16 Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

17. Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

18. Transporter's Proposal

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

19. Text

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters