

Modification proposal:	Uniform Network Code (UNC): Reconciliation following AQ Amendment where an SSP becomes an LSP prior to calculation of Provisional Annual Quantity (UNC 136v)		
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:	22 August 2007	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

Under the terms of the UNC, Gas Transporters (GTs) are required to undertake an Annual Quantity (AQ) review, which is an annual review of the amount of gas consumed at each Supply Point on the pipe-line system.

The first stage of the AQ review process requires the GTs to calculate Provisional Annual Quantity (PAQ) values and send these to UNC Users (shippers). The UNC describes how AQs may be amended by shippers and their obligations in approaching this exercise in a consistent and balanced way. The quantities assessed under this process not only drive the allocation of energy for consumption billing processes, but underpin the calculation of daily consumption on Non-Daily Metered supply points for energy balancing purposes.

As a result of the AQ review, a number of Smaller Supply Point (SSPs) are identified as having increased consumptions and have crossed the 73,200 kWh threshold (known as 'threshold crossers'), meaning they should ordinarily be classified as Larger Supply Points (LSP). LSPs are subject to individual reconciliation, rather than Reconciliation by Difference (RbD). Incorrect classification of Supply Points can result in the misallocation of costs, generally to the detriment of the 'RbD community'.

Approved Network Code Modification 640 which was implemented in June 2004, introduced arrangements to reconcile the energy and transportation commodity charges at the end of year, where the revision of the Annual Quantity (AQ) had caused a Supply Point to be re-classified as a LSP. Approved Modification Proposal 640 contained three specific exclusions in order to simplify the amendment, such that end of year reconciliations would not be carried out where:

- the AQ increases by less than 15,000 kWh or 20%, or
- the Supply Point has transferred to another User during the past year; or
- the AQ was revised above the threshold by the shipper, prior to the GT issuing a provisional AQ.

At the time Modification 640 was implemented these exclusions were considered to be of little significance and of low materiality. However, figures provided by Xoserve and recreated in the Final Modification Report show that these exclusions amounted to around 1.3 TWh in the 2004/05 gas year, of which 0.2TWh related to threshold crosser appeals during the appeal window.

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.

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

In July 2006, UNC 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 UNC. The proposer considered that the implementation of these modification proposals would further facilitate relevant objective d) of the UNC, the securing of effective competition between relevant shippers and relevant suppliers.

The Authority subsequently approved UNC Modification Proposals 094 & 095 but rejected 096, which sought to remove a shipper's exclusion from a User Annual Quantity Revision Difference Transportation Charge Adjustment (the revision charge) where the AQ is revised above the threshold by the shipper prior to the GT issuing a PAQ.

As stated within the Authority's decision letter to reject UNC Modification Proposal 096, we considered that the ability to avoid the revision charge provides an incentive on shippers to proactively monitor and pursue threshold crosser appeals. In addition, the Authority considered that correctly allocating costs to the individual LSP rather than the RbD sector at an earlier stage should provide administrative efficiencies, encouraging appeals to be made throughout the year, rather than concentrated in the post-PAQ window.

The modification proposal

UNC Modification Proposal 136v seeks to remove the exclusion contained within Section E 7.4.3 (c) of the UNC, enabling the reconciliation of all threshold crossers regardless of the fact that an amendment of the AQ above the SSP threshold may have taken place prior to the GT issuing a PAQ. Under UNC Modification Proposal 136v, the relevant registered shipper would then be liable to pay 90% of the revision charge.

The Proposer considers that the remaining exclusion provides a perverse incentive on Shippers to ensure that appeals are concluded prior to, and as close as possible to the post-PAQ 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 revision charges. The 90% charge proposed under 136v seeks to allay the Authority's concerns expressed in its decision letter for UNC Modification Proposal 096.

UNC Modification Proposal 136v is a variation on UNC 136, clarifying the application and effect of the '90% charging rule' referred to in the proposal. The clarification asserts that shippers should be charged 90% of the revision charge only when threshold crosser appeals are successfully undertaken prior to the calculation of the PAQ by the GT. Successful threshold crosser appeals undertaken after the calculation of the PAQ, or where the User has failed to appeal the AQ, would continue to be subject to the full revision charge, in accordance with existing UNC arrangements.

At the Modification Panel meeting held on 21 June 2007, the variation to UNC Modification Proposal 136 was considered to be substantive. UNC Modification Proposal 136 was subsequently withdrawn and replaced with UNC Modification Proposal 136v. Following the variation, it was noted that National Grid Distribution and Wales & West Utilities changed their representation to now support UNC Modification Proposal 136v.

UNC Panel Recommendation

At the Modification Panel meeting held on 19 July 2007, of the 9 Voting Members present, 7 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel recommend implementation of this Proposal.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 25 July 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 FMR. The Authority has concluded that:

1. implementation of modification proposal UNC136v will better facilitate the achievement of the relevant objectives of the UNC ; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties .

Reasons for the Authority's decision

We note that the Joint Office received twelve responses to its consultation on UNC modification proposal 136v, of which eight were supportive and four were opposed.

Some respondents who were supportive of UNC modification proposal 136v considered that in excluding this particular category of threshold crossers the 640 process inadvertently rewards shippers for erroneously amending a supply point below the SSP threshold. These respondents considered that UNC modification proposal 136v removes this perverse incentive by ensuring that shippers are not excluded from the revision charge, whilst also seeking to maintain the incentives upon shippers to proactively monitor and pursue threshold crossers appeals.

Some respondents who did not support this modification considered that there should be a reasonable incentive on shippers to correct AQs and improve the data held to ensure a fair cost allocation via the reconciliation process. They also considered that the marginal improvement in the level of data quality held by Xoserve resulting from this proposal would not warrant the additional workload to shippers.

We consider that the removal of the exemption referred to above will ensure that the correct allocations of energy and transportation commodity charges are appropriately borne by the relevant Users, thereby allocating costs to the individual LSP rather than the RbD sector at an earlier stage. We note that this exemption amounted to around 0.4TWh in the 2005/06 gas year, up from 0.2TWh the previous year, though some of this increase will be due to the implementation of Modification Proposals 094 & 095 which removed two of the exclusions under which many of these threshold crossers may otherwise have been classified. As indicated in the FMR, the remaining exemption currently represents circa £10m of misallocated charges, which we do not consider to be insignificant.

Whilst we agree with those respondents who suggested that there should be a reasonable incentive on shippers, we consider that this proposal will retain the current incentive upon shippers to ensure that threshold crosser appeals are conducted in a timely manner. Although the proposal will potentially expose shippers to 100% of the revision charge, they do have the opportunity to proactively manage this exposure and limit it to

90% where they successfully undertake a threshold crosser appeal. If they do not undertake such an appeal, or delay it until after the calculation of the PAQ they will incur 100% of the revision charge.

We understand concerns of some respondents that there has been little or no analysis or rationale to confirm the extent to which the 10% discount in the revision charge may affect shipper behaviour. One respondent in particular considered that this represented a huge dilution of the incentive. In this respect, we consider that it would have been helpful if such analysis could have been undertaken and made available to market participants during the development of this proposal. However, we also note that those respondents had the opportunity to raise these points during development and even propose alternative modifications with different levels of discount, but did not do so.

We would also expect industry parties to maintain their monitoring of these arrangements to ensure that they continue to facilitate market arrangements. In particular we would request that Xoserve make available information relating to shipper behaviour in respect of threshold crosser appeals over the coming year. Subject to the effect the 10% discount has on shipper behaviour, it may prove appropriate for it to be revised, though this need not necessarily be upwards.

Notwithstanding whether the 10% discount will continue to be an effective incentive, we do not consider that this detracts from the principle that this proposal will facilitate a more accurate allocation of charges, whilst continuing to reward shippers who submit threshold crosser appeals in a timely manner. We therefore agree with those respondents who considered that this proposal will better facilitate relevant objective (d), *the securing of effective competition between relevant shippers and relevant suppliers*.

One of the perceived disadvantages of the proposal is that in order to minimise the revision charge, there will be increased work undertaken by shippers in monitoring threshold crossers. However, we do not consider this to be an inappropriate burden. Indeed this is precisely the behaviour which we seek to encourage. Further, we consider that correctly allocating costs at an earlier stage should provide administrative efficiencies, encouraging appeals to be made throughout the year rather than concentrated in the post-PAQ window. To this extent we consider that the proposal will marginally further facilitate relevant objective f) *the promotion of efficiency in the implementation and administration of the UNC*.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 136v: 'Reconciliation following AQ Amendment where an SSP becomes an LSP prior to calculation of Provisional Annual Quantity' be made.



Mark Feather,
Associate Director, Industry Codes & Licensing

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