

Modification proposal:	Uniform Network Code (UNC) 658: CDSP to identify and develop improvements to LDZ settlement processes (UNC 658)		
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:	6 July 2018	Implementation date:	6 July 2018

Background

Prior to the implementation of UNC432³ on 1 June 2017 as part of the Project Nexus, 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.

NDM consumption is no longer used as the *balancing figure* in each LDZ, for each day. Instead, an 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, with any residual Unidentified Gas (UIG) usage being the new balancing figure. This daily UIG is apportioned across all supply points, in accordance with a weighted scaling factor determined by an independent expert, the AUGE⁴.

Prior to the implementation of UNC432, the industry had become accustomed to *permanent* Unidentified Gas estimates of around 1% of throughput. This figure represents the residual amount of gas still unaccounted for at the UNC cut-off date, i.e. after 3-4 years of reconciliation. However, the daily UIG figures since 1 June 2017 have generally been in excess of this and have shown considerable volatility (UIG can be a positive or negative value). This unpredictability makes it difficult for gas shippers to determine how much gas they should purchase in order to balance their daily positions. The issue is compounded by uncertainty over how much of the variance between allocated gas and actual consumption will be resolved through subsequent reconciliation, and when this will occur. In the meantime payment for energy - including the shipper's allocation of UIG - will become due.

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

The modification proposal

UNC658 proposes that Xoserve as the Central Data Services Provider (CDSP) be given a mandate to assign resources to investigate the root causes and influencers of UIG, with a target of reducing its volatility and scale and developing a robust predictive model for daily UIG for use by all parties.

The proposal seeks to achieve this by effecting a change to the CDSP Data Services Contract (DSC) rather than to the legal text of the UNC itself. Separately, Xoserve has raised DSC change request XRN4695: 'Investigating Causes and Contributors to Levels and Volatility of Unidentified Gas'.

UNC Panels recommendation

At the UNC Panel meeting on 21 June 2018, all members who cast a vote did so in favour of recommending that UNC658 be implemented.

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 22 June 2018. We have considered and taken into account the responses to the industry consultation(s) on the modification proposal which are attached to the FMR⁶. We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC;⁷ and
- directing that the modification be made is consistent with our principal objective and statutory duties.⁸

Reasons for our decision

We note the strong degree of support for the intent of this proposals. Of the 17 representations received, ten supported its implementation with a further three offering qualified support. Four respondents offered comments only. Whilst none of the respondents were opposed to the modification or its intention, several respondents, including those offering qualified support, queried whether a UNC modification was necessary. It was noted that no modification to the legal text is required in order to achieve the intent of the proposal; it could instead be progressed through a change to the DSC.

The UNC Panel also recognised this aspect of dual governance, with some members questioning whether this was an efficient use of industry time and resources. It was noted that whilst under normal circumstances a change request would be raised through the DSC in the first instance, a UNC modification may subsequently be raised to "provide

⁵ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁶ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

⁷ 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>

⁸ The Authority's statutory duties are wider than matters which the Panel must take into consideration; they are detailed mainly in the Gas Act 1986 as amended.

more traction” to achieve a desired result. It was also noted that there is no urgency process in the DSC procedures.

While XRN4695 has now been formally raised, the Business Evaluation Report is not expected to be considered by the DSC change management committee until 13 July 2018.

Whilst recognising that UNC658 is purely a facilitating modification, we consider that its implementation will further relevant objective d), outweighing any marginally detrimental impacts upon efficient administration (objective f). We consider that the proposal would have a neutral impact upon the other relevant objectives.

(d) the securing of effective competition between relevant shippers

As noted on our recent impact assessment and minded to position on modification proposals 642, 642A and 643⁹, we recognise that that the current volumes and volatility of UIG are currently making it difficult for some gas shippers to make efficient purchasing decisions, and to forecast when UIG volumes may be ‘returned’ to them through reconciliation. However, we also set out our view that none of UNC642, 642A or 643 would offer any immediate relief to the UIG issue, and that the problems stem from poor data quality rather than the gas allocation arrangements being inherently flawed. This remains our view. We therefore fully agree with those respondents who said that more needs to be done to identify and address the root causes of UIG volatility, and that this work should be done at pace. We also share the frustration that some respondents expressed, that this work remains necessary and outstanding more than a year after the new arrangements were implemented. Whilst we recognise that the intent of UNC658 may have been achieved through other means, it is hoped that the implementation of this proposal will go some way to expedite this work.

We also welcome the development of a UIG predictive model. Whereas those shippers that were previously subject to the RbD regime may have effectively priced this UIG exposure into their tariffs, those who have little or no previous experience of RbD and exposure to unidentified gas cost are now faced with more complex forecasting and pricing decisions. Rather than price this risk into their energy tariffs, we are aware that some shippers are choosing to introduce a discrete UIG charge, passed directly through to consumers. Given that the revised gas allocation arrangements are still relatively new and could still be considered to be ‘bedding in’, if forward estimates of UIG are simple extrapolations of the UIG levels seen to date, they may prove to be artificially high. To the extent that these projections do prove to be too high and that shipper exposure to UIG will in any case reduce over time as actual gas usage is reconciled, we are also concerned that these adjustments and reconciliations may not similarly be passed through to consumers, resulting in a windfall gain for shippers.

We therefore fully support the intention of the proposal, not only to provide the CDSP with a target of reducing the volatility and scale of UIG, but to develop a robust predictive model for daily UIG that can be used by all parties. We consider that this will not only address some of the asymmetries of knowledge that exist between shippers, but also allow for greater transparency in how any discrete UIG charged have been derived, increasing gas shippers’ accountability to their customers.

⁹ See: www.ofgem.gov.uk/publications-and-updates/initial-impact-assessment-and-minded-position-unc642-642a-and-643-allocation-unidentified-gas

To the extent that the implementation of UNC658 will expedite the provision of additional UIG services by the CDSP, we consider that it will further facilitate effective competition between gas shippers.

(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

We recognise that there is an element of dual governance insofar as the intent of this proposal is also subject to change request XRN4695. However, the DSC governance arrangements anticipate a degree of interaction between that contract and the UNC. Whilst the implementation of UNC658 should expedite to the process, we do not consider that it is of itself prejudicial to any further consideration of funding levels, standards of service, etc. We also consider that the impacts of UIG are sufficiently important, and impact upon a community of interested stakeholders that extend beyond the DSC Parties, to warrant this being escalated to a UNC matter. Therefore, whilst we acknowledge that there has been some duplication, we consider that it is in this case warranted, and any concerns about administrative efficiency are outweighed by the expected beneficial impacts upon competition.

We also consider that any work facilitated by UNC658 to identify the root causes of UIG will be complementary, and without prejudice, to any of the other modification proposals and initiatives in this area. We therefore consider that overall, directing the implementation of this proposal will serve to further our Principal Objective of protecting the interests of consumers, wherever appropriate by promoting effective competition.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority hereby directs that modification proposal UNC658: '*CDSP to identify and develop improvements to LDZ settlement processes*' be made.

Rachel Clark
Programme Director, Consumers and Markets

Signed on behalf of the Authority and authorised for that purpose