

**CODE MODIFICATION PROPOSAL No 0171A**  
**Amendment to “User SP Aggregate Reconciliation Proportion” to incorporate historical**  
**AQ Proportions**

**Version 1.0**

**Date:** 28/12/2007

**Proposed Implementation Date:** 1/4/2008, or on a future date to be determined by Ofgem in directing implementation and by the Transporters in enacting that implementation direction.

**Urgency:** Non Urgent

**1 The Modification Proposal**

**a) Nature and Purpose of this Proposal**

Modification proposal 0171 raised by RWE Npower seeks to change retrospectively the arrangements for the allocation of LDZ Aggregate charges.

Shippers contract for the services associated with the Uniform Network Code for a given gas day/s on the basis of the arrangements that are in place at that time. It is widely understood and accepted that reconciliations may take place after a given gas days. However this is on the basis that such reconciliations will be applied in accordance with those arrangements that were set out and in effect at the time of those particular gas day/s.

The retrospective nature of the RWE Npower proposal is a fundamental flaw. Retrospection introduces commercial uncertainty, undermining confidence around industry rules and trading arrangements. This creates unacceptable levels of risk that destabilise competition, and stimulate inflated risk premiums.

Ofgem have to date consistently opposed retrospective changes to industry arrangements, and most recently stated the following in their decision letter regarding UNC modifications 117 and 0122 issued 20<sup>th</sup> December 2006.

“We consider that retrospective changes to industry codes will damage market confidence in, and the efficient operation of, the trading arrangements. Rather than protecting participants from “unforeseen unfairness” we take the view that signatories would generally prefer the assurance and certainty of rules that are unlikely to be changed retrospectively. We consider that there are generally accepted and well understood legal reasons why retrospective modifications are to be avoided. It is a general principle of law that rules ought not to change the character of past transactions completed on the basis of the then existing rules”

This Alternative proposal (0171A) raised by British Gas seeks to avoid the issues of retrospection by specifying a revision of the present arrangements for back dated charges but only from a fixed future date.

We propose that from 1/4/2008, or an alternate future implementation date to be specified by the Ofgem and enacted by the Transporters, hereafter referred to as the "Proposed Effective Date", that reconciliations covering a period after this date be allocated based on daily AQ share, as described in more detail further on.

By changing the regime from some future date shippers can take an informed view of the enduring regime, and apply the appropriate risk premiums or discounts based upon their view of the regime, and the likely directional shifts in their portfolio. This also means that such risk premiums or discounts can be applied to those customers to whom any back dated charges may relate. Unlike 0171 this proposal, 0171A, does not seek to impose charges upon shippers that can apply to customers who are no longer supplied by them, and for whom there is no mechanism for recovering backdated costs.

This proposal provides new Shippers, entering the UK market after the "Proposed Effective Date", confidence that they will not incur charges that relate to a period prior to their market entry. In addition this Alternative proposal provides new and existing Shippers confidence that they can make commercial decisions based on a regime that will not be changed retrospectively.

British Gas proposes that, from the "Proposed Effective Date", LDZ Aggregate reconciliations are levied based upon historical daily AQ share. Any element of the charge that relates prior to this date will be applied based upon suppliers' market share as at implementation of this modification.

Where a reconciliation period crosses the cut-over date between the existing and new arrangements, xoserve will calculate the volume for the period prior to cut over and this will be charged based on AQ share at cut-over, the period post the "Proposed Effective Date" will be reconciled using a daily AQ share.

It is recognised that due to changes in the shipping community which occur after the "Proposed Effective Date", there may be instances when not all the costs can be recovered, for instance due to a Shipper becoming insolvent. It is additionally proposed that under these circumstances such monies that cannot be recovered and relate to a period prior to the "Proposed Effective Date" should be smeared across the industry based upon Shippers' proportion of the AQ holdings within that LDZ at cut-over. Costs which cannot be recovered and relate to a period after the "Proposed Effective Date" will be smeared based on AQ holdings on the dates that the costs were incurred. In the case of a User being merged with or acquired by another User, the existing post-merger User or the User that carried out the

acquisition will be liable in relation to the former User.

Because this proposal seeks to change the regime prospectively Shippers can take an informed view of the potential for such charges being applied, and can adjust prices accordingly. If Shippers believe their potential exposure to invoice adjustments has increased further to the liquidation of another Shipper or Shippers, they can adjust prices accordingly, and immediately.

We should stress that modification proposal 0171 magnifies the issues associated with Shipper failures because it seeks to apply charges that relate further back and to apply them retrospectively. Shippers have had less opportunity to apply any risk premium or credit because the customers to which these charges relate may no longer be supplied by them, and the period of time to which they apply is greater, and has already elapsed.

It should be noted that this proposal is intended to apply equally to both credits and debits.

For the purposes of clarity it should be noted that the revised reconciliation arrangements proposed herewith are only to be applied where the reconciliation amount is a minimum of 50 GWhs. This proposal is specifically aimed at adjustments to NTS / LDZ offtakes. We believe that this can be managed by xoserve via an off line solution, and that a demarcation line of 50 GWhs is a reasonable balance between introducing added complexity and cost in to industry processes and improving the equitability of cost allocation. Users are able to propose further alternatives thresholds should they see fit.

Failure to implement this proposal will mean that the present barrier to entry for any new shipper or those seeking to gain market share that are associated with the allocation of historical costs shall persist.

**b) Justification for Urgency and recommendation on the procedure and timetable to be followed (if applicable)**

Urgent procedures are not requested for this proposal.

**c) Recommendation on whether this Proposal should proceed to the review procedures, the Development Phase, the Consultation Phase or be referred to a Workstream for discussion.**

As an Alternative, this proposal should progress in parallel with the RWE Npower modification proposal 0171.

**2 Extent to which implementation of this Modification Proposal would better facilitate the achievement (for the purposes of each Transporter’s Licence) of the Relevant Objectives**

**Standard Special Condition A11.1 a)** The efficient and economic operation of the pipe-line system to which this licence relates, by ensuring costs are better targeted at those that incur them.

**Standard Special Condition A11.1d)** The securing of effective competition between relevant shippers, suppliers and DN operators by:

1. Ensuring better targeting of costs and by removing from the date of implementation a potential barrier to entry from any new shipper entering the UK, and those entering new areas outside their core business.
2. Protecting the fundamental principle of commercial certainty. Existing and new market entrants would have confidence that the market conditions are sufficiently stable to enable the pricing decisions that they make to be based upon an informed view of risk.

**Standard Special Condition A11.1f)** Promotion of efficiency in the implementation and administration of the UNC:

The introduction of a retrospective modification such as RWE Npower proposal 0171 could act as a trigger for multiple retrospective modifications. Specifically shippers would be encouraged to raise modifications that seek commercial advantage from any directional shift in the shape of their portfolio, after that directional shift had occurred.

Such retrospective modifications would under mine the stability of the Uniform Network Code, creating a surge in modification activity and increased administration costs. This modification avoids such precedent.

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

This modification avoids creating a precedent for retrospection; such retrospection could undermine any element of the Uniform Network Code or party to it. This extends to operation of the total system and to security of supply in that Users may have less confidence that the arrangements that apply to these are stable and will not be retrospectively altered.

### **4 The implications for Transporters and each Transporter of implementing this Modification Proposal, including:**

#### **a) The implications for operation of the System:**

None Identified

#### **b) The development and capital cost and operating cost implications:**

We believe that an offline process could be used to deal with the revised arrangements set out in our proposal.

- c) **Whether it is appropriate to recover all or any of the costs and, if so, a proposal for the most appropriate way for these costs to be recovered:**

We do not believe that the costs associated with this modification proposal are significant enough to warrant special recovery mechanisms.

- d) **The consequence (if any) on the level of contractual risk of each Transporter under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal**

We do not believe that this proposal has any effect on Transporters’ level of contractual risk. This is unlike modification proposal 0171, which undermines the whole basis of the Uniform Network Code by introducing the concept of retrospection and so creating uncertainty and increased levels of risk.

- 5 **The extent to which the implementation is required to enable each Transporter to facilitate compliance with a safety notice from the Health and Safety Executive pursuant to Standard Condition A11 (14) (Transporters Only)**

None identified.

- 6 **The development implications and other implications for the UK Link System of the Transporter, related computer systems of each Transporter and related computer systems of Users**

None identified

- 7 **The implications for Users of implementing the Modification Proposal, including:**

- a) **The administrative and operational implications (including impact upon manual processes and procedures)**

None identified. Modification 0171A avoids the surge in administrative activity that could arise from the flood of retrospective modifications that would be triggered by the RWE Npower proposal.

- b) **The development and capital cost and operating cost implications**

None identified.

- c) **The consequence (if any) on the level of contractual risk of Users under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal**

None identified. This proposal avoids the significant increase in contractual risk that would result from the modification proposal 0171. Because this Alternative proposal does not seek to introduce retrospection, it does not undermine the whole basis of commercial certainty surrounding the Uniform

Network Code.

**8 The implications of the implementation for other relevant persons (including, but without limitation, Users, Connected System Operators, Consumers, Terminal Operators, Storage Operators, Suppliers and producers and, to the extent not so otherwise addressed, any Non-Code Party)**

None identified. This proposal avoids the significant and unacceptable impacts that could flow through to third parties, not least inflated risk premiums applied by shippers in order to protect themselves from unforeseeable retroactive changes to the Uniform Network Code.

**9 Consequences on the legislative and regulatory obligations and contractual relationships of the Transporters**

None identified. This proposal avoids setting a precedent whereby obligations can be changed retrospectively and “historical performance” becomes non-compliant. Thus creating regulatory uncertainty.

**10 Analysis of any advantages or disadvantages of implementation of the Modification Proposal not otherwise identified in paragraphs 2 to 9 above**

**Advantages**

- ◆ This Alternative proposal improves the ability of shippers to price accurately by apportioning costs more accurately to them.
- ◆ This Alternative proposal is not retrospective and so does not present a barrier to entry that arises from lack of confidence in the industry rules and trading arrangements.
- ◆ From the date of its implementation this Alternative proposal will remove the barrier to entry associated with the allocation of historical costs.
- ◆ From the date of its implementation this Alternative proposal will protect suppliers who are seeking to gain market share in the same way as the Npower modification.
- ◆ This Alternative proposal avoids the precedent of initiating retrospective modifications that seek commercial advantage from a directional shift in a Shipper’s portfolio AFTER that directional shift has occurred.

**Disadvantages**

- ◆ In some cases a credit or debit results in a reciprocal increase or reduction in charges to ensure that revenues match those allowed. Under this and to a greater extent modification proposal 0171 there is potential for shippers to receive charges one way i.e. based on historic market share, and credits a different way i.e. based on present market share.

**11 Summary of representations received as a result of consultation by the Proposer (to the extent that the import of those representations are not reflected elsewhere in this Proposal)**

None.

**12 Detail of all other representations received and considered by the Proposer**

No other representations received.

**13 Any other matter the Proposer considers needs to be addressed**

No other matters outstanding.

**14 Recommendations on the time scale for the implementation of the whole or any part of this Modification Proposal**

The proposer believes that this proposal is fully developed and ready for consultation, with a target date for implementation of April 2008.

**15 Comments on Suggested Text**

**16 Suggested Text**

**Code Concerned, sections and paragraphs**

Uniform Network Code

Transportation Principal Document

**Section(s)** E

**Proposer's Representative**

*Chris Wright, (British Gas)*

**Proposer**

*Mitch Donnelly, (British Gas)*