

Modification proposal:	Uniform Network Code (UNC) 204: Amendment to the Calculation of WCF (UNC204)		
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:	18 July 2008	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

The current methodology for the allocation of gas to each shipper both in advance of the gas day as a part of the NDM nominations process, and after the gas day as part of the NDM allocation process, has been in place since the development of the Network Code regime.

The formula used to allocate energy between shippers is defined in Section H2.2 of the UNC as follows:

$$NDM\ Demand = AQ / 365 * ALP_t * (1 + WCF_t * DAF_t) * SF_t$$

Where

NDM Demand: NDM Supply Point Meter demand on Day t

AQ: annual quantity under seasonal normal conditions

ALP: annual load profile (a daily value per EUC)

DAF: daily adjustment factor (a daily value per EUC)

WCF: weather correction factor (value(s) for each LDZ)

SF: scaling factor (value(s) for each LDZ)

WCF and SF are set individually for each LDZ and require the value of aggregate NDM demand.

Ahead of the gas day, demand is derived using forecast total gas demand and shared to each shipper pro-rata using the above formula. After the gas day (post D+5), actual gas demand is shared to each shipper pro-rata using the formula but scaled to ensure all gas transported on the day is allocated. The scaling factor necessary to balance the calculation should be close to 1.

The NDM demand parameters are calculated by xoserve on behalf of the gas Transporters using sample information. To enable the parameters to apply to the population, the DAF and WCF are currently scaled to a forecast Seasonal Normal Demand (SND) derived separately by each of the Distribution Networks.

The WCF calculation is based on the underlying principal that network forecasts are accurate and any change in demand on the day, once geographical location, time of year and type of consumer are factored in, is due to temperature. However, over the past few years it has become evident that changes in demand on the day are not wholly the result of changes in temperature. This has led to concerns from industry that the network forecasts may have been overstating demand and thus introducing a bias to the WCF. In turn, this could feed through to the scaling factor and potentially increase misallocation

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.

between NDM and DM market sectors, directly influencing the level of reconciliation required.

This was particularly evident during the 2006/07 gas year where actual demand was significantly lower than forecast demand leading to a scaling factor that was significantly different to 1.

Review Group 176 was established in November 2007 to investigate whether an alternative to SND could be used to produce the WCF and DAF variables. UNC Modification Proposal 204 was raised based on the work and recommendations of the Review Group.

The modification proposal

UNC204 aims to remove network forecasts of SND from the allocation process by using an AQ derived measure which maintains the intent of the WCF while relying on a measure of "expected demand" that is industry driven through a transparent process.

UNC204 aims to amend the WCF formula as follows:

From:

$$WCF_t = \frac{AggregateNDMDemand_t - AggregateNDM(SND)_t}{AggregateNDM(SND)_t}$$

To:

$$WCF_t = \frac{AggregateNDMDemand_t - (\sum AQ_{EUC} / 365 * ALP_t)_{LDZ}}{(\sum AQ_{EUC} / 365 * ALP_t)_{LDZ}}$$

UNC204 also proposes that the DAF will continue to be derived from the demand estimation sample data to represent the ratio of the weather sensitivity of each EUC to the weather sensitivity of total LDZ demand, but will no longer use the Transporters' view of future SND³.

The proposal provides that any implementation for October 2008 will require approval by the Authority in time to enable xoserve to calculate and load the necessary base data into xoserve's Gemini systems during September.

The proposer considers that the modification would better facilitate the achievement of relevant objective (d) – so far as is consistent with relevant sub-paragraphs (a) to (c) the securing of effective competition between relevant shippers, suppliers and DNS⁴.

³ The DAF for an EUC is calculated as the ratio of the percentage weather sensitivity for the EUC to the percentage weather sensitivity of total LDZ demand. Historically the EUC and LDZ demand models are scaled to ensure they sum to the Network demand forecasts. Removing SND would mean that these would not be scaled, but this will impact both the EUC and LDZ ratios equally, removing the need to change the DAF formula.

⁴ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see:

http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

UNC Panel⁵ recommendation

At the Modification Panel (the "Panel") meeting held on 17 April 2008, of the 10 Voting Members present, capable of casting 10 votes, 10 votes were cast in favour of implementing this modification proposal. Therefore the Panel recommended 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 09 July 2008. 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 FMR⁶. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC⁷; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties⁸.

Reasons for the Authority's decision

Relevant objective (d) – so far as is consistent with relevant sub-paragraphs (a) to (c) the securing of effective competition between relevant shippers, suppliers and DNs

All of the seven responses received to the Joint Office consultation supported the implementation of UNC204. Respondents were universally of the view that improvement in the allocation profiles would ensure that energy was allocated more accurately on the original commodity invoice which would minimise the movement of energy between market sectors through reconciliation. All respondents considered that replacing the SND variable within the WCF formula with an ALP based alternative would achieve this goal⁹ and therefore considered that UNC204 would better facilitate the achievement of relevant objective (d).

We acknowledge the efforts made by xoserve and the industry to explore a number of options for an appropriate alternative to using SND to produce WCF and SF variables. Of the options considered, Review Group 176 recommended that the SND be replaced with an ALP alternative. This recommendation was based on a set of analysis which explored the change in the difference between NDM allocations and actual consumption using both SND and an ALP alternative in the WCF formula. Using data from the 2006/07 gas year, substitution of SND with the ALP alternative reduced the variability of the WCF, and produced an SF closer to 1. For the sample sites considered, this in turn produced a final

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.com

⁷ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

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

⁹ Annual load profiles, when applied to an EUC's average daily consumption (i.e. when applied to total AQ/365 for each EUC), provide an approximation for seasonal normal demand. This allows the WCF and SF to be calculated based upon an alternative, less variable, view of "normal demand" other than SND.

NDM allocation 32% closer to actual consumption than the NDM allocations derived using SND during the 2006/07 gas year. This would have resulted in reduced reconciliation volumes in 2006/07, and demonstrated that, for this year, UNC204 would have led to lower costs for the industry from processing reconciliation.

In respect of the work carried out by Review Group 176 and also with regard to responses to this consultation, it is Ofgem's view that UNC204 is likely to produce more accurate original commodity invoices than the current methodology. We consider that increased accuracy of demand attribution will facilitate competition between Shippers by increasing certainty of revenue for all Parties. This will be particularly significant for smaller players who may be less able to handle uncertainty and volatility in their cash flow. Therefore we consider that UNC204 will better facilitate the achievement of relevant objective (d).

We acknowledge that the proposal places significant emphasis upon the use of AQ volumes which themselves have been the subject of significant industry debate. However, we also recognise that AQ volumes are based on industry data and derived in a transparent and controlled manner. We note that respondents did not raise any concerns regarding the use of AQ volumes in the formula, and we remain comfortable that they represent a better approach than the current arrangements.

Quarterly review

We understand that the new WCF values within the WCF formula will be calculated by EUC band using the AQ values that will be live on 1st October of each gas year. The proposal recommends that the values should be reviewed quarterly and in instances when the LDZ aggregate AQ varies by more than 1%, the system will be updated with the new values applicable from the 1st of the following month.

One respondent considered that a 1st of the following month application of any amended values was unrealistic due to the lead times required to update the xoserve system while another respondent considered that further analysis and discussion was required before a reasonable period for application of the new volumes could be established. The proposer noted in its response that an AQ snapshot would be taken a few weeks prior to the date required for each quarterly review, in order to enable xoserve to complete their analysis. We note these views on the implementation of UNC204 but considered it is for xoserve to determine, in consultation with the industry where necessary, how to achieve the code requirements.

Implementation timescales

Three respondents, including the proposer, recognised and commented on the dual aspects of the proposal in terms of the proposed changes to the calculations of WCF and DAF. While two of these respondents held the belief that the DAF amended methodology could not be implemented until 2009 (although the WCF changes could be implemented for the 2008/09 gas year), the proposer noted that a decision by the Authority ahead of the end of June could in fact allow the DAF based on the amended methodology to be implemented before final NDM proposals are required to be published in August.

Given these views, we are disappointed that final legal text was not submitted to us until 9 July. However, we understand that this delay was partly caused by ambiguity around the intended definition for DAF. Whilst the proposal clearly stated that '*DAF will continue to be derived from the demand estimation sample data and scaled to Gemini connected*

load, but will not use the Transporters' view of future SND', it did not prescribe what the revised definition should be.

We understand that further business rules which clarify the intended definition of DAF have been developed by the proposer in conjunction with Xoserve and discussed at the Demand Estimation Sub-Committee, though this was subsequent to Panel's recommendation and submission of the FMR to the Authority. A proposer may request the variation of a proposal at any point prior to the UNC Panel making its decision on whether to recommend implementation of that proposal, but not after¹⁰.

Given the above, the Transporters are of the opinion that the revised business rules which describe the intended revision to DAF cannot appropriately inform the legal text for UNC204. Therefore the text provided would modify the definition of WCF only.

We are disappointed that the issue surrounding DAF was not identified and addressed earlier in the process, though we accept that it would be inappropriate for business rules developed subsequent to the UNC Panel recommendation and outwith the normal modification process to influence the legal text, which after all is the actual modification to the UNC. However, we note that DAF is not currently a defined term within the UNC and may therefore not require a modification to revise it. We also understand that xoserve have confirmed there would be no material difference to the calculation of WCF, this year at least, whichever DAF definition is used.

We discussed this matter with the UNC Panel at its meeting of 17 July 2008 and agree with its conclusion that the debate surrounding DAF should not detract from the benefits of implementing the modification to WCF; we have therefore based our decision on the FMR and associated legal text as submitted to us on 9 July. However, this decision on UNC204 does not preclude any party from seeking to insert a definition of DAF as part of a further modification, if they consider it to be necessary. It may also be appropriate for parties to consider whether the current procedures surrounding the production of legal text are adequate, either as part of the current Ofgem led review of Industry Codes Governance or as a stand alone piece of work.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 204: '*Amendment to the Calculation of WCF*' be made.



Kersti Berge
Head of GB Markets

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

¹⁰ See UNC Modification Rules, paragraph 6.5