Modification proposal:	**Uniform Network Code (UNC) 225: Revised Timescales for LDZ Shrinkage Arrangements**		
Decision:	The Authority[1] directs that this proposal be made[2]		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Publication Date:	19 December 2008	Implementation Date:	29 December 2008

Background to the modification proposal

Shrinkage is gas lost from the distribution network through leakage, theft and own use gas (e.g. purging the system during system operations or gas pre-heating prior to pressure reduction). In order to compensate for this unaccounted for gas leaving the system, additional gas to that input by Users has to be purchased by the Gas Distribution Networks (GDNs) and the cost passed onto Users. This process is governed by UNC Section N.

GDNs therefore have a UNC responsibility to purchase Local Distribution Zone (LDZ) Shrinkage gas. This shrinkage volume is based on an estimate of likely shrinkage in the forthcoming Gas Year using a variety of assumed system parameters known at the time. At the end of the Gas Year, a shrinkage assessment is made using revised known parameters and the differences reconciled with Users.

The GDNs therefore have LDZ Shrinkage volumetric allowances within their price control revenue allowances which limits the shrinkage volumes that they are allowed to pass through to Users. GDNs are thus incentivised to minimise shrinkage. If they incur shrinkage volumes below their shrinkage allowances they retain the value of this over the price control period.

In the 2008-2013 Gas Distribution Price Control[3], Ofgem based LDZ Shrinkage allowances on the previous practice of using shrinkage factors (as percentages of throughput) for each LDZ for the first six month period between 1 April 2008 to 30 September 2008 and thereafter based LDZ Shrinkage on fixed annual shrinkage volumetric allowances for each LDZ for the remainder of the price control.

In order to assess the estimated LDZ Shrinkage, each GDN has UNC obligations and timescales for estimating, notifying and consulting on the aggregate anticipated amounts of LDZ own use gas and LDZ unaccounted for gas for the forthcoming Gas Year (1 October to 30 September). These obligations are defined in Section N, 3.1 and 3.2 of UNC. Currently these initial LDZ Shrinkage estimates are undertaken by 1 September each year.

At the end of the Gas Year, the GDN also has UNC obligations and timescales to assess, reconcile and carry out adjustments between previously estimated and assessed LDZ Shrinkage. These obligations are defined in Section N, 3.3 and 3.4 of UNC. Currently these shrinkage assessments are undertaken within six months of the end of the Gas Year i.e. by 31 March each year.

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[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.
[2] This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.
[3] http://www.ofgem.gov.uk/Networks/GasDistr/GDPCR7-13/Documents1/final%20proposals.pdf

All other LDZ Shrinkage related Transporter activities (e.g. regulatory and incentive reporting, LDZ Transportation pricing changes) are now based around the Formula Year (1 April to 31 March).

In 2008-2013 GDPCR Final Proposals document, Chapter 7 Para 7.21, it was stated that:

"...the volume of shrinkage gas purchased by the GDNs is determined by the UNC. The GDNs have indicated that they intend to propose modifications to UNC to align their responsibility for procuring gas to the actual gas used by the GDNs. They consider that the current rules for calculating shrinkage under the UNC do not accurately reflect actual shrinkage and the volumes calculated under the UNC will differ significantly from their proposed price control volume allowances."

This modification proposal seeks to achieve this.

The modification proposal

UNC Modification Proposal 225 proposes the following changes to Section N of UNC:

- the proposal retains identical obligations and timescales with respect to 3.1 and 3.2 but seeks to change these to be relative to the Formula Year rather than to the Gas Year as at present. Therefore the initial LDZ Shrinkage estimates currently due for completion by 1 September just before the start of each Gas Year will, under the proposed modification become due for completion by 1 March just before the start of the Formula Year.

- the proposal retains the obligations with respect to 3.3 and 3.4 but seeks to change these to be relative to the Formula Year rather than to the Gas Year and additionally to reduce the timescale allowed for the GDNs to carry out LDZ Shrinkage assessments from six months to four months. Therefore the LDZ Shrinkage assessments currently due for completion within six months of the end of the Gas Year (31 March) will, under the proposed modification become due for completion within four months of the end of the Formula Year (31 July).

The proposer is of the view that implementation of the changes would:

- allow the GDNs to use more timely network and operational data when carrying out LDZ Shrinkage estimates;

- allow the GDNs to carry out LDZ Shrinkage assessments sooner following the completion of the relevant 12 month period and in turn be able to carry out any necessary LDZ Shrinkage adjustments (reconciliations).

UNC Panel[4] recommendation

At the Modification Panel meeting held on 20 November 2008, of the 8 Voting Members present, capable of casting 10 votes, 10 votes were cast in favour of implementing the modification proposal. Therefore the Modification Panel recommended implementation of the proposal.

[4] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) V3.0 dated 26 November 2008[5]. 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 the modification proposal will better facilitate the achievement of the relevant objectives of the UNC[6]; and

2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties[7].

Reasons for the Authority's decision

GDNs are only able to recover the costs incurred for purchasing shrinkage from Users in accordance with the fixed volumetric allowances set out in the 2008-2013 GDPCR Final Proposals based on price control Formula Years.

The dominant parameters used for estimating and assessing LDZ Shrinkage are the average system gas pressures (since leakage is broadly related to differential pressure) and the length of the metallic mains population (since a significant portion of gas leakage is from the joints of metallic mains).

All GDNs are engaged upon a substantial iron mains replacement program that annually replaces a proportion of metallic main with mainly plastic pipe. Since plastic pipe systems have a lower leakage rate than iron mains, the point at which system asset data is taken for calculating shrinkage is significant.

The 2008-2013 GDPCR LDZ Shrinkage allowance baselines took into account GDN's forecasts which we understood to be based on projected mains asset data at the end of each Formula Year (31 March). This resulted in leakage volumes based on the assumption that the replacement plastic pipes had been in operation throughout each Formula Year.

The UNC LDZ Shrinkage estimates and assessments also use projected or actual mains asset data at 31 March each year. However this date is in the middle of the Gas Year when a higher proportion of metallic mains are assumed to be still in existence which results in a higher leakage volume.

The proposed modification corrects this asymmetry. Our estimate of the effect of this proposal is that the discrepancy between the shrinkage volumes incurred under UNC and the GDPCR allowed shrinkage volumes will be reduced by approximately 1 to 1.5%. This will reduce the GDNs' costs by avoiding their need to purchase the excess volumes.

Six responses were received to the Joint Office consultation on this proposal. The three responses of the shippers all supported the proposal.

SSE had some concerns over whether the proposal would enable better use of data but agreed it was sensible to align price control allowances and incentives with values

[5] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com
[6] 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
[7]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.

applying to Users under UNC. SSE felt there would be benefit due to the quicker turnaround of shrinkage assessments and adjustments and while SSE had minor concerns over whether better use of actual data would be achieved they considered that on balance the proposal would better facilitate the achievement the relevant objectives set out in Standard Special Condition A11.1.

Npower agreed it was logical for the LDZ Shrinkage timescales to align with the incentives and targets set in GDPCR. Npower also felt the change to assess LDZ Shrinkage within four months of the end of the Formula Year would provide benefits to Users in more timely reconciliation and that the use of more recent operational data should improve the accuracy of estimating LDZ Shrinkage volumes.

British Gas expressed some concerns over how the revised timings will affect the effectiveness of the presentation of the GDNs' estimated LDZ Shrinkage to the Shrinkage Forum over the Christmas holiday period. Overall, British Gas felt this is a low impact proposal with apparent minor benefits to GDNs and Users and that the claimed likely reduced reconciliation volumes would be a benefit to the facilitation of competition between shippers.

The three responses of the GDNs all supported the proposal and considered that aligning the shrinkage process to the Formula Year would assist both shrinkage purchases and leakage assessment.

We consider that, by aligning the annual UNC shrinkage assessments with regulatory reporting requirements and licence incentives, the modification will enable the use of more timely operational and network information which is likely to lead to greater accuracy of LDZ Shrinkage assessments and hence reduced reconciliation volumes. We consider the modification will better facilitate the achievement of the relevant objectives in Standard Special Condition A11.1(a) "the efficient and economic operation of the pipe-line system to which this licence relates;"

In addition, we consider that GDNs assessment of LDZ Shrinkage within four months rather than six months of the end of the relevant year will result in Users benefiting from more timely financial reconciliation of their liabilities. We consider the modification will better facilitate the achievement of the relevant objectives in Standard Special Condition A11.1(d) " the securing of effective competition between relevant shippers"

Overall we consider this modification will benefit the industry and consumers.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 225: *Revised Timescales for LDZ Shrinkage Arrangements* be made.

Rachel Fletcher,
Director, Distribution.
Signed on behalf of the Authority and authorised for that purpose.