

Modification proposal:	Uniform Network Code (UNC) 292: Proposed change to the AQ Review Amendment Tolerance for SSP sites (UNC292)		
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:	15 April 2011	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

The Annual Quantity (AQ) is the quantity of gas oftaken or estimated to be oftaken at a supply meter point during a period of one year³. AQs are used in a number of Uniform Network Code (UNC) processes, including billing of energy and transportation charges.

The UNC requires Gas Transporters (GTs) and Shippers to engage every year in a process for reviewing AQs at supply meter points. Under this AQ review process, each year GTs will provide Shippers with a provisional AQ for the supply meter points in their portfolios, and Shippers will then have a period – the AQ review amendment period – to review the AQ values before they become effective for the next gas year.

Transco Network Code Modification 0624 (NCM624) implemented the current UNC arrangements in relation to amending AQs⁴. This modification was raised in response to concerns that Shippers were shaping the AQ amendments during the AQ review in a way that would bring them benefits in terms of energy balancing and transportation charges. Inaccurate AQs can lead to the misallocation of costs to other Shippers operating in the Smaller Supply Point (SSP)⁵ market, through the Reconciliation by Difference process.

NCM624 introduced a tolerance level of 20% to the AQ review process in the SSP market – Shippers can only amend SSP AQs when the amended AQ is at least 20% different (higher or lower) than the provisional AQ⁶. In addition, Shippers must apply a consistent methodology in reviewing AQs within their supply points portfolio (both upward and downward), and not materially differentiate their treatment of supply meter points where they seek to either increase or decrease the AQ.

The AQ review process has been further enhanced with the subsequent UNC Modification 081 (UNC81)⁷, by requiring GTs to make anonymous Shipper performance data available to all parties on the different stages of the AQ review process.

The modification proposal

UNC292 was raised by Scottish Power (the proposer) to reduce the SSP AQ amendment tolerance from 20% to 5%. The proposer considers that it is inappropriate to maintain such a high restriction on Shippers' ability to amend SSP AQs and their ability to manage the costs associated with them.

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 Referred to as the gas year. It represents an estimation of the annual consumption for a supply meter point.

⁴ Modification 0624 'Changes to the 2003 Annual Quantity (AQ) Amendment Process' was implemented on 12 April 2004. More information available at <http://www.gasgovernance.co.uk/NCMP>

⁵ In the GB gas market consumers may be classed as being part of the SSP market, where its AQ (the annual consumption) is below 73.2MWh, or of the Large Supply Points (LSP) market, if the AQ is above this limit.

⁶ There is no tolerance level applied to AQ amendments in the LSP market.

⁷ UNC81: 'AQ Review Process- publication of information' was implemented on 01 October 2006. More information available at <http://www.gasgovernance.co.uk/node/1152>

The proposer argues that SSP AQs have the potential to significantly impact Suppliers' profitability, and are also used by the Transporters to assess available network capacity and investment needs. The proposer argues that it is therefore inefficient to keep SSP AQ values at a level of up to 20% over/under their potential amendment values.

It also proposes to extend the current provisions within the UNC Section G 1.6.4. Each year, prior to the start of the AQ review amendment window on 31 May, GTs will issue to each Shipper a volume cap based on its supply points market share for the number of AQ amendments that can be submitted in each business day⁸ during the AQ review amendment period (up to 13 August), together with the total number of industry amendments that can be submitted per day.

UNC292 proposes additionally that the GT agent⁹ will be required, following consultation with Shippers, to produce and publish a guidance document¹⁰ which will set out how amendments should be submitted. It will also set out how they will be processed, including how amendments submitted in excess of the volume cap will be processed.

The proposer requested that UNC292 would follow urgent modification procedures. Further to the rejection of this request¹¹, the proposer requested a prompt development of the proposal, and recommended the proposal to be implemented as soon as possible, so the changes would be implemented in time for the 2011 AQ review process.

UNC Panel¹² recommendation

At the Modification Panel meeting held on 20 January 2011, of the ten Panel members, capable of casting eleven votes, four voted for implementation of the proposal. Therefore the UNC Panel did not recommend the modification proposal for implementation.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 16 March 2011. The Authority has also considered and taken into account the responses to the UNC's consultation on the modification proposal. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC¹³; and
2. directing that the modification to be made is consistent with the Authority's principal objective and statutory duties¹⁴.

Reasons for Authority decision

⁸ The daily volume cap is subject to a minimum level of 500 amendments per Shipper per day or to a value equal to the meter point count of the Shipper portfolio, whichever is lower. This allows smaller Shippers to manage their amendments submission process in a more efficient way.

⁹ Xoserve is the GT agent.

¹⁰ The guidelines document has been discussed in the last stages of development of the modification proposal and is available at <http://www.gasgovernance.co.uk/0292>

¹¹ Ofgem did not consider the evidence supporting the proposal sufficiently satisfied the criteria for granting urgent status. See <http://www.gasgovernance.co.uk/0292>

¹² The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

¹³ 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

¹⁴ 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.

We have assessed the proposed modification against the UNC Relevant Objectives. We consider this proposal will further objectives (a), (c) and (d) and is with regards to the other Relevant Objectives.

Standard Special Condition A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates

One respondent considers that, should Shippers have sufficient notice to implement the associated system changes, this proposal would increase their ability to register more accurate AQs. Therefore, the respondent believes that more accurate AQs will have an impact on the development and planning of the system. Another respondent however considers that this modification increases the risk of gaming, whereby a Shipper may artificially adjust AQ values for its benefit. This would result in less accurate AQ information being held in the industry about the SSP market, and thus impact negatively on the GTs ability to accurately predict demand patterns.

We have addressed the concerns raised in relation to gaming in more detail below. We consider that the proposal brings benefits through potential improvements to the accuracy of AQs, by enabling the submission of more AQ amendments and/or by enabling AQ amendments more reflective of the actual consumption. The potential improvements to the accuracy of AQs could enable GTs to improve their processes for development and planning of their pipe-line networks. For this reason we consider that this proposal may further relevant objective (a).

Standard Special Condition A11.1 (c): the efficient discharge of the licensee's obligations under this licence

Some respondents consider that implementing this proposal for the 2011 AQ Review could potentially place GTs in breach of their licence obligations not to unduly discriminate between users. These parties consider that some Shippers would not be able to make the necessary system changes to use the process so that they would be likely to face higher costs. This, they consider, would distort competition. Two respondents argue that they would need a minimum of five to six months to make the system changes associated with this modification. A further respondent favoured a 2012 implementation date. Three other respondents favour implementation in 2011. They consider that in face of the increasing costs and uncertainty associated with inaccurate AQs, a 2011 implementation would be more appropriate and would enable the changes to be in place in time for the 2011 AQ review.

We note the concerns on the time required for Shippers to make changes to their systems. We note that the materiality of the impact of introducing the change in 2011, when some Shippers may not have had an opportunity to make the necessary system changes, is not known. We note that, for the application of UNC292 to have been potentially viable for the 2011 AQ review, some Shippers would have required an Ofgem decision by the end of January at the latest (we discuss delays in the time it has taken for us to receive the FMR below). We consider that an implementation date in time for the 2012 AQ review would be more likely to enable a level playing field for all Shippers in terms of the benefits they would be able to receive from implementation. We note also the preference of some respondents to put the business rules, currently set out within the guidance document, under the UNC governance. We consider that a 2012 implementation date would provide industry parties with flexibility to address this issue.

Some Shippers were concerned that the timing of implementation coupled with the daily cap on the number of AQ amendments submitted may lead to less amendments being able to be submitted than at present, in particular for Shippers with large supply point portfolios, and that the mechanism for the capacity allocation may therefore lead to a

discriminatory treatment of Shippers. However, analysis based on data presented by xoserve on the capabilities of its systems suggests xoserve would be able to process approximately 50% more amendments than it estimates Shippers would require¹⁵. We also note that a non-discriminatory mechanism is to be operated to allocate additional capacity that is unused on any given day. We further note that UNC292 improves clarity on the daily number of AQ amendments that can be processed so that Shippers can better manage their submissions.

We consider that this proposal facilitates improvements in the accuracy of AQs by increasing the number that can be amended. More accurate AQs will improve the allocation of energy and transportation charges. We consider that this would improve the ability for a GT to comply with its licence obligations, namely to set out a charging methodology that is reflective of its transportation costs¹⁶. We consider that this proposal will therefore better facilitate relevant objective (c).

Standard Special Condition A11.1 (d): the securing of effective competition between relevant Shippers, between relevant Suppliers, and between Distribution Network Operators and relevant Shippers

The proposer and some respondents consider that UNC292 would ensure more accurate allocation of costs, with AQs being more reflective of customer usage. They consider that inaccurate AQs may result in increased unpredictability of Shippers' costs and hence increased risk, and that this proposal will help to mitigate the risk of increased commercial and regulatory costs by enabling Shippers to take advantage of more resources for better aligning costs and revenue.

Some respondents challenged the materiality of the impact of the proposal in the SSP market. They argue that the impact on an individual SSP site is likely to be small, and there is also likely to be a "cancelling out" effect within any portfolio, as amendments should be submitted for both decreases and increases in AQs. This netting effect may also be likely between Shipper portfolios. These respondents generally argued that implementation costs would be incurred without clear benefits and increased workload by Shippers. One respondent considered that these costs would be detrimental to competition.

As stated above we consider that the modification is likely to facilitate improvements in the accuracy of AQs. We consider that this should have a beneficial impact on competition. Where AQs are more reflective of individual consumption, allocation of energy and transportation charges will also be more cost reflective and accurate. Each Shipper will therefore benefit from more accurate information on which to base their pricing, volume, and investment decisions. We consider therefore that the SSP market and the industry as a whole would benefit from more accurate AQs, as these should bring competitive benefits to the SSP market in relation to the LSP market.

Some respondents expressed concern that the reduction in the materiality threshold would increase the opportunity to misuse the AQ amendment process. They considered that the increased risk of abuse of the system and weakening of the controls which allow scrutiny of Shippers performance (introduced by modification UNC081) could disadvantage Shippers who operated in accordance with the UNC requirements, exposing them to a larger proportion of energy costs and therefore distorting competition.

¹⁵ See <http://www.gasgovernance.co.uk/sites/default/files/MOD%20292-293%20dist-workstaream%20OCT%20-10.pdf>.

¹⁶ Standard Licence Condition 4A(5), 4B(5), and 4C(5) of the Gas Transporters Licence.

We note however that other respondents have not accepted this argument, as the existing reports, other UNC controls (for example under NCM624 and UNC81) and Shipper licence requirements¹⁷ will continue to reflect and influence behaviour regardless of the level at which the amendment tolerance is set.

We do not consider that UNC292 weakens the controls which influence and scrutinise Shippers' performance. We therefore do not consider that UNC292 materially impacts the current level of robustness of the process. We note the concerns raised in relation to the increased number of AQs that could be subject to gaming¹⁸. We acknowledge that, were parties not to comply with the UNC requirements, then there is potential for gaming behaviour to increase. We further recognise that some parties may consider that there are commercial benefits in not fully complying with the code. As set out in more detail below, we consider that the current concerns about gaming, which exist regardless of UNC292, should be addressed. However, on balance we consider that there are likely to be benefits accruing from improvements in AQ accuracy facilitated by UNC292. On this basis we consider that UNC292 will better facilitate relevant objective (d).

Further issues

We are disappointed that it has taken nine months for the FMR to be sent to Ofgem. This is despite our request for the UNC Panel to expedite the process when we rejected the request for urgency in 30 April 2010. In particular, we note the concerns expressed to us that this delay has, at least in part, resulted from the difficulty in obtaining cost and implementation impact information from xoserve¹⁹.

We also recognise the concerns raised in relation to the potential for gaming behaviour and that the industry does not have sufficient confidence in the robustness of the AQ review process. We note that these concerns are evident now as well as going forwards. We note that NCM624, when introducing the current controls around the AQ review process, considered that other changes were required to guarantee a satisfactory level of robustness and invited the industry to propose the necessary amendments. We consider that this matter should be addressed and would encourage the GTs and Shippers to investigate how this process could be improved. If it is felt that the level of assurance with the robustness of the UNC controls around the AQ review process is insufficient, we would urge the industry to review the current UNC arrangements in order to ensure that proper controls are in place – both ensuring proper behaviour from Shippers, and also introducing robust controls to identify clearly where and how any breach of the rules has been made. We understand that some parties may already be taking steps to address any perverse incentives in the AQ review process and we look forward to seeing these issues progressed in advance of next year's AQ review.

Decision notice

The Authority directs that modification proposal 'UNC292: Proposed change to the AQ Review Amendment Tolerance for SSP sites' be made.

Emma Kelso,
Associate Partner, Retail and Market Processes
Signed on behalf of the Authority and authorised for that purpose.

¹⁷ Shippers Standard Licence Condition 3.

¹⁸ We note that even under the current rules, there is potential for gaming at sites where the AQ had not reduced by more than 20%.

¹⁹ Ofgem has announced in the RIIO-GD1 Strategy consultation that it intends to conduct a review of xoserve and stakeholders are encouraged to fully engage with it in order to address these and other potential concerns (Section 4, RIIO-GD1 Outputs and Incentives, available at <http://www.ofgem.gov.uk>).