

Draft Modification Report
Interim Allocation of Unidentified Gas Costs
Modification Reference Number 0317 / 0317A
Version 1.0

This Draft Modification Report is made pursuant to Rule 9.1 of the Modification Rules and follows the format required under Rule 9.4.

1 The Modification Proposal

Modification Proposal 0317

Background

Reconciliation by Difference (RbD) was introduced, following the launch of competition to the domestic gas market. RbD is the method of reconciling the difference between actual (metered) and deemed (estimated) measurements of gas. It was introduced in 1998 in order to facilitate competition in the Small Supply Point (SSP) sector, as at the time it was not considered practical to individually reconcile all supply points in this sector (which numbered around 20 million on average during 2008) based on actual meter readings. The introduction of RbD was designed to offer an efficient mechanism for reconciling consumption in the Large Supply Point (LSP) sector to that in the SSP sector, as a cost-efficient alternative to individual meter point reconciliation for each SSP consumer, which would require development of an extensive system at considerable cost.

RbD was established to manage errors in the allocation of gas to shippers in the SSP market. Such errors may be caused by theft or gas offtaken at late registered or unregistered sites.

Gas that is not directly attributed to a shipper is known as Unidentified Gas. It is treated as a smeared cost for all shippers operating in the SSP market. By contrast, no volumes of Unidentified Gas are attributed to the LSP sector.

A number of UNC Modification Proposals were raised (115, 115A, 194, 194A, 228 and 228A) to allocate some of this Unidentified Gas to the LSP sector. While SSP and LSP shippers agreed that some contribution should be made by the LSP sector there was broad disagreement on the level of contribution that should be made. Shell Gas Direct (SGD) Ltd therefore proposed that an independent Allocation of Unidentified Gas Expert (AUGE) should be appointed to set the level of contribution - see UNC Modification 229 (229).

Ofgem conducted an Impact Assessment covering the various proposals before identifying 229 as providing the most appropriate means of identifying and charging the costs of Unidentified Gas. However, the approval letter acknowledged some market participants' concerns that the process in 229 could take some time to implement and come up with the first set of charges to be paid by the LSP sector.

In order to address these concerns, SGD is therefore proposing that the NDM LSP market should contribute a level of unidentified gas from 1 April 2011 until such time as the AUGE has followed the process set out under 229.

The ICoSS Group sponsored an independently produced report (copy attached)

that demonstrated that the evidence currently available shows a reasonable level of contribution to be in the range of £60,000 (low case), £600,000 (mid case) and £4,900,000 (high case). It therefore appears fair and logical that LSP shippers should contribute within that range immediately and on an interim basis, prior to the more detailed work being undertaken by the AUGE underpinning the enduring solution as envisaged by 229.

SGD proposes that LSP shippers should pay for a volume of gas at the midpoint of the central and high case estimates of 0.3% and 2.6% of RbD throughput. Using the report's assumed average gas cost of 45.86p/th, this volume would equate to £2.75m. Given the nature of measuring flows at DM supply points, it would seem reasonable that this money should be recovered from the NDM sector.

This level of contribution would be made, in line with the principles of 229 until such time that the AUGE calculates and implements charges of its own. (AUGE calculated volumes/charges expected to apply from 1st April 2012.)

Proposal

It is proposed that the Transition Document be modified such that, if values have not been established in accordance with the UNC to populate Table E1 in Section E of the Transportation Principal Document, for the AUG Year commencing 1 April 2011, those in the table below will apply until such time as this happens:

AUG Table beginning AUG Year 2011

<u>LSP Apportionment: £2.75m</u>	
<u>DM</u>	<u>£0</u>
<u>NDM</u>	<u>£2.75m</u>

Consequential changes in the legal text produced for 229 will be required to give the above the necessary interim or temporary effect.

Modification Proposal 0317A

Background

Modification Proposal 0229, "*Mechanism for Correct Apportionment of Unidentified Gas*", was raised by Shell Gas Direct in order to provide a mechanism through which unidentified gas could be more accurately allocated between the Small Supply Point (SSP) sector and Large Supply Point (LSP) sector.

The process through which the new split of allocation between the SSP and LSP sectors would be arrived at involved both a tendering process to procure an Allocation of Unidentified Gas Expert (AUGE) and subsequent work by that

AUGE in order to create an Allocation of Unidentified Gas Statement (AUGS) - the determination on how unidentified gas should be allocated between the SSP and LSP sectors.

The legal text produced in support of Modification Proposal 0229, clearly states that first AUG year starts from 1 April 2011 and that the reallocation of costs between the SSP and LSP sectors will be attributable back to this date, regardless of when the AUGE delivers its AUG Statement.

Modification Proposal 0317 proposes an interim allocation solution which details a level of contribution to be made by the LSP sector until such time as the AUGE calculates and implements its own statement. The level of this contribution being derived from an ICOSS sponsored report.

We are of the view that the LSP Apportionment of £2.75m proposed by 0317 significantly underestimates the true volume of unidentified gas which should be attributable to the NDM LSP market.

With this in mind it is essential that NDM LSP market participants ensure that appropriate financial provisions are made in readiness for reconciliation back to 1 April 2011 and that it would be inappropriate for any financial provision to be formulated based upon the value proposed within Modification Proposal 0317.

Modification Proposal 0317 states that *'This level of contribution would be made, in line with the principles of 229 until such time that the AUGE calculates and implements charges of its own. (AUGE calculated volumes/charges expected to apply from 1st April 2012).*

Although we believe it is evident that LSP Shippers should pay for a volume of gas far in excess of £2.75m, this Modification Proposal proposes the same value of LSP Apportionment as defined within 0317 but provides clarity over how this interim value will be reconciled following delivery of the AUG Statement.

The Proposal

Similar to the intent of Modification Proposal 0317, it is proposed that the Transition Document be modified such that, if values have not been established in accordance with the UNC to populate Table E1 in Section E of the Transportation Principal Document, for the AUG Year commencing 1 April 2011, an interim value will be applicable.

It is proposed that the values detailed within the table below will apply from 1 April 2011 until such time as the AUGE publishes and implements its AUG Statement. It should be noted that under this proposal that all values paid under these interim arrangements will ultimately be reconciled back to 1 April 2011 following delivery of the AUG Statement regardless of the date which this occurs, resulting in a subsequent debit/credit reconciliation to the LSP sector as appropriate. For the avoidance of doubt the AUG Statement will be applied back to 1 April 2011.

AUG Table beginning AUG Year 2011

LSP Apportionment: £2.75m	
<u>DM</u>	<u>£0</u>
<u>NDM</u>	<u>£2.75m</u>

2 User Pays

a) Classification of the Proposal as User Pays or not and justification for classification

Provision of the xoserve elements of these services will be on a User Pays basis as provided for in 229. No change to this will be introduced by these Proposals. They are not, therefore, User Pays Proposals.

b) Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification

No User Pays charges applicable.

c) Proposed charge(s) for application of Users Pays charges to Shippers

No User Pays charges applicable to Shippers.

d) Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve

No charges applicable for inclusion in ACS.

3 Extent to which implementation of the proposed modification would better facilitate the relevant objectives

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

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (b): so far as is consistent with subparagraph (a), the coordinated, efficient and economic operation of

(i) the combined pipe-line system, and/ or

(ii) the pipe-line system of one or more other relevant gas transporters;

Implementation would not be expected to better facilitate this relevant

objective.

Standard Special Condition A11.1 (c): so far as is consistent with subparagraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs (a) to (c) the securing of effective competition:

(i) between relevant shippers;

(ii) between relevant suppliers; and/or

(iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;

Implementation of either Proposal would allocate costs more accurately between shippers/suppliers to the relevant LSP and SSP market sectors. As such, this could reasonably be assumed to facilitate effective competition between relevant shippers.

Standard Special Condition A11.1 (e): so far as is consistent with subparagraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers;

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (f): so far as is consistent with subparagraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

These Proposals seek an early introduction of a temporary framework that facilitates better-informed decision taking with regard to the allocation between market sectors of unidentified gas. It is believed that both Proposals achieve this objective and ensures that the level of contribution by the LSP and SSP sectors respectively is set in a fair, transparent and non-discriminatory manner.

4 The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

5 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) Implications for operation of the System:

No implications

b) Development and capital cost and operating cost implications:

No costs are anticipated as a result of these Proposals, which utilises the mechanism introduced by 229.

c) Extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

Not applicable.

d) Analysis of the consequences (if any) this proposal would have on price regulation:

No such consequence is anticipated.

6 The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

None identified.

7 The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

None identified.

8 The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

Administrative and operational implications (including impact upon manual processes and procedures)

As a result of implementing 0229, some Users are likely to face small administrative and operational costs to manage additional bills from Gas Transporters and the requirement to pass through these costs to consumers. Implementation of either Proposal has the potential to bring forward the time at which such costs are first incurred.

Development and capital cost and operating cost implications

No changes beyond the requirements for 229 are anticipated.

Consequence for the level of contractual risk of Users

None identified.

9 The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

There will be a fairer allocation of charges to consumers in the LSP and SSP markets. **It is the view of the Proposer of 0317A that until reconciliation with the AUG Statement takes place there will still be a significant misallocation of costs.**

10 Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

No such consequences have been identified.

11 Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

These proposals seek to provide an **interim** framework for the determination of unidentified gas values that the market must account. The benefits of these proposals are they will:

- reduce the current cross-subsidy between the LSP and SSP sectors in a clear and simple **interim** mechanism, **, albeit to a level which is inappropriately low**, allowing costs to be recovered from the LSP sector until such time as the AUG produces a statement in line with 229.
- provide for an earlier allocation of costs to help reduce the current degree of cross-subsidy between the SSP and LSP sectors immediately. The impact on competition between shippers and suppliers – and therefore benefits to consumers – will be immediate.
- incentivise a timely resolution of the ongoing industry discussions regarding the AUG appointment process under 229
- **introduce interim arrangements which will ultimately result in interim values being reconciled back to 1 April 2011, providing clarity to all parties.**
- **allows NDM LSP market participants to ensure that appropriate financial provisions are made in readiness for reconciliation back to 1 April 2011.**

Disadvantages

- Both Proposals introduce some additional costs to the industry, although it is not envisaged that these will be in addition to those already accounted for in approval and implementation of 229.
- **Significantly underestimates the true volume of unidentified gas, which should be attributable to the NDM LSP market.**

12 Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Written Representations are now sought in respect of this Draft Report.
Consultation End Date: **Friday 10 September 2010**

13 The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

14 The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence.

15 Programme for works required as a consequence of implementing the Modification Proposal

No programme of works would be required as a consequence of implementing either Modification Proposal.

16 Proposed implementation timetable (including timetable for any necessary information systems changes and detailing any potentially retrospective impacts)

Proposal could be implemented with immediate effect following direction from Ofgem.

17 Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications of implementing either Modification Proposal upon existing Code Standards of Service have been identified.

18 Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

19 Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas and Electricity

Markets Authority in accordance with this report.

20

Text

UNC Modification Proposal 0317

Transition Document

TPD Section E10

1. It is acknowledged that the steps (including appointment of AUG Expert, establishing AUG Methodology and establishing AUG Table) first required under TPD Sections E10.2 and E10.4 will not be completed by the start of the first AUG Year (1 April 2011).
2. For each AUG Year commencing with the first AUG Year up to but not including the AUG Year commencing 1 April next following the first occasion on which the Committee establishes and adopts an AUG Table as provided in TPD Section E10.4.3(g), there shall be deemed to be an AUG Table for the purposes of TPD Section E10.5 in which:
 - (a) there is only one Unidentified Gas Source;
 - (b) for that Unidentified Gas Source, the Unidentified Gas Quantity is:
 - (i) for Larger DM SPCs, zero;
 - (ii) for Larger NDM SPCs, defined (in relation to a Reconciliation Billing Period) as follows:
$$UGC_{SPC} = \text{£}2,750,000 / (\text{TDSAP}_m * 12)$$
 - (c) for Smaller SPCs, defined as the negative of the amount in (b)(ii) above;and TPD Section E10.5 shall be given effect accordingly.

UNC Modification Proposal 317A

Transition Document

TPD Section E10

1. It is acknowledged that the steps (including appointment of AUG Expert, establishing AUG Methodology and establishing AUG Table) first required under TPD Sections E10.2 and E10.4 will not be completed by the start of the first AUG Year (1 April 2011).
2. Accordingly, for the purposes of TPD Section 10:
 - (a) the first AUG Table to be established and adopted by the Committee as provided in TPD Section E10.4.3(g) shall apply (notwithstanding TPD Section E10.5.4) for the purposes of TPD Section E10.5 in relation to:
 - (i) the AUG Year commencing 1 April next following the adoption of such AUG Table, and
 - (ii) each prior AUG Year commencing with the first AUG

Year;

- (b) for each prior AUG Year (as referred to in paragraph (a)(ii)), TPD Section E10.5 shall apply provisionally on the basis of a deemed AUG Table as provided in paragraph 3 below;
- (c) as soon as reasonably practicable following the adoption of the first AUG Table as referred to in paragraph (a), a reconciliation and adjustment shall be made, for each User and each Reconciliation Billing Period in each prior AUG Year (as referred to in paragraph (a)(ii) above) between:
 - (i) the User Unidentified Gas Amount as determined on the basis of such AUG Table; and
 - (ii) the User Unidentified Gas Amount as determined on the basis of the deemed AUG Table as provided in paragraph 3 below;

and the net adjustment amount shall be calculated and paid by or to such User (and shall be invoiced and payable in accordance with TPD Section S), without interest in respect of the period prior to the due date of the relevant invoice for such adjustment amount.

- 3. For the purposes of paragraph 2(b) there shall be deemed to be an AUG Table for the purposes of TPD Section 10.5 in which:
 - (a) there is only one Unidentified Gas Source;
 - (b) for that Unidentified Gas Source, the Unidentified Gas Quantity is:
 - (i) for Larger DM SPCs, zero;
 - (ii) for Larger NDM SPCs, defined (in relation to a Reconciliation Billing Period) as follows:
$$UGC_{SPC} = \text{£}2,750,000 / (\text{TDSAP}_m * 12)$$
 - (c) for Smaller SPCs, defined as the negative of the amount in (b)(ii) above;

and TPD Section E10.5 shall be given provisional effect accordingly.

Representations are now sought in respect of this Draft Report and prior to the Transporters finalising the Report.

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters