

Modification Report
Clarification of the AUG Year in respect of UNC Modification 0229 (alternative)
Modification Reference Number 0340

Version 3.0

This Modification Report is made pursuant to Rule 9.3.1 of the Modification Rules and follows the format required under Rule 9.4.

1 The Modification Proposal

Nature and Purpose of this Proposal

Uniform Network Code (UNC) Modification 0229 ‘Mechanism for correct apportionment of unidentified gas’ was implemented with effect from 10th June 2010.

Included within Proposal 0229 was the business rule "Changes to the volumes in the Large Supply Point Unidentified Gas allocation table would be announced and could only be implemented for the following year.....". Although no specific date for the first AUG Year was contained within the Proposal, in order to create certainty in terms of the mechanics of the AUG process the legal text contained a definition of an AUG year as “the twelve month period commencing 1 April 2011.....”

As a consequence of industry development and review of the Allocation of Unidentified Gas Document (currently entitled 'Guidelines for the appointment of an Allocation of Unidentified Gas Expert'), the legal text provides for the first AUG Year to commence on 1 April 2011. However, it is clear that the AUG's determination in the form of an approved AUG Methodology (statement) will not be completed by this date.

As a result, there is some ambiguity in the legal text currently contained within the UNC and, as the parties responsible for the implementation of Proposal 0229, the Transporters would like to ensure absolute clarity exists in terms of the AUG Year to which the first energy reconciliation would apply.

This ambiguity has been noted by numerous UNC parties and prompted British Gas (BGT) to raise UNC Modification Proposal 0313 ‘Application Date for MOD0229’ This proposal reinforced the application of 1st April 2011 as being the first AUG Year. Under the circumstances stated above, NGD welcomed this proposal as a measure to create absolute clarity as to the date of the first AUG Year and in a note issued to the Uniform Network Code Committee (UNCC) dated 11th August 2011 provided suggested legal text in respect of this Proposal which detailed changes to the UNC Transition Document. This clearly set out the fact that irrespective of when the AUG Methodology became available, energy charge adjustments would be applied from 1st April 2011. BGT withdrew Proposal 0313 on 14th September and provided a note to the industry explaining its reasons for this action.

While we respect BGT’s right to withdraw the Proposal, we believe that the additional text which would have been included in the UNC by the implementation of Proposal 0313 would have provided the additional clarity that we now believe to be imperative for implementation. Since this Proposal has been withdrawn it is now

necessary for the Transporters to gain further regulatory and contractual assurance to provide all parties with certainty over the date of the first AUG Year.

In the light of the above position we have provided Transitional legal text which clearly sets out the circumstances under which reallocation of costs would occur and that this would take place from 1st April 2011 (irrespective of the date when the AUG Methodology is approved).

Note: Transporters are financially neutral to the allocation of costs associated with Unidentified Gas between Users operating in the two market sectors. Indeed, it is a condition of our licence that we treat all Users in a non-discriminatory way and this Proposal is not intended to confer any advantage on any individual User through its effects on the timing of the reallocation of energy costs. The Proposal has been raised to provide Transporters and all Shippers with absolute clarity as to what Transporters are expected to do and by when we are expected to do it.

In addition to the views of the Proposer as set out above, the contents of this Modification Proposal are endorsed by:

Scottish and Southern Gas Networks, Wales & West Utilities and Northern Gas Networks.

Suggested Text

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) as soon as reasonably practicable following the adoption of such AUG Table, the net aggregate amount of the User Unidentified Gas Amounts for each User and for all Reconciliation Billing Periods in each prior AUG Year (as referred to in paragraph (a)(ii) above) shall be paid (by or to the User, as provided in TPD Section E10.5.3), and shall be invoiced and payable in accordance with TPD Section S, as a single net aggregate payment, in satisfaction of TPD Section E10.5.3, without

interest in respect of the period prior to the due date of the relevant invoice.

2 User Pays

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

No changes to User Pays Services are proposed. Consequently this Modification Proposal is not classified as User Pays.

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 coordinated, 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 sub-paragraph (a), the (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 sub-paragraphs (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 sub-paragraphs (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;

Some Shippers believed that the legal text currently in the UNC meant that cost allocation would occur from 01 April 2011 and the effect of this modification would be to confirm this date securing early release from misallocated costs.

Some Shippers believed that Retrospective Charging will result in Shippers and ultimately customers bearing a lesser or greater share of the unidentified gas costs owing to fluctuation in market share. In addition any resulting revenue from unidentified gas reallocation cannot be reimbursed for customers who originally paid for it.

EDF Energy considers it is widely recognised that cross subsidies are not beneficial to competition, or in the consumers' interests. It is therefore imperative that this cross subsidy is removed as soon as possible. They consider Modification 0340 facilitates this objective by removing the cross subsidy.

Corona Energy considers that a retrospective charging structure will have a disproportionate affect on smaller suppliers and is therefore anti-competitive. Therefore it does not further this relevant objective.

First Utility considers that implementation of this modification could have a detrimental impact on the securing of effective competition between relevant shippers and suppliers due to the consequences that any retrospective element created by implementation might have on purely or mainly non-domestic suppliers.

RWE npower considers that implementation of Modification 0340 better meets this relevant objective by providing earlier relief to the SSP sector. They recognise that the consequential debit to the LSP market may be an issue for some Shippers, however, there has been ample time since the decision by the Authority for this to be taken into account. In addition, the SSP market currently manages an uncertainty of final reconciliation costs across small business and domestic customers and as such they foresee no issues in sharing this risk across both market sectors.

Scottish Power considers the introduction of Modification 0340 will ensure that the correct allocation of energy between LSP and SSP shippers takes effect from 01 April 2011, hence being of benefit to competition.

Total Gas & Power considers this modification would create retrospective charges, which will unfairly penalise or benefit shippers depending on whether their market share has increased or decreased since when the costs were first incurred. There is also a risk that shippers will be required to fund any shortfall in charges from defunct shippers.

Standard Special Condition A11.1 (e): so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers' licences) 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 sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.*

This modification removes ambiguity from the UNC and clarifies the date the AUG statement applies – the first AUG year will be applied from 01 April 2011.

British Gas and RWE npower considers the current UNC is clear in its interpretation of the relevant date of affect of Modification 0229. As such, RWE npower considers that this modification does not meet this relevant objective.

British Gas considers that it is efficient administration of the UNC to ensure parties are adequately incentivised to ensure the AUG process is delivered on time. They consider that the whilst each of Modifications 0339, 0339A and 0340 do this by making it clear that any delay to the AUGS implementation timeline will not effect the point when SSP Shippers will benefit from accurate charges, the incentive on LSP Shippers to avoid delay is increased as the effective from date for the initial AUGS is brought forward.

RWE npower considers that the current UNC drafting is clear in its interpretation of the relevant date of affect of Modification 0229. However, they appreciate that this modification clarifies that and the transitional period and so believe that it contributes to effective administration of the Uniform Network Code.

Scottish Power considers this modification provides clarity and certainty, therefore removing any ambiguity, over the date that the first AUGS will apply from 01 April 2011. They also believe it potentially provides an incentive for the timely appointment of the AUGS.

Total Gas & Power considers that the intent of Modification 0229, and the associated AUGS guidelines, was clear as to when charges should be applied to shippers. They do not consider any of the modifications provides clarity on the current process. They therefore do not consider that implementation of any of these modification will facilitate this relevant objective.

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:

There are no implications for operation of the System.

b) development and capital cost and operating cost implications:

Some additional administrative costs could be incurred undertaking an associated reconciliation between the annual charge identified 0317 and the AUGE statement.

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 consequences have been identified.

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

No such consequence is anticipated.

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

There are no development implications for the Transporters UK-Link system or any other Transporter system. The Proposer is not aware of the implications for Users computer systems.

Total Gas & Power considers that Modification 0340 will require retrospective charges. Any form of retrospective payment process will be very costly to implement for shippers and will require significant system changes to track payments.

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)

Total Gas & Power considers any form of retrospective charges will create significant costs as customers are billed or credited a significant time after the event.

Development and capital cost and operating cost implications

Total Gas & Power believe any occurrence of retrospective payments will increase

operating costs.

Consequence for the level of contractual risk of Users

The Proposer is aware that the timing of the application of the first AUG Year could have an impact on a Users contractual risk under the UNC as modified by this modification in terms of the extent of their liability for Unidentified Gas costs so incurred.

Some Workgroup members believed that the timing of the application of the first AUG Year could have an impact on a Users contractual risk in terms of the extent of their liability for Unidentified Gas costs so incurred. If the AUGE does not produce a statement in time for 01 April 2011 costs would still be reconciled back to the 01 April 2011.

There would be a consequential impact associated with UNC0317 i.e. £2.75m would not be netted off against the AUG Statement.

Total Gas & Power considers it will be difficult for shippers to recover reconciliation amounts from customers even if their contracts cater for such eventualities.

EDF Energy notes that under the current arrangements SSP Shippers are exposed to all of the costs of unallocated energy. They recognised as part of the Ofgem Significant Code Review (SCR) in Gas Security of Supply arrangements, Ofgem noted one of their key objectives was to ensure that risks were targeted at those who were best placed to manage and mitigate these. Allocating LSP unidentified gas costs to LSP shippers as early as possible would be consistent with this approach, as LSP Shippers are arguably better placed to forecast this level of energy than SSP Shippers, who may not have any exposure to this market, and are in a better position to identify and reduce this energy. They therefore consider that implementation of Modification 0340 will ensure that the costs and risks are correctly targeted as soon as possible.

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

Total Gas & Power considers that introducing a retrospective charge will mean that LSP consumers will be charged additional costs a year after they have been incurred and shippers are likely to build additional costs into their charges to cover any unrecoverable debt. They also believe that a retrospective charge is unlikely to be passed on in full to SSP consumers, so providing a windfall profit to those organisations.

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

Total Gas & Power considers there is an increased likelihood of contractual dispute between consumers and shippers if retrospective charges are implemented.

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

Advantages

- Ensures that the date for the first application of the reallocation of Unidentified Gas is clearly set out within the UNC.

Disadvantages

- Some Workgroup members consider this Modification does not deliver the intent of Mod0229 and its interaction with Mod0317 ie the potential duplication of charges resulting from the AUGS and Mod0317.

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

Representations were received from the following parties:

Organisation	Position
British Gas	Supports
Corona	Not in Support
EDF Energy	Supports
E.ON UK	Qualified Support
First Utility	Not in Support
Gazprom	Not in Support
RWE Npower	Supports
Scottish Power	Supports
SSE	Supports
Total Gas & Power	Not in Support

Of the ten representations received, five representations were in support of Modification 0340, one offered qualified support, with four parties not in support.

In comparison to Modifications 0339 and 0339A, the same parties offered three representations in support of Modification 0339 with the remaining seven not in support. Five representations offered support for Modification 0339A, one offered comments, with three parties not in support. Of the ten representations received for each modification, five gave a preference to Modification 0339A. However British Gas and Scottish Power indicated a preference to 0340 over and above their stated preference against 0339A.

British Gas provided a detailed response on each modification and it considers each of the modifications if implemented would further the relevant objectives. However, it considers Modification 0339A resolves the conflict, which exists between Modifications 0339 and 0340 and the interim reallocation of unidentified gas costs introduced by Modification 0317. Under Modifications 0339 and 0340, the £2.75m interim payment from the LSP to SSP communities would not be reconciled against the final Allocation of Unidentified Gas Statement (AUGS), exposing the LSP community to a potential “double reconciliation”. However, Modification 0339A expressly provides for the initial AUGS to discount any interim payment made under Modification 0317.

Corona Energy comments that the proposers have confirmed that this modification would create the possibility of retrospective charges being applied to I&C shippers and customers. They also consider that retrospective charges would create perverse incentives for domestic shippers to delay the AUG process. They consider this modification could have an impact on competition and would require a full Regulatory Impact Assessment to be completed to properly assess the consequences of implementation.

EDF Energy considers this modification seeks to address the cross subsidy that currently occurs from the SSP to LSP market. It is widely recognised that cross subsidies are not beneficial to competition, or in the consumers’ interests. It is therefore imperative that this cross subsidy as removed as soon as possible. Modification 0340 facilitates this objective by removing the cross subsidy. They note that under the current arrangements SSP Shippers are exposed to all of the costs of unallocated energy, and so the risks. The result is that when developing charges and energy allocation, SSP Shippers have to forecast both SSP and LSP contributions to unidentified gas costs. Some SSP Shippers will have interests in both markets, but others are solely domestic Shippers with a small SME portfolio and so have no experience of operating in the LSP market.

E.ON UK welcomes the intent of Modification 0340 to establish clarity around the date of the AUG year. However, they appreciate concerns from LSP shippers that the 1 April date does not fit with the timetable for the production of the AUGS and so will not allow costs applied in April to be predicted. Therefore, their preference is for UNC 0339A, which balances the need for predictable costs with the need to apply costs to different market sectors on a fair and equitable basis.

First Utility was concerned that a slight reduction in costs related to RbD as a domestic supplier would be outweighed by the retrospective risk potentially created by the implementation of this Modification, in relation to their non- domestic LSP

portfolio.

Gazprom believe that Modification 0229 was clear in its intent and scope and that retrospection of any nature was not inherent within the proposal.

RWE Npower considers this modification best fulfills the intention of the current legal text and therefore the expectations of parties affected by the process of allocating Unidentified Gas. The current cross-subsidy of the LSP sector to the detriment of the SSP sector is not equitable and places cost on domestic customers in particular that are not supportable. They would urge all parties to ensure that any ambiguity is removed by allowing proper consultation on the legal text as well as the intent of the modification.

SSE considers implementation of Modification 0229 recognised the fact that a cross subsidy exists between the LSP and SSP market sectors. From the initial starting point of the development of Modification 0229, a significant amount of time has elapsed and it is, therefore, important that this cross subsidy exists for as short a time as possible. They, therefore, support the modification, which allocates costs and risks between the LSP and SSP market sectors on a more correct and equitable basis at the earliest opportunity. Due to the amount of time that has elapsed on the whole suite of modifications and development work in this area, the LSP sector has had sufficient time to build any associated costs into tariffs.

Scottish Power acknowledge that the development of the AUGS and the first AUG Methodology will not be completed by 01 April 2011, despite awareness and recognition of the inequitable cross-subsidy that currently exists between the LSP and SSP sectors and has done for a number of years. They therefore do not believe it is acceptable for true reconciliation between the market sectors to be delayed any longer than necessary. They recognise the steps taken, via UNC 0317, to attempt to address this balance but they believe that a further reconciliation is required should the AUGS determine the allocation to the LSP sector differs from £2.75m currently in place.

Total Gas & Power is in support of correcting the cross-subsidy that currently exists between LSP and SSP sectors, though it was always been the intention not to create retrospective charges. They are therefore disappointed that the Legal Text for Modification 0229 created uncertainty. They consider that this modification is seeking to create a fixed date for when unidentified gas charges will apply. A fixed date means that if the AUGS's findings are delivered after that date, then retrospective charges will be levied. This creates a significant risk to suppliers. They note that shippers have no contractual control of the AUGS and if the AUGS does not deliver it does not ensure that the unidentified gas issues are resolved in good time it merely creates the risk of retrospection. This is avoided in the process that is currently in place.

Total Gas & Power considers that this modification does not adequately address the issue of the interim payment continuing when the enduring solution charges are also being levied. As none of these issues exist in the current process the modifications go

against the relevant objectives.

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

No such requirement has been identified.

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

No such requirement has been identified.

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 the Modification Proposal.

16 Proposed implementation timetable (including timetable for any necessary information systems changes)

It is recommended that this Modification Proposal be implemented immediately upon direction.

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

No implications of implementing this 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

The Panel Chair summarised that the modification seeks to clarify the application date for energy reconciliations in accordance with the first Allocation of Unidentified Gas Statement. Modification 0340 proposes this should be 1st April 2011.

Members recognised that the modification seeks to clarify the existing UNC text, which some have suggested is ambiguous. To this extent, therefore, implementation could be regarded as consistent with promotion of efficiency in the implementation and administration of the Code.

Members also recognised that implementing the modification would deliver certainty regarding the initial date for the energy reallocations. Implementation would therefore provide some certainty, and increasing certainty regarding the market arrangements could be expected to facilitate the securing of effective competition.

However, some Members considered that, while the initial date would be certain, the value of any reconciliation would be uncertain. This is because the initial AUGS will not be available prior to this date such that there will be retrospective reconciliations. Retrospectivity creates uncertainty and would undermine the securing of effective competition.

Other Members were concerned that costs are being incorrectly allocated at present and wished to see this corrected at the earliest possible opportunity, with more accurate cost targeting being expected to remove cross subsidies and facilitate the securing of effective competition. They therefore considered that implementation of the modification would facilitate effective competition even though costs would be reallocated retrospectively.

Three votes were cast in favour of implementing Modification 0340. Therefore the Panel did not determine to recommend implementation of Modification 0340.

Panel's view of the benefits of implementation against the Code Relevant Objectives	
Description of Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) 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.	None
c) Efficient discharge of the licensee's obligations.	None
d) 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.	Impacted
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply	None

security standards... are satisfied as respects the availability of gas to their domestic customers.	
f) Promotion of efficiency in the implementation and administration of the Code	Impacted

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 0340

LEGAL TEXT

Clarification of the AUG Year in respect of UNC Modification 0229 (alternative)

Transition Document Part IIC

TPD Section E10

Add new paragraph 3 as follows:

3. For the purposes of TPD Section 10:

- (a) In addition and separate to the establishment and adoption of a deemed AUG Table as set out in paragraph 2 above, for the avoidance of doubt, 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 01 April next following the adoption of such AUG Table, and
 - (ii) each prior AUG Year commencing with the first AUG Year;

- (b) as soon as reasonably practicable following the adoption of such AUG Table, the net aggregate amount of the User Unidentified Gas Amounts for each User and for all Reconciliation Billing Periods in each prior AUG Year (as referred to in paragraph (a)(ii) above) shall be paid (by or to the User, as provided in TPD Section E10.5.3), and shall be invoiced and payable in accordance with

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TPD Section S, as a single net aggregate payment, in satisfaction of TPD Section E10.5.3, (in addition to any payment made pursuant to such deemed AUG Table) without interest in respect of the period prior to the due date of the relevant invoice.

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters