Stage 04: Final Modification Report

What stage is this document in the process?

01 Proposal

02 Workgroup Report

03 Draft Modification Report

04 Final Modification Report

0388:

Fixed parameters for determining Shipper contribution to Unidentified Gas

This modification proposes to move to fixed annual gas price and market share for determining Shipper contribution to Unidentified Gas.

Panel recommends implementation

High Impact: Shippers

Medium Impact: Customers

Low Impact: Transporters

Contents

About this document:

This document is a Final Modification Report, presented to the Panel on 20 October 2011. The Authority will consider the Panel's Recommendation and decide whether or not this change should be made.

Any questions?

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1 Summary

Is this a Self-Governance Modification?

The Panel determined Self-Governance procedures were not appropriate for this modification.

Why Change?

The AUGE process will determine a fixed quantity of Unidentified Gas that is attributable to the LSP NDM sector, but the resulting financial calculation will use varying monthly SAP and market shares. This has resulted in suppliers having difficulty in pricing the Unidentified Gas adjustment into their market offerings, increasing uncertainty and risk to shippers and making it difficult to pass the costs through to LSP NDM customers.

Solution

To remove this uncertainty it is proposed to:

- Replace the rolling SAP calculation with a fixed annual reference price created using industry prices.
- Replace the rolling market sector volume calculation for the LSP NDM and DM sector with an annual market sector volume calculation as of 1st October.
- Make consequential adjustments to the SSP NDM Unidentified Gas process to ensure that all of the resulting credit from the LSP NDM and DM sectors is passed through to the SSP NDM sector.

For the avoidance of doubt individual shipper market shares would not be fixed for the year and individual shipper contributions would still vary proportionally on a monthly basis.

With these two parameters fixed it will be possible for shippers to create a fixed p/kWh charge for their DM and LSP NDM customers that can be applied to a LSP NDM customer's contract.

Impacts & Costs

The resulting process will be simpler to administer for both the transporters and shippers, in particular removing the need to undertake reconciliation of Unidentified Gas costs contained in pass through supply contracts. There will also be less uncertainty to shippers on what the financial impact of the Unidentified Gas process will be. This will reduce costs to customers, as no additional risk premiums will need to be built into prices. Finally, the Unidentified Gas cost will be readily transparent to customers, ensuring straight forward pass through to LSP NDM customers.

In terms of implementation costs, it is not considered there would be any material change in costs associated with this modification, as it proposes a replacement of rolling variables with fixed parameters. If Xoserve indicate that any costs are involved, however, these should be met by those organisations that benefit from this change and should be targeted at the LSP NDM and DM sectors through the User Pays mechanism.

Some Workgroup members consider that as a consequence of SAP being removed from the UAG calculation, results in price risk being passed from LSP Shippers to SSP Shippers. Under this modification LSP Shippers will be able to fix a variable cost and any risk due to a variation in SAP is passed onto SSP Shippers. This risk is in addition to the usual risks faced by the RbD market. The Proposer believes that this will sometimes result in windfall profits for SSP shippers if LSP shippers pay for UAG above the SAP price.

Implementation

In order to avoid duplicated costs from varying parameters applying for a period and then fixed parameters, and to give shippers time to incorporate the new processes into their contracts, the proposer considers that this modification should be implemented in time to allow the new calculation methodology to be used in determining the estimated rates to be published by 1st November 2011.

The Workgroup recognises that implementation would be beneficial sooner to avoid additional system development costs should Ofgem direct implementation of the modification.

The Case for Change

This modification will remove uncertainty in the current process, reducing overall risk to customers and promoting transparency.

Some Workgroup members consider that as a consequence of SAP being removed from the UAG calculation, results in price risk being passed from LSP Shippers to SSP Shippers. Under this modification LSP Shippers will be able to fix a variable cost and any risk due to a variation in SAP is passed onto SSP Shippers. This risk is in addition to the usual risks faced by the RbD market. The Proposer believes that this will sometimes result in windfall profits for SSP shippers if LSP shippers pay for UAG above the SAP price.

2 Why Change?

By the end of September, the AUGE will determine a fixed amount of Unidentified Gas attributable to the DM and LSP NDM sectors. This volume of gas will then be converted into a financial amount using a rolling averaged SAP for the applicable reconciliation period. As shown in section 3 below, this SAP value can vary significantly (for example in 2009-2010 it varied from 32p/th to over 60 p/th). The total market sector volume will also vary for each reconciliation period, though to a much lesser extent.

The variability of these two factors means it is difficult for shippers to determine a unit price for Unidentified Gas to be passed onto DM or LSP NDM customers. For customers supplied on the basis of contracts, which allow for the pass through of transportation costs this will mean that an initial estimate will need to be corrected over time as the actual Unidentified Gas charges become known. This is considered to affect a significant proportion of LSP customers (the proposer believes it impacts in excess of 75% of its LSP NDM customers). This results in significant additional risk and uncertainty for such customers, as well as significant costs for shippers in administering this reconciliation. More generally, this uncertainty also has a detrimental impact on DM or LSP NDM customers who do not operate on pass-through contracts as the current unpredictability makes it difficult for the financial cost to be accurately priced.

3 Solution

High Level Solution

It is proposed that the rolling monthly calculations of Unidentified Gas price and LSP NDM and DM SPC Class volumes are instead replaced with an annual process, undertaken after the AUGE has finalised the Unidentified Gas Quantity, but before the transporters have published the indicative unit rates (i.e. between October and November each year). These fixed volumes would be used for the forthcoming AUGE Year (i.e. starting from the following April).

For the avoidance of doubt individual Shipper market shares would not be fixed for the year and individual Shipper contributions would vary proportionally on a monthly basis in line with changes to their portfolio.

The net effect of fixing these parameters would be to create a unit rate which will correspond to the debits shippers will receive (though we recognise that the detailed process the transporters operate does not involve applying a unit rate to the AQ of a shipper's portfolio). This unit rate would be published by the transporters in accordance with section 9 of the AUGE guidelines.

Proposed Unidentified Gas Changes

The changes needed to achieve this new process are threefold

- Use a commonly available forward reference price instead of a rolling average SAP calculated after the reconciliation period has concluded.
- Fix each market sector volume for LSP NDM & DM market sectors at the 1st October, rather than using a rolling monthly market volume.
- Consequential Change to the redistribution process for SSP NDM market sector.

Reference Price

At present, in order to convert an individual Shipper's Unidentified Gas Quantity into a financial value it is multiplied by the System Average Price, averaged over the previous reconciliation billing period.

It is proposed to replace this rolling average price with an average price derived from the forward prices published by ICIS Heren, specifically the daily average closing prices over the month of August for the 4 quarters for the period commencing 1st April of the following year as published by ICIS. (termed "Unidentified Gas Price"). In the event that prices are not available from ICIS, then we propose that the Transporters would be required to source a suitable alternative set of published information. It is further proposed that the AUGS should specify the source used for this calculation.

It is our view that ICIS Heren prices give a comparable value to rolling average SAP over the course of the year. To illustrate this a comparison of these prices with historic SAP prices for 2010-11 is shown below:

ICIS Heren Prices (p/th)

Date	Q2-10	Q3-10	Q4-10	Q1-11
03/08/09	41.87	41.22	55.05	62.40
04/08/09	42.06	41.40	55.49	62.68
05/08/09	41.92	41.3	55.36	62.55
06/08/09	43.50	42.83	56.75	63.95
07/08/09	42.90	42.19	56.41	63.50
10/08/09	43.07	42.51	56.65	63.88
11/08/09	42.75	42.13	56.1	63.3
12/08/09	42.69	42.06	56.22	63.26
13/08/09	43.26	42.63	57.04	64.12
14/08/09	42.83	42.2	56.29	63.67
17/08/09	41.95	41.23	55.19	62.22
18/08/09	41.83	41.2	55.22	63.31
19/08/09	41.92	41.31	55.43	62.59
20/08/09	40.88	40.28	54.79	61.63
21/08/09	40.04	39.56	54.08	61.44
24/08/09	38.95	38.48	53.43	60.69
25/08/09	38.08	38.31	53.21	60.49
26/08/09	37.95	37.49	52.80	60.06
27/08/09	37.58	37.23	52.82	59.98
28/08/09	38.06	37.65	53.23	60.33
Average Price				**49.81**

Rolling SAP prices (p/th)

	Month Av	Quarter Av
30/04/10	32.76	
31/05/10	39.82	
30/06/10	41.85	38.14
31/07/10	46.30	
31/08/10	42.90	
30/09/10	40.56	43.26
31/10/10	45.51	
30/11/10	49.50	
31/12/10	61.77	52.26
31/01/11	56.27	
28/02/11	53.83	
31/03/11	60.50	56.87
Average	**47.63**	

As referenced in section 2 above, this information highlights the variability in rolling SAP over the course of the year.

Market Sector Volume

The current process determines an individual Shipper's share of total Unidentified Gas volume by dividing the Shipper's aggregate AQ for that sector by the total market volume for that sector for that month.

It is proposed for the LSP NDM and DM sectors that the total market volume is fixed for the forthcoming AUGE year by aggregating all AQs for each qualifying site in each SPC Class on 1 October each year. Each month, each Shipper's current aggregate AQ for the LSP NDM and DM sectors would be divided by the appropriate fixed market volume. Thus for each month, a User's percentage share of that AQ would be calculated, and that percentage would be their share of the Unidentified Gas to be apportioned for that month.

Redistribution of Unidentified Gas Amounts

The current Unidentified Gas process ensures that any resulting debits that are due from the LSP NDM and DM sectors are mirrored as corresponding credits to the SSP NDM market sector.

By fixing the market sector volumes for the LSP NDM and DM sectors, it will be necessary to make consequential amendments to the Unidentified Gas process to ensure that all debits received from the LSP NDM sector are passed onto the SSP NDM sector.

It is proposed that the current process of determining each Shipper's SSP NDM market share is maintained (i.e. a shipper's SSP NDM market share for each reconciliation billing period is divided by the sum of the AQs for that sector for that month in order to give each SSP Shipper's proportional market share), but this market share will be used to determine the proportion of revenue from the LSP NDM sector that is redistributed to each shipper.

Worked Example

In order to illustrate the impact of these proposed changes on Unidentified Gas, and to assist in clarifying the intent of this modification, a worked example is provided:

Parameters

Whatfield Country Gas – supplier that concentrates exclusively on mid-size non-domestic customer (i.e. supplies LSP NDM customers only)

Hadleigh Energy – supplier that concentrates exclusively on small domestic properties (i.e. SSP NDM customers only)

Unidentified Gas LSP NDM Market	= 500 million KWh
Unidentified Gas DM Market	= 0 KWh (so ignored for this process)
Average ICIS Heren Forward Price	= 43.40 p/th (1.48 p/kWh)
April 2011	
Whatfield Gas Portfolio Size	= 1 GWh
1st October LSP NDM market	= 100 GWh
Current LSP NDM market (April 2011)	= 100 GWh
Whatfield Gas UG Cost for April	= Proportion of LSP NDM Market * Unidentified Gas volume/12 * ICIS Heren Forward Price = (1/100)* (500million/12)*1.48p/th = £6,166.67
Total LSP NDM UG charges for April	= £616,666.67 (sum over 100 GWh)
Hadleigh Town Energy Portfolio Size	= 10 GWh
Total LSP NDM portfolio (for April 2011)	= 1000 GWh
Hadleigh Energy UG Credit April	= Proportion of SSP NDM Market * Total LSP NDM UG charges for April = (10/1000)* £616,666.67 = £6,166.67
November 2011	
Whatfield Gas Portfolio Size	= 2 GWh
1st October LSP NDM market	= 100 GWh
Current LSP NDM market (November 2011)	= 105 GWh

Whatfield Gas UG Cost for November	= Proportion of LSP NDM Market Unidentified Gas volume/12 * ICIS Heren Forward Price = (2/100)* (500million/12)*1.48p/th = £12,333.34
Total LSP NDM UG charges for November	= £647,500.35 (sum over 105 GWh)
Hadleigh Town Energy Portfolio Size	= 20 GWh
Total LSP NDM portfolio (for November 2011)	= 1100 GWh
Hadleigh Energy UG Credit November	= Proportion of SSP NDM Market * Total LSP NDM UG charges November = (20/1100)* £647,500.35 = £11,772.73

4 Relevant Objectives

Implementation will better facilitate the achievement of **Relevant Objective d.**

The benefits 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.	Yes, see below.
e) 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.	None
f) Promotion of efficiency in the implementation and administration of the Code	None

Relevant Objective (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.

Fixing the parameters used to determine the apportionment of Unidentified Gas will allow a unit rate to be created that LSP shippers can apply to their own portfolio. This will provide certainty to LSP customers with regard to the Unidentified Gas costs they will be charged in pass through contracts and will reduce potentially substantial shipper costs by avoiding reconciliation of estimated pass through costs. The administrative and bad debt costs avoided will be significant (the proposer estimates for its portfolio alone the cost saving will be around £100,000 a year). The increased certainty would also mean that shippers may adopt lower risk premiums. Reducing administrative and bad debt costs will improve competition between shippers.

Some Workgroup attendees consider the modification would have a detrimental impact on competition as it passes price risk from LSP shippers to SSP Shippers leading to inappropriate allocation of risk, by removing SAP prices from the LSP UAG calculation.

The Proposer believes that when SAP prices are lower than the UAG price paid by LSP shippers, then SSP shippers will receive a higher payment than the SAP price. Conversely SSP Shippers, will receive a lower payment when the UAG price paid by LSP Shippers is lower than the SAP price paid by SSP Shippers.

Both British Gas and EDF Energy consider that this Proposal will inappropriately move risk from the LSP to the SSP sector. British Gas believe the modification seeks to move risk of variations in commodity cost to tariff charged without good reason. To force SSP Shippers to cover the cost associated with this risk would merely create an imperfection in the operation of the market, which would distort competition between SSP and LSP Shippers.

Corona Energy considers that creating certainty to LSP customers on the unit rate they are expected to pay for Unidentified Gas will remove the need to reconcile initial estimates. This will remove the risk to customers of unrecovered costs being passed on as well reducing administration costs incurred through reconciliation.

EDF Energy considers implementation of this proposal would add further complexity to the UNC. They note that Total has indicated that they believe the AUGE could take any mis- allocations caused by divergence between SAP and the index price. However, they do not believe that the current arrangements support this and a further modification would be required. Any modification that requires subsequent code changes to address deficiencies would not appear to facilitate the relevant objective of efficient administration of the UNC.

GDF Suez support is offered in relation to improving competition between shippers and suppliers due to the increased certainty of the charges, resulting in more accurate customer billing and minimising any requirement for retrospective adjustments. This would improve the customer transfer process.

ScottishPower considers that this modification would be detrimental to SSP Shippers and their customers and increase uncertainty and risk in relation to unidentified gas in this market segment. This would reduce confidence in this market sector and potentially impact the attractiveness of this market to new entrants.

Total considers that this modification furthers relevant objective (d) as fixing the parameters used to determine the apportionment of Unidentified Gas will allow a unit rate to be created that LSP shippers can apply to their own portfolio. This will provide certainty to LSP customers with regard to the Unidentified Gas costs they will be charged in pass through contracts and will reduce potentially substantial shipper costs by avoiding reconciliation of customer bills.

5 Impacts and Costs

Consideration of Wider Industry Impacts

None identified by the Workgroup.

Costs

The Workgroup did not consider the development costs of this modification will significantly increase the overall costs for the implementation of Modification 0229. However a ROM is required to understand the costing.

Indicative industry costs – User Pays
Classification of the Proposal as User Pays or not and justification for classification
This change will alter the transporter agent's processes and is likely to result in some change in costs, so should be classified as User Pays.
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification
This proposal will primarily benefit shippers with LSP NDM customers and it is therefore proposed that any cost should be aimed at that market sector.
Proposed charge(s) for application of Users Pays charges to Shippers
To be completed once an indication of costs is received from Xoserve.
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from Xoserve
Xoserve is unable to provide a rough order of magnitude for the development and ongoing operational aspects.

Impacts

Impact on Transporters' Systems and Process	
Transporters' System/Process	Potential impact
UK Link	None
Operational Processes	Some changes to the Unidentified Gas process have been identified (see section 3 for details).
User Pays implications	To be confirmed – see above.

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	Users will be able to price Unidentified Gas charges into their products with greater certainty, so reducing risk costs. It will also reduce administrative costs as there will no longer be a need to reconcile Unidentified Gas costs for those parties with pass through contracts.
Development, capital and operating costs	None
Contractual risks	Unidentified Cost charge variability will be removed for LSP NDM customers. This makes any cost pass through more predictable so reducing the risk of non-payment. It was also remove a barrier to customer switching as retrospective charges will not need to apply to such customers. Some Workgroup members consider a consequence of SAP being removed from the UAG calculation is price risk being passed from LSP Shippers to SSP Shippers. Under this modification LSP Shippers will be able to fix a variable cost and any risk due to a variation in SAP is passed onto SSP Shippers. This would result in a higher risk premium or a higher cost for SSP customers if SSP Shippers decided to hedge this risk.
Legislative, regulatory and contractual obligations and relationships	None

Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	None
Development, capital and operating costs	The changes to accommodate Modification 0388 are very difficult for Xoserve to assess in terms of development cost impact as the project work for Modification 0229 is already in progress and it is unclear when any changes to present design may be required to be applied. It is the case that the later any implementation decision is made the greater will be the cost of change as some work completed would be redundant and greater re-work required.
Recovery of costs	None
Price regulation	None
Contractual risks	None
Legislative, regulatory and contractual obligations and relationships	None
Standards of service	None

Impact on Code Administration	
Area of Code Administration	Potential impact
Modification Rules	None
UNC Committees	None

1

Where can I find details of the UNC Standards of Service?

In the Revised FMR for Transco's Network Code Modification **0565 Transco Proposal for Revision of Network Code Standards of Service** at the following location: http://www.gasgovernance.co.uk/sites/default/files/0565.zip

Impact on Code Administration	
General administration	Moving to a fixed parameter will simplify the administration undertaken by the Transporter's agent when administering the AUGE process, in particular when determining the indicative unit rate in accordance with Section of the AUGE process. Consideration should be given to the provision of data should ICIS Heren be removed, changed or unavailable for publication.

Impact on Code	
Code section	Potential impact
TPD E10.5	Change to Unidentified Gas Amount apportionment calculations.

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact
Network Entry Agreement (TPD I1.3)	None
Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4)	None
Storage Connection Agreement (TPD R1.3.1)	None
UK Link Manual (TPD U1.4)	None
Network Code Operations Reporting Manual (TPD V12)	None
Network Code Validation Rules (TPD V12)	None
ECQ Methodology (TPD V12)	None
Measurement Error Notification Guidelines (TPD V12)	None
Energy Balancing Credit Rules (TPD X2.1)	None
Uniform Network Code Standards of Service (Various)	None

Impact on Core Industry Documents and other documents	
Document	Potential impact
Safety Case or other document under Gas Safety (Management) Regulations	None
Gas Transporter Licence	None

Other Impacts	
Item impacted	Potential impact
Security of Supply	None
Operation of the Total System	None
Industry fragmentation	None
Terminal operators, consumers, connected system operators, suppliers, producers and other non code parties	The potential volatility in the Unidentified Gas charge apportionment process will be removed, so ensuring that gas costs will be more predictable and reducing the exposure LSP consumers have through their suppliers to volatile price variations. Some Workgroup members consider as a consequence of SAP being removed from the UAG calculation, price risk would be passed from LSP Shippers to SSP Shippers. Under this modification LSP Shippers will be able to fix a variable cost and any risk due to a variation in SAP is passed onto SSP Shippers. This would result in a higher risk premium or a higher cost for SSP customers if SSP Shippers decided to hedge this risk. ScottishPower is concerned that in the longer term, this modification would result in an ongoing cross subsidy from the SSP to LSP market to the detriment of SSP customers.

6 Implementation

To allow sufficient time for the new fixed unit rate to be taken into account by suppliers for the start of the reallocation process in April 2012, the indicative rates need to be published by the Transporters in November 2011. In accordance with the UNC Modification Rules Paragraph 6.2.1, the Workgroup therefore suggests the following:

- An implementation date of 1 October if an Authority decision is received by 30 September.
- If no decision has been received by 30 September, an implementation date of 1 November if an Authority decision is received by 31 October.
- If no decision has been received by 31 October, then implementation will be one day after the Authority decision has been received.

7 The Case for Change

In addition to that identified above, the Workgroup has identified the following:

Advantages

- Greater Transparency of the impact of Unidentified Gas on customers with pass through contracts.
- Reduction in bad debt risk on Unidentified Gas costs, reducing costs for LSP Shippers.
- Enables straight forward pass through of UAG costs to LSP NDM customers by fixing the parameters. However, some Workgroup members consider straight forward pass through of costs is possible with the current methodology.

Disadvantages

- Provides a free hedge for LSP shippers against UAG price movement at a cost to SSP Shippers.
- Some Workgroup members consider as a consequence of SAP being removed from the UAG calculation, price risk would be passed from LSP Shippers to SSP Shippers. Under this modification LSP Shippers will be able to fix a variable cost and any risk due to a variation in SAP is passed onto SSP Shippers.

8 Legal Text

EDF Energy does not consider that the suggested legal text will deliver the intent of the modification. They therefore believe formal legal text should be provided and this should be consulted upon.

DRAFT TEXT

UNIFORM NETWORK CODE – TRANSPORTER PRINCIPAL DOCUMENT

SECTION E – DAILY QUANTITIES, IMBALANCES AND RECONCILIATION

…

10.5 Allocation of Unidentified Gas

10.5.1 For the purposes of this paragraph 10, for each AUG Year, for each User, Reconciliation Billing Period and SPC Class:

(a) subject to paragraph (b) below, the "**User SPC Aggregate AQ**" ($USAAQ_{SPC}$) is the amount calculated as follows:

$$USAAQ_{SPC} = \Sigma_d \Sigma_r AQ_{rd}$$

where

Σ_d is the sum over Days in the Reconciliation Billing Period;

Σ_r is the sum over the User's Registered Supply Point Components and CSEP Equivalent Points of the relevant SPC Class in all LDZs on Day d;

and where for each such Supply Point Component or CSEP Equivalent Point and Day, AQ_{rd} is the Annual Quantity of such Supply Point Component or the equivalent quantity determined pursuant to the relevant CSEP Network Exit Provisions;

(b) the "**User SPC Aggregate AQ Proportion**" ($USAAQP_{SPC}$) is the decimal factor calculated as follows:

$$USAAQP_{SPC} = USAAQ_{SPC} / \Sigma_U USAAQ_{SPC}$$

where for $\Sigma_U USAAQ_{SPC}$:

Σ_U is the sum over all Users;

$USAAQ_{SPC}$ is calculated in respect of Smaller SPCs in accordance with paragraph (a) above;

$USAAQ_{SPC}$ is calculated in respect of Larger NDM SPCs and Larger DM SPCs as follows:

$$USAAQ_{SPC} = \Sigma_r AQ_{rd} * ND$$

where

Σ_r is the sum over the User's Registered Supply Point Components and CSEP Equivalent Points of the relevant SPC Class in all LDZs on Day d;

Day d is the first Day of the October preceding the commencement of the relevant AUG Year;

and where for each such Supply Point Component or CSEP Equivalent Point, AQ_{rd} is the Annual Quantity on Day d of such Supply Point Component or the equivalent quantity determined pursuant to the relevant CSEP Network Exit Provisions;

ND is the number of Days in the Reconciliation Billing Period.

10.5.2 For the purposes of this paragraph 10, for each AUG Year, for each User and Reconciliation Billing Period:

(a) the "**User Unidentified Gas Quantity**" (UUGQ) is the amount in kWh calculated as follows:

$$UUGQ = \Sigma_{SPC} (\Sigma_{UGS} \ UGQ_{SPC} * USAAQP_{SPC}) / 12$$

where

Σ_{SPC} is the sum over SPC Classes

Σ_{UGS} is the sum over Unidentified Gas Sources set out in the AUG Table

and where for each Unidentified Gas Source and SPC Class

UGQ_{SPC} is the Unidentified Gas Quantity set out in the AUG Table

and where for each SPC Class

$USAAQP_{SPC}$ is User SPC Aggregate AQ Proportion

(b) the "**User Unidentified Gas Amount**" (UUGA) is the amount calculated as follows:

$$UUGA = UUGQ * TDHeren$$

where

TDHeren is the arithmetic average of:

(i) the NBP price assessment for each quarter commencing on 1 April, 1 July, 1 October and 1 January in the relevant AUG Year published by ICIS Heren in the ICIS Heren Gas Report during the August preceding the commencement of that AUG Year (the "**relevant prices**"); or

(ii) where ICIS Heren does not publish the relevant prices, the prices shall be prices sourced by the Transporters which are reasonably comparable to the relevant prices whether published by ICIS Heren during a different month or published by another comparable reporting service. The Transporters shall give notice to Users of the prices. For the avoidance of doubt the Transporters owe no duties or responsibilities to any User in respect of any prices sourced pursuant to this paragraph 10.5.2(b)(ii).

10.5.3 Without prejudice to paragraph 10.5.4, the User Unidentified Gas Amount shall be payable, by way of adjustment in respect of the aggregate User Aggregate Reconciliation Clearing Values:

(a) by the User to National Grid NTS, where such amount is positive;

(b) by National Grid NTS to the User, where such amount is negative;

and shall be invoiced (at the same time or as soon as practicable after the Invoice in respect of the Aggregate NDM Reconciliation) and payable in accordance with Section S.

10.5.4 Where, in respect of a Reconciliation Billing Period, the aggregate amounts payable pursuant to paragraph 10.5.3:

(a) by National Grid NTS to Users would otherwise exceed the amounts payable by Users to National Grid NTS; or

(b) by Users to National Grid NTS would otherwise exceed the amounts payable by National Grid NTS,

paragraph 10.5.5 shall apply.

10.5.5 Where paragraph 10.5.4 applies the amount payable by National Grid NTS pursuant to paragraph shall be adjusted as follows:

$$UUGA_{ad} = UUGA_{uad} * (\Sigma_U (UUGA_u) / \Sigma_U (UUGA_{uad}))$$

where:

$UUGA_{ad}$	is the User Unidentified Gas Amount payable by National Grid NTS to the User pursuant to paragraph 10.5.3(b) as adjusted pursuant to this paragraph 10.5.5;
$UUGA_{uad}$	is the User Unidentified Gas Amount (expressed as a positive number) which would otherwise be payable by National Grid NTS to the User pursuant to paragraph 10.5.3(b) without adjustment pursuant to this paragraph 10.5.5;
Σ_U	is the sum over all Users; and
$UUGA_u$	is the User Unidentified Gas Amount which is payable by the User pursuant to paragraph 10.5.3(a).

10.5.6 This paragraph 10.5 does not apply where for any AUG Year no AUG Table is established or there are no non-zero values of Unidentified Gas in the AUG Table.

Table E1 – Form of AUG Table

AUG Table for AUG Year

	Aggregate	Unidentified Gas Quantity

Unidentified Gas Source	quantity of Unidentified Gas	Larger DM SPCs (A)	Larger NDM SPCs (B)	Smaller SPCs (C)*
(etc)				

*C = $-$ (A + B)

9 Consultation Responses

Representations were received from the following parties:

Respondent	
Company/Organisation Name	**Support Implementation or not?**
British Gas	Not in Support
Corona Energy	Support
EDF Energy	Not in Support
E.ON UK	Not in Support
Gazprom	Support
GDF Suez	Support
RWE npower	Not in Support
ScottishPower	Not in Support
SSE	Not in Support
Total Gas & Power Ltd	Support

Of the 10 representations received 4 supported implementation and 6 were not in support.

Summary Comments

British Gas are aware that some have argued that it would be prudent to allow the existing (AUG) process to run its course for at least the first year before changes such as these are implemented. They agree with this view and think that were the industry to have an opportunity to embark on a "lessons learnt" exercise in 2012, it may be more beneficial than an attempt to pre-judge and amend the outcome now.

Both British Gas and EDF Energy notes that the legal text has been amended subsequent to development and discussion of the modification, such that it introduces a new concept to the AUG process to reconcile any payments made with the full amount due under the AUGS process. They are concerned this is a material change to the modification and has not been assessed or discussed by industry and that they have not had any opportunity to assess how it may impact their businesses. They consider that the modification is under developed and should be referred back to the Workgroup so that this aspect of the modification can be understood by industry Parties.

Corona Energy considers that this modification provides a clear cognitive link between the price that LSP customers will pay and the published values that are provided by the Transporters, in line with the Transportation values, which are published at the same time. Allowing the cost of unidentified gas to be known in advance will benefit consumers as this can be clearly calculated in advance and displayed in quotations and contracts. Where Transportation pass-through clauses are operated, this will remove the requirement to reconcile an initial estimated position, so significantly reducing administrative costs. It also removes the risk of these reconciliation amounts not being met (by customers who have changed supplier or gone out business for example) and being smeared across all other customers.

Corona Energy does not believe that there is any impact on wholesale balancing activities. Shippers are obliged to procure gas to the best of their ability to meet the gas demand they are allocated by the transporters. This modification does not seek to reallocate gas and so the wholesale costs of Shippers are completely unaffected. As the level of gas allocated will not change this modification should not be seen in the light of adjusting the risk profile of market sectors in the wholesale market.

EDF Energy believes that this modification seeks to remove all of the price risk faced by LSP Shippers and pass this to the SSP Shippers. This appears to be contrary to the intent of Modification 0229 which sought to remove the cross subsidy from SSP Shippers to LSP Shippers and to ensure that risks and costs were appropriately targeted. EDF Energy note the argument that LSP Shippers are unable to hedge the risk of price movements in SAP compared to the contracted price in LSP contracts, but believe this appears to overlook the basic principles of financial risk management, which allow a Shipper to hedge against these risks for a cost. EDF Energy opposes this modification as it appears to be an attempt to avoid the costs of hedging price risk by passing this risk from LSP to SSP Shippers and consumers.

E.ON UK argues that this Modification would mean that the SSP sector would bear the SAP price risk for the total amount of Unallocated Gas, both the SSP and LSP contributions. The point of having an AUGE process is to remove the cross subsidy of the LSP sector by the SSP sector by determining an appropriate LSP contribution to Unallocated Gas energy cost. This Modification would have the effect of re-establishing part of this subsidy. In terms of fixed volumes, whatever the merits or de-merits, E.ON UK cannot see how LSP Unallocated Gas can be fixed. The AUGE will determine the levels of Unallocated Gas and to which activities they are attributable. These may be constant or they may be associated with activities or usage patterns that vary throughout the year. This is for the AUGE to determine and not for any shipper or sector to pre-judge.

Gazprom considers that calculating the price in advance of delivery allows for costs to be priced transparently into gas contracts and for LSP Customers to have certainty of the value of Unidentified Gas which they will have to fund. By fixing the cost they avoid the need for pricing in risk premiums. In addition, they avoid the need for any reconciliation. This approach is also consistent with existing Transportation Charges and Notices.

In addition, Gazprom notes that the proposer has made it clear that the purpose is not to reduce the value of the Unallocated Gas to be returned to the SSP sector but to simply fix its value in advance.

RWE npower does not agree the modification removes risk; it shifts it onto the SSP sector. There is no business or economic justification for the modification. Moreover, the suggested implementation date is too early for an orderly implementation.

ScottishPower is unconvinced that the scale of the issue described within the modification is material and believes that it represents a risk that Shippers would be reasonably expected to manage. They do not believe that the modification has shown that the issue being experienced by the LSP shippers is material and cannot be expected to be accounted for as part of their normal risk management policy. Using the £2.75m figure purported by the ICOSS Shippers (which includes the proposer) to be the contribution of LSP supply points to unidentified gas, this translates to a value of approximately £6.11 per LSP customer. Given the scale of the businesses operating in this sector and the volumes used by these customers, it is not unreasonable for LSP shippers to be expected to manage this "risk".

SSE is of the view that the modification will definitely discriminate between LSPs and SSPs, as LSP uncertainty is reduced at the expense of greater uncertainty for SSPs. The risk borne by SSPs would increase under this modification as SSPs incur costs for unallocated gas at a SAP price, but would get the rebate back at a non SAP price. Effectively LSPs would hedge the price of their unidentified gas at a fixed price against the SSP market for no risk premium, which is inequitable. Furthermore, by fixing the market sector volume at 1st October any risks on changes to the sector volumes after this date would again be borne by the SSP sector.

Total raised this modification in order to achieve a number of objectives. Calculating the price in advance of delivery allows:

1) A cost that can be priced transparently into gas contracts.
2) A cost that is fixed and therefore removes the need for risk premiums to be built into future gas contracts. This will also help the SSP suppliers when returning this benefit to the SSP sector.
3) Removes the need for any reconciliation, or retrospective billing to the customer and therefore reduces both complexity and cost and further risk of reconciliation amounts not being met where customers have switched.
4) Will also provide the LSP sector with certainty of the value of Unidentified Gas prior to the period.
5) Would act in a similar way to the existing Transportation Charges and Notices. They do not believe that there is any impact on wholesale balancing activities.

Total recognise that the overall cost of Unallocated Gas is an arbitrary one, and not an exact science, as the volume to which prices are applied is an estimate. They also recognise that the value returned to the SSP sector will, under this modification, be different to the existing UNC, but this could be up or down. This in turn should not be seen as an issue as, within the AUGE guidelines, the mechanism is there to allow for any under or over recovery to be smeared into the following year(s). It is not Total's intent to reduce the value of Unallocated Gas to be returned to the SSP sector, it is merely to fix it in advance.

Total advise that if there is any concern that the existing AUGE process cannot take carried forward amounts into account in the AUGE guidelines document they will raise the "roll-over" process as a change to complement this modification.

10 Panel Discussions

The Chair summarised that the AUGE will deliver a fixed volume of energy that is to be allocated to the LSP sector in an AUGE year. This modification seeks to additionally fix the unit price, such that a fixed value of energy is allocated to the LSP sector. This will enable contracts to be struck by LSP Shippers without the need to include an additional risk premium, nor to introduce a new reconciliation process for customers with cost pass-through contracts.

Some Panel Members considered that the increased certainty would facilitate effective competition when supplying LSP customers in particular, both by avoiding the need for an increased risk premium and also by avoiding the administrative costs associated with subsequent reconciliations. However, other Members considered that the case had been made, and accepted, that costs associated with unidentified gas should be reallocated. Changing the arrangement to a revenue rather than volume basis would leave risks and costs of varying gas prices with SSP Shippers, and so would undermine the principle of reducing cross subsidies and ensuring that costs are accurately allocated to the party responsible for those costs. Accurate cost allocation underpins effective competition and hence implementation would be counter to the relevant objective of securing effective competition.

With five votes cast in favour and two votes against, Panel Members determined to recommend that Modification 0388 should be implemented.

Implementation will impact the achievement of **Relevant Objective d.**

The benefits 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 security standards… are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code	None

11 Recommendations

Panel Recommendation

The Panel recommends that Modification 0388 should be made.