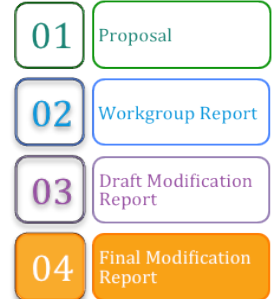


Stage 04: Urgent Modification Report

0405:

Bottom Stop SOQ Appeal Mechanism for 2011/12

What stage is this document in the process?



This is an urgent proposal to create a window, in early 2012, to allow Users to 'appeal' the Bottom Stop SOQ (BSSOQ) and SOQ of DN-connected Daily Metered (DM) sites. It will allow a User to reduce a site's BSSOQ and SOQ subject to the relevant transporter being satisfied that the appeal is made as a result of economic necessity on the part of the consumer and takes UNC Modification Proposal 0275 as a model and precedent.



The Panel recommends:

- that proposed Modification 0405 should be made;
- that the industry works to develop an enduring solution to this issue.



High Impact:

Certain consumers



Medium Impact:



Low Impact:

Shipper Users and Transporters

Contents

- 1 Summary
- 2 Why Change?
- 3 Solution
- 4 Relevant Objectives
- 5 Impacts and Costs
- 6 Implementation
- 7 The Case for Change
- 8 Legal Text
- 9 Consultation Responses
- 10 Panel Discussions
- 11 Recommendations

About this document:

This document is a Final Modification Report, to presented to the Panel on 09 December 2011 based on the timetable below:

	<u>Date</u>
Modification Panel Recommendation	09/12/11
Recommended latest date for Ofgem decision	15/12/11
Proposed implementation date	16/12/11



3 Any questions?

5 Contact:

Joint Office



7 enquiries@gasgovernance.co.uk



12 **0121 623 2115**

13 Proposer:

Graham Jack



14 graham.jack@centrica.com



17 **07979 564929**

18 Transporter:

Simon Trivella



simon.trivella@wvutilities.co.uk



07813 833174

Xoserve:

Alison Jennings



commercial.enquiries@xoserve.com

0405

Final Modification Report

09 December 2011

Version 2.0

Page 2 of 18

© 2011 all rights reserved

1 Summary

Is this a Self-Governance Modification

As the proposal is for an urgent change, the self-governance approach is not appropriate.

Why Change?

The Proposer is concerned that the continuing adverse economic climate will mean that customers/ consumers may need some relief from current gas transportation arrangements. In particular, we are mindful that large DN-connected Daily Metered customers have limited ability under the UNC to amend their SOQs since reductions are constrained by a Bottom Stop SOQ (BSSOQ). Such a constraint may not allow customers to obtain an SOQ reduction that better reflects true capacity requirements at this time. During such a highly volatile economic situation as we face today, where the need to be flexible and adaptable could mean the difference between the survival or failure for a business, gas transporters should, where reasonable and practicable, seek remedies to help such customers through these difficult times. We are already aware of a customer who is in such a position.

The issue has already been highlighted through the implementation of UNC modification 0275. However, the effects of that modification were time limited in anticipation, we believe, of improved economic conditions by 2011. There was also an expectation that the DM capacity regime would be changed as a result of the output from UNC Review Group 0264 "Review of Industry Arrangements to Accommodate Reduced Demand at DM Supply Points". Such changes have yet to be made and, as far as we are aware, have been delayed due to the overall review of UNC processes that the Nexus Workgroup is looking at. Therefore, the possible benefits arising from UNC modification 0275 do not extend to the current capacity reduction window even though the economic conditions remain difficult and very uncertain.

This proposal therefore seeks to effectively extend the provisions of UNC modification 0275 to the current 2011/12 capacity reduction window to enable DN-connected Daily Metered customer sites to have their SOQs set to a meaningful level such that gas transportation costs more accurately reflect customers' intended usage of gas.

Solution

The proposal is to extend the 'appeal' process, established via the implementation of UNC Modification 0275 for years 2009/10 and 2010/11, to the year 2011/12.

This would provide some 'transitional relief' to a DN-connected Daily Metered customer such that, on its behalf and subject to certain conditions, a User would be able to apply for a reduction to the customer's site's SOQ below the current BSSOQ level.

Impacts & Costs

There were no changes to system functionality for Implementation of Modification Proposal 0275 as any BSSOQ reductions were dealt with manually by the Transporter Agency. The same will apply to this Modification Proposal so we do not envisage there being any material implementation or ongoing operational costs.



UNC Modification 0275 can be viewed here:

[0275 \(Urgent\) - Reduction in DM LDZ Exit Capacity for Supply Points with Significant Changes in Usage](#)

0405

Final Modification Report

09 December 2011

Version 2.0

Page 3 of 18

© 2011 all rights reserved

Implementation

This proposal should be implemented immediately upon direction by Ofgem with a target date of 16/12/11.

The Case for Change

In the view of the Proposer, this proposal for change will allow certain customers to more accurately reflect their gas usage requirements to DN transporters and thereby incur costs that are more appropriate to their actual needs. Without this there is a real possibility of significant, yet avoidable, business customer hardship and we have been already alerted to a real possibility of one large Daily Metered customer closing its business. Whilst, apart from a cash flow issue, there will be no adverse financial impact on the transporter, there will be financial implications for other customers as their transportation charges will likely rise as a result of customers ceasing to take gas. There will therefore be potential benefits to customers as a whole in implementing the proposed change if it means more customers contribute to transportation charges than would otherwise be the case. Since an 'appeal' will only be acceptable if the relevant transporter is satisfied that the customer can present a compelling case for a lower SOQ, the opportunities for a User/customer trying to artificially reduce an SOQ will be unlikely to arise.

2 Why Change?

The Proposer is concerned about the continued hardship among business customers due to the tough current economic conditions and has only very recently become aware of a large customer/ consumer whose business will become unviable unless it can adapt to new circumstances. In pursuance of this it is critical that gas transportation costs be allowed to more accurately reflect the reasonably expected and intended operating requirements of such customers. This ability to adapt is very restricted under the UNC rules since DN-connected Daily Metered sites might be prohibited from reducing their SOQs to meaningful levels, restricted as they are by Bottom Stop SOQs (BSSOQs) that could reflect actual gas usage requirements almost 2 years ago.

Already, a customer has presented a case to the Proposer that the resultant high transportation costs do not reflect its current and intended gas requirements and that this might consequently lead to the closure of its business. If this were to arise then transportation costs not recovered from such a customer would need to be recovered from the remaining customers.

This proposal therefore seeks to extend the provisions of UNC modification 0275 to allow an additional window within which relevant customers can 'appeal' their BSSOQs and SOQs. The economic conditions have not improved since modification 0275 was implemented and it is therefore appropriate for DN transporters to again offer more flexibility around transportation arrangements to meet the real needs of consumers.

In the Proposer's opinion, there will be benefits to all customers in allowing bona fide 'appeals' under this proposal if such appeals significantly reduce the likelihood of customers ceasing to take gas. This is consistent with the requirement on licensees' to efficiently discharge their obligations (Standard Special Condition A11.1 (c)). Additionally, enabling more cost-reflective charging of customers during a period of economic difficulty will facilitate competition between both shippers and suppliers, thus being consistent with Standard Licence Condition A11.1 (d) of the transporters' licence.

UNC modification 0275 provides a useful precedent here and the arguments advanced in pursuance of that proposal remain valid today.

The urgency of this proposal reflects the fact that the current capacity reduction window will soon close (31 January 2012) and any 'appeals', along with supporting documentation from customers, will need to be well underway by the end of 2011. There is also a very high probability of a serious commercial impact on at least one customer if this proposal does not proceed.

3 Solution

The proposal is to extend the 'appeal' process, established via the implementation of UNC Modification 0275 for years 2009/10 and 2010/11, to the year 2011/12.

This would provide some 'transitional relief' to qualifying DN-connected Daily Metered customers such that, on their behalf and subject to certain conditions, Users would be able to apply for a reduction to their customers' sites' SOQs below the current BSSOQ levels. Specifically, a User would apply for a concurrent reduction of the BSSOQ and SOQ during the current capacity reduction window.

The 'certain conditions' referred to above are that:

1. An 'appeal' may only be effected during the period 1 October 2011 to 31 January 2012 and must be made via the current UNC rules for making SOQ reductions.
2. To be valid, an 'appeal' must seek to set the SOQ and BSSOQ to the same value and such value must be lower than the current BSSOQ value.
3. A User may also seek to change the SHQ value via the 'appeal' but the current UNC rules governing the relationship between SHQ and SOQ will still apply.
4. The 'appeal' will be accompanied by a signed letter from the customer that sets out its anticipated gas usage over the next 12 months and the reasons for the change in usage.
5. Only one 'appeal' will be permitted in respect of any site / supply point during the capacity reduction window.
6. For the avoidance of doubt, following a successful 'appeal' a Registered User may subsequently apply for an increased SOQ at the supply point using existing mechanisms.

4 Relevant Objectives

The Proposer believes that the modification will better facilitate the achievement of Relevant Objectives c, d (i) and d (ii) listed below.

Proposer's view of 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 None
c) Efficient discharge of the licensee's obligations.	Yes
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 Yes None
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
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators	None

In the view of the Proposer, and for the reasons explained in Section 2 above, implementation of this proposal will significantly reduce the likelihood of large customers facing unrealistically high transportation charges during a period of economic difficulty. In the event that large gas consumers go out of business there will be a requirement to recover allowable costs from other consumers that will have an adverse impact on competition on shipping and supply.

National Grid Distribution considers implementation of this modification would further facilitate the relevant objectives as set out within Standard Special Condition A11.1 (a) and (d):

1. By ensuring that capacity is booked that reflects prospective consumption; the network can be more accurately modelled thereby ensuring the efficient and economic operation of the pipe-line system.
2. By allowing shippers to book capacity, which accurately reflects future use, appropriate charges can be levied, thereby securing effective competition between relevant shippers and between relevant suppliers.

Wales & West Utilities felt that, as this modification simply extends the regime that was introduced by Modification 0275, the same relevant objective will be furthered by its implementation as determined by Ofgem in their decision letter: Relevant objective (a) - the efficient and economic operation of the pipe-line system.

5 Impacts and Costs

Consideration of Wider Industry Impacts

The Proposer has identified no impact upon wider industry developments. The proposal is for a time-limited change to the UNC rules.

Costs

According to the Transporter contact, there were no changes to system functionality for implementation of Modification Proposal 0275 as any BSSOQ reductions were dealt with manually by the Transporter Agency. The same will apply to this Modification Proposal so we do not envisage there being any material implementation or ongoing operational costs.

National Grid NTS understands that the proposer envisages that there will be no material or ongoing operational costs, but it is their view that costs will be driven by the number of parties who take up this service. If sufficient numbers take up this service it may lead to additional process costs for Xoserve and if this occurs it may be appropriate to revisit the issue of User Pays.

Indicative industry costs – User Pays

None identified.

Impacts

Impact on Transporters' Systems and Process

Transporters' System/Process	Potential impact
UK Link	No system changes are proposed as manual processes can be utilised.
Operational Processes	No impact anticipated.
User Pays implications	None identified.

Impact on Users

Area of Users' business	Potential impact
Administrative and operational	Minimal administrative; e.g. gathering and consideration of customer evidence in support of an 'appeal'.
Development, capital and operating costs	None identified.
Contractual risks	No impact.



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:
www.gasgovernance.co.uk/sites/default/files/0565.zip

Impact on Users	
Legislative, regulatory and contractual obligations and relationships	The pass-through of cost savings to the benefit of customers would involve the shipper and supplier.

Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	None
Development, capital and operating costs	Some additional small administrative costs are anticipated.
Recovery of costs	Some transportation charge re-balancing might be required at a future date.
Price regulation	None
Contractual risks	It is not envisaged that the proposal will result in any change to the level of contractual risk to Transporters.
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
General administration	None

Impact on Code	
Code section	Potential impact
Transition Rules (TDIIC)	Amendment to paragraph 1.9 of TPD Section G: Supply Points to allow for an additional 'appeal' window.

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact
Network Entry Agreement (TPD I1.3)	None

Impact on UNC Related Documents and Other Referenced Documents	
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	Highly likely to be of business critical importance to some large Daily Metered customers.

6 Implementation

Implementation should be made by 16/12/11 or as soon as possible following a direction to implement from Ofgem.

7 The Case for Change

None in addition to that identified above.

8 Legal Text

The following legal text has been provided by Wales & West Utilities:

UNC Transition Document: Part IIC Transition Rules (*changed marked*)

Amend paragraph 1.9 as follows:

1.9 TPD Section G: Supply Points

1.9.1 TPD Section G5.2

Until 0600 on 1 October ~~2011~~2012 but not thereafter, for the purposes of TPD Section G5.2:

- (a) Notwithstanding TPD Section G5.2.1, in relation to an LDZ DM Supply Point Component, a Registered User may apply at any time, in accordance with this paragraph 1.9, to reduce the Registered DM Supply Point Capacity held to an amount below the Bottom-Stop Supply Point Capacity (the "**Capacity Reduction Application**").
- (b) The Registered DM Supply Point Capacity may only be reduced using a Capacity Reduction Application to take effect once within the Capacity Reduction Period for the Gas Year commencing 1 October 2009, ~~and once for the Capacity Reduction Period for the Gas Year commencing 1 October 2010~~ and once for the Capacity Reduction Period for the Gas Year commencing 1 October 2011.
- (e) By making a Capacity Reduction Application, the Registered User warrants to the Transporter in writing that the information contained in such Capacity Reduction Application is accurate and reflects a bona fide estimate of the future consumption up to 1 October ~~2011~~2012.

No changes have been proposed to paragraph 1.9.2 as it deals with Interruptible supply points only (all sites Firm since 1 October 2011).

9 Consultation Responses

Representations were received from the following parties:

Respondent	
Company/Organisation Name	Support Implementation or not?
British Gas Trading	Support
Derwent Cogeneration	Support
First Utility	Support
Gazprom	Support
MEUC	Support
National Grid Distribution	Support
National Grid NTS	Support
Northern Gas Networks	Support
RWE npower	Support
Scotia Gas Networks	Support
Shell Gas Direct	Support
Wales & West Utilities	Support

Of the twelve representations received implementation was unanimously supported.

Summary Comments

British Gas is convinced that this modification needs to be implemented as a matter of urgency so as to serve the needs of consumers who might be faced with unnecessarily high transportation charges as a result of unreasonably restrictive Bottom Stop SOQ requirements.

Derwent Cogeneration considers their gas usage is dictated by market conditions. These changed market conditions have had the effect of reducing their gas requirement this year, and peak value is anticipated to remain below the level of last year; the use of the BSSOQ in their case has the effect of forcing them to book an overcapacity with attendant transportation costs which need to be absorbed or passed on. If the BSSOQ could be challenged, a more accurate gas requirement would be made, with the transportation charge levied against that volume.

First Utility agrees with the Proposer that non implementation of the Proposed Modification is likely to result in severe financial consequences for at least one of its customers. The situation can be avoided by the simple extension of Modification 0275, which originally instituted this process, and this should be done.

Gazprom and Shell Gas Direct consider the economic climate remains difficult and given the current economic conditions, it is appropriate for an appeal mechanism to be

implemented to allow customers to reduce their booked and Bottom Stop SOQ to a more accurate level for 2011/12.

National Grid Distribution considers that this proposal could be of particular use to certain sectors of energy intensive, industrial gas market and that consideration should be given to customers where changes to market conditions mean that historic consumption patterns may not necessarily be an indication of future use.

National Grid NTS are keen to ensure that both Users and end consumers are fully aware of the implications of reducing their capacity bookings through this process. It should be noted by Users and end consumers that if they reduce their capacity holdings and subsequently wish to increase their capacity holding back to their previous usage, that in the intervening period the capacity may be allocated to other parties and may no longer be available.

Northern Gas Networks agrees the reasons for the temporary nature of modification 0275 may still be in existence and in particular, the current economic climate. They agree that, as a result of this, it is appropriate to extend the transitional rules that allow Daily Metered sites to reduce registered capacity below that of the previous winter's peak.

RWE npower considers it is unfair where a customer had reduced consumption but could not reduce capacity below the BSSOQ, and would want a mechanism to be able to set it lower. The basis for the lower SOQ would have to be proven - in the new regime as most sites are now firm, ratchet charges also provide a safeguard against artificially lowered SOQs.

Scotia Gas Networks recognise that there may only be a very modest uptake of this service but do not think this should impede implementation due to the support that this service could potentially offer to businesses and hence UK Plc. They request that shippers utilising this process during the Capacity Reduction Period be mindful of the importance of the Supply Point Offtake Rate (SHQ) to Transporter network and capacity planning and wherever possible look to amend this value alongside the Supply Point Capacity (SOQ).

Wales & West Utilities advised they have been approached directly by an end user / consumer that would directly benefit from the implementation of this modification. Implementation of this modification may enable the consumer to remain in business and continue as a consumer on their network. The reduction that they would be able to secure will result in the associated User use of system charges being borne by all other Users. WWU are willing to provide Ofgem with further details in relation to this if that would help them with their decision process. However, the potential reduction in booked capacity, and associated charges, would be far greater if this consumer ceased being a customer on their network.

Due to the timescales involved, and from the level of take-up during the two previous Capacity Reduction Periods, Wales & West Utilities do not consider a significant number of consumers will utilise the appeals mechanism and therefore expect the transfer of charges to other Users will be minimal.

10 Panel Discussions

The Panel Chair summarised that the modification is seeking to reinstate arrangements that allow DM customers to reduce Supply Point Capacity to an amount below the Bottom-Stop Supply Point Capacity. Transitional arrangements to implement this were introduced by Modification 0275, but expired in 2010. Modification 0405 seeks to reinstate this for the current Gas Year only, and would help to ensure that capacity bookings continue to accurately reflect prospective consumption, and potentially avoid some DM customers disconnecting from the network.

Members recognised that if any DM customers were to disconnect from the network, this could lead to under-utilisation of the network. Providing an alternative which incentivises remaining connected and encourages system utilisation would therefore be consistent with facilitating economic and efficient operation of the system.

Members also noted that capacity bookings that more accurately reflect future use would be expected to lead to more appropriate allocations of costs between system users, reflecting network utilisation. Appropriate cost allocations avoid inappropriate cross subsidies and facilitate the securing of effective competition between Shippers.

Members suggested that, if directed, implementation of this modification is an interim measure for 2012 and that enduring options for post 2012 should be pursued.

The Panel Chair indicated that, while offering apologies for absence, P Broom (GDF Suez) had provided a written view recommending that the modification be implemented. Members then voted unanimously in favour of recommending implementation of Modification 0405.

11 Recommendations

Panel Recommendation

Having considered the 0405 Urgent Modification Report, the Panel recommends:

- that proposed Modification 0405 should be made;
- that the industry works to develop an enduring solution to this issue.