

Modification proposal:	Uniform Network Code (UNC): Improve AQ performance (UNC421)		
Decision:	The Authority <sup>1</sup> has decided to reject this proposal <sup>2</sup>		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	29 January 2013	Implementation Date:	N/A

## Background to the modification proposal

The Annual Quantity (AQ) is an estimate of the quantity of gas to be off-taken at a Supply Meter Point during the gas year<sup>3</sup>. AQs are used in a number of Uniform Network Code (UNC) processes, including settlement and transportation charge calculations.

AQs are used to allocate volumes of gas amongst Smaller Supply Points (SSP) shippers as part of the Reconciliation by Difference process. This allows for gas to be allocated across the market by reconciling the difference between actual (metered) and deemed (estimated) measurements of gas allocated to SSP shippers. These reconciliations are used in the calculation of energy and transportation charges to shippers.

The UNC requires Gas Transporters (GTs) and shippers to engage every year in a process to review AQs at Supply Meter Points (the AQ Review Process). This process requires that each year GTs provide shippers with Provisional Meter Point AQ values by 31 May and 30 June respectively for SSPs and Larger Supply points (LSPs). From then to 13 August, shippers can review the AQ values (the AQ amendment period). The AQs are then confirmed by the GT by 14 September<sup>4</sup> and effective on 1 October (the start of the next gas year). An AQ appeal period allows shippers the opportunity to challenge the AQ from when the GT confirms the AQ<sup>5</sup> until 31 July in the following calendar year.

Transco Network Code Modification 0624 (NCM624)<sup>6</sup> introduced controls to the AQ Review Process in response to concerns around the potential misuse of the process by shippers. Amongst other things, this required shippers to apply a consistent methodology in reviewing AQs within their portfolio and not to materially differentiate in their treatment of Supply Meter Points where they seek to either increase or decrease the AQ. To further enhance the robustness of this process, modification UNC081 put in place an obligation on GTs to publish information covering the AQ amendment period<sup>7</sup>. As a result, Xoserve publishes an annual report that provides shipper performance data while maintaining the anonymity of the shipper<sup>8</sup>.

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

<sup>3</sup> The gas year is a twelve-month period commencing 1st October each year.

<sup>4</sup> The confirmed AQ will either be the same as the Provisional AQ or the AQ as amended by the shipper.

<sup>5</sup> GTs confirm the new AQs within the period from 13 August to 14 September.

<sup>6</sup> Modification 0624 'Changes to the 2003 Annual Quantity (AQ) Amendment Process' was implemented on 12 April 2004. See <http://www.gasgovernance.co.uk/NCMP>

<sup>7</sup> UNC081: "AQ Review Process- publication of information" was implemented on 1 October 2006. See <http://www.gasgovernance.co.uk/sites/default/files/UNC081D.pdf>

<sup>8</sup> Data in these reports includes the effect of the AQ recalculation, the total number of amendments raised, the number of successful amendments and the numbers of speculative calculations. The report provides the data at varying levels of granularity, including at aggregate level, by EUC and Local Distribution Zone.

## The modification proposal

Scottish Power (the Proposer) raised UNC421 (the modification) in April 2012. The modification seeks to improve the allocation of energy and transportation charges in the gas market by requiring shippers to update at least 85% of their AQs during the AQ Review process (for SSP and LSP portfolios individually)<sup>9</sup>. This performance standard would exclude updates implemented through the AQ Appeal process. UNC421 also specifies the structure of the charge that would be incurred for failure to meet the performance target.

Under the modification, any shipper failing to satisfy the proposed performance target would become subject to a charge calculated in accordance with the method set out in the table below. In summary, these charges would be applied according to the proportion of the shipper's portfolio for which AQ Review figures were not submitted.

**Table 1: shipper charge banding according to AQ volume:**

<b>AQ Banding</b>	<b>Shipper Charge (£ per static meter point<sup>10</sup>)</b>
1-73,200	20
73,201-293,000	164
293,001-732,000	479
732,001 - above	983

Once collected, these charges to LSPs and SSPs would be re-distributed to Non-Daily Metered SSP shippers that have satisfied the performance standard. Each shipper would receive a proportion of the total amount collected equal to their share of the total number of Meter Points in the portfolios of other Non-Daily Metered SSP shippers meeting the 85% performance target.

## UNC Panel<sup>11</sup> recommendation

At the UNC Panel meeting held on 20 December 2012, which considered the draft Final Modification Report, four Panel Members voted that it would better facilitate the relevant objectives and six voted that it would not. Accordingly, the Panel recommended the rejection of UNC421. The full views of Panel members appear in the Final Modification Report (FMR)<sup>12</sup>.

## The Authority's decision

**The Authority has concluded that implementation of the modification will not better facilitate the achievement of the relevant objectives of the UNC<sup>13</sup> and therefore UNC421 should not be implemented.**

---

<sup>9</sup> UNC 421 proposes that this performance measure should include sites that have an updated AQ value at 'Notification of Revision to Meter Point AQ stage', have been subject to successful AQ Appeal activity and those for which the shipper has proposed a successful AQ amendment.

<sup>10</sup> Where a static meter point is one that is not updated during the AQ Review process.

<sup>11</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

<sup>12</sup> <http://www.gasgovernance.co.uk/sites/default/files/Final%20Modification%20Report%200421%20v2.0.pdf>

<sup>13</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: [http://epr.ofgem.gov.uk/Pages/EPRInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRFiles%2fS\\_tandard+Special+Condition+PART\\_A\\_-\\_Consolidated\\_+-+Current+Version.pdf](http://epr.ofgem.gov.uk/Pages/EPRInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRFiles%2fS_tandard+Special+Condition+PART_A_-_Consolidated_+-+Current+Version.pdf)

## **Reasons for the Authority's decision**

We have assessed the proposed modification against the UNC Relevant Objectives. We have also considered our statutory duties and functions in reaching this decision. The proposer considered that UNC421 would better facilitate relevant objectives (a), (c) and (d) in the operation of the AQ review process. We have set out our assessment of the modification proposal against these relevant objectives below.

### ***UNC Relevant objective (a): the efficient and economic operation of the pipeline system***

The proposer argues that better AQ update performance in the AQ Review process would lead to more accurate AQs, making energy and transportation charge allocation more accurate. The proposer then contends that through UNC421, GTs would have a more accurate prediction of customer demand, helping to improve decisions on system capacity planning and investment.

We consider that the FMR did not provide a compelling case that UNC421 would materially improve AQ Review performance, or that in order to improve AQ accuracy, it is best to target the AQ Review, as only one part of the AQ update process. Xoserve report that performance for the AQ process led to 92.03% and 89.88% of AQs being updated for SSPs and LSPs respectively<sup>14</sup>, including AQ amendments. We consider it necessary to focus efforts to improve AQ accuracy on the whole process, rather than solely on the AQ Review process.

We do not consider that UNC421 would deliver material improvement in system capacity planning decisions or any consequent potential improvements to investment efficiency. Furthermore, one gas distribution network company considered that AQ values do not have any influence on investment or system capacity decisions as well as security of supply.

For these reasons we cannot conclude that UNC421 would further relevant objective (a).

### ***UNC Relevant objective (c): Efficient discharge of the licensee's obligations:***

The proposer argues that UNC421 will support all licensees in meeting their obligations to maximise the accuracy of data supporting the AQ review process and associated performance. The proposer also notes that while shippers have obligations to update the Supply Point Register, GTs have a role to maintain it<sup>15</sup>.

As with the claimed benefits for relevant objective (a), we are not able to conclude from the information provided in the FMR that UNC421 would better meet relevant objective (c)<sup>16</sup>.

### ***UNC Relevant objective (d): the securing of effective competition:***

The proposer argues that UNC421 would improve the allocation of energy and transportation costs by encouraging shippers to update their AQs more frequently.

We first consider the potential impact of the shipper charge on AQ Review performance, followed by evidence of the appropriateness of the performance level and potential distortions to competition introduced by the shipper charge. In aggregate these impacts must be set against the costs of implementing the modification.

First, as noted above, we do not consider that UNC421 provides sufficient evidence to conclude that the proposed structure of the shipper charge, combined with an 85%

---

<sup>14</sup> Source: Xoserve: "The AQ Operational Review Group (Actual Calculations)"- Mod81 report: 2012

<sup>15</sup> SLC 31

<sup>16</sup> We consider that relevant objective (c) sets out obligations for only GTs rather than other market participants.

performance level would appropriately incentivise AQ Review performance. We cannot find a clear rationale within the proposal as to how the proposed shipper charge was set, or what level of response alternative ways of setting this charge might produce. UNC421 proposes that the shipper charge is charged against all non-updating Meter Points of a failing shipper's portfolio. This structure appears to severely penalise failure to meet the target performance level, while failing to differentiate performance levels above the target<sup>17</sup>. It seems unlikely that this charge structure reflects costs to the market as a whole of misallocation resulting from non-updating AQ during the Review process. Moreover, some consultation responses questioned even whether improved AQ Review performance would actually lead to better allocation of energy and transportation charges.

Second, we turn to the appropriateness of the proposed performance level – as questioned by one consultation respondent. UNC421 presents little evidence to justify the proposed 85% figure. Consultation respondents also expressed concerns as to whether the target performance level is appropriate and whether it would lead to more accurate AQ values.

To justify any such performance level we would expect to see a case made that the performance standard delivered sufficient market benefits to exceed the costs to shippers of achieving the performance level. Any such assessment would give some indication of the most cost-effective level of AQ Review performance across the market. UNC421 does estimate the total value of misallocation within the market. However, it is unclear how much misallocation would be eliminated by UNC421. Moreover, the net benefit to the market of more accurately allocating a volume of gas differs from the value of that gas. A strong case would then examine the total market benefit associated with gas of a given value being allocated more accurately. It is even possible that introducing a target below current average performance levels for the AQ update process as a whole could encourage reductions in shippers' AQ Review performance, by suggesting that 85% is an acceptable level of performance.

Any benefit potentially arising from UNC421 needs to be set against the estimated one-off and ongoing implementation costs for the modification proposal, which are significant for UNC421. These are estimated at £240-460k one-off and £25-55k per year ongoing. The greater the anticipated implementation costs, the greater the need for a robust evidence base to demonstrate potential benefits of the proposal.

We are also concerned that in proposing a shipper charge UNC421 would create a new cash flow between shippers. As noted, the charge would be applied to under-performing shippers with either SSP or LSP portfolios, but the money collected would only be re-distributed amongst SSP shippers. This creates potential for re-distributive effects both amongst SSP shippers and overall from LSP shippers to SSP shippers. One or both of these potential effects could distort competition across the market and be detrimental to relevant objective (d), as noted by some consultation respondents.

We also note that a number of consultation respondents were not satisfied that UNC421 would further any of these objectives, while some suggested that implementing the modification would be detrimental to effective competition.

We therefore cannot conclude that the modification would further relevant objective (d).

### **Further issues**

Adjustments to the AQ Review process are one way to improve AQ accuracy, but other parts of the gas settlement regime are also important, such as meter-reading activity required to update Aqs and the AQ Appeals process. We support the objective of this

---

<sup>17</sup> For example, a shipper achieving 85% performance would incur no charges, while a shipper achieving 84% performance would incur charges against 16% of its portfolio.

modification to improve overall accuracy of energy and transportation cost allocation in the gas market. However we are not convinced that UNC421 would deliver these potential benefits over and above the additional costs and risks to effective competition that it would introduce.

Previously we have indicated our support for industry to develop a more robust set of performance assurance control around the AQ and other UNC processes<sup>18</sup>. We therefore welcome the recent industry initiative to create a work group to develop a performance assurance framework.

Colin Sausman

**Partner, Retail Markets and Research**

Signed on behalf of the Authority and authorised for that purpose

---

<sup>18</sup> For example see decision letters on [UNC 292](#), [UNC 387](#) and [UNC 378](#)