

# 0473 0473A:

## Project Nexus – Allocation of Unidentified Gas

- 01 Modification
- 02 Workgroup Report
- 03 Draft Modification Report
- 04 Final Modification Report

These modifications are two of a series seeking to implement the requirements identified under Project Nexus. These modifications identify changes to the UNC to enable determination in the proposed energy allocation process to enable an appropriate distribution of Unidentified Gas.



Panel determined that either 0473 or 0473A could be implemented, with a preference for 0473A



High Impact: Shippers

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## About this document:

This Final Modification Report was considered by the Panel on 20 November 2014.

The Authority will consider the Panel's recommendation and decide whether or not these changes should be made.



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# 1 Summary

## Is this a Self-Governance Modification?

The Modification Panel determined that these are not self-governance modifications because they may have material effect on competition.

## Why Change?

Following the decision to implement Modification 0432 - Project Nexus – Gas Demand Estimation, Allocation, Settlement and Reconciliation reform<sup>1</sup>. The Business Requirements Documents (BRDs) which constitute the business rules currently provide that no manual intervention in the distribution of Unidentified Gas<sup>2</sup> between relevant market sectors would occur, as might be a consequence of the determination of an Allocation of Unidentified Gas Expert (AUGE)<sup>3</sup>. Notwithstanding this, Modification 0432 and associated legal text identifies a mechanism whereby, should such determination be deemed necessary, this could be readily incorporated within the proposed regime.

The use of a single scaling factor proposed in Modification 0432 could offer a less accurate means of allocating unidentified gas than is currently offered by the Allocation of Unidentified Gas Expert (AUGE). As the aim should be to reduce unidentified gas, not simply target its allocation, and a universal scaling factor would seem to dilute any existing incentives to do so. Modifications 0473 and 0473A offer two different approaches to the allocation of unidentified gas.

## Solution

Modifications 0473 and 0473A propose arrangements to determine the allocation of unidentified gas between markets by the use of an appointed expert in readiness for the Project Nexus go live date. The expert will be responsible for the development of a methodology for allocating unidentified gas on an equitable basis.

Modification 0473 proposes that an Allocation of Unidentified Gas Expert be appointed so that a methodology can be developed and used to populate the AUG table prior to the Project Nexus Go live date.

Modification 0473A proposes that a new Independent Expert be appointed in readiness for Project Nexus Go Live Date. The new Independent Expert will be responsible, if required following assessment and analysis of evidence/data, for the development of a methodology for correcting Project Nexus allocation arrangements, which subject to a consultation and approval processes will be modified and applied on an annual basis.

## Relevant Objectives

Implementation of the changes identified within these modifications could be expected to facilitate the securing of effective competition between Users. The changes are expected to lead to more accurate allocation of Unidentified Gas costs between Users.

## Implementation

No implementation timescales are proposed. However, implementation as soon as possible after an Authority decision to do so would maximum the time available for the tender process ahead of the Project Nexus implementation date.

## Do these modifications affect the Nexus delivery, if so, how?

Both modifications are proposing changes to the arrangements approved under Modification 0432 - Project Nexus – Gas Demand Estimation, Allocation, Settlement

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<sup>1</sup> [Modification Proposal 0432: http://www.gasgovernance.co.uk/0432](http://www.gasgovernance.co.uk/0432)

<sup>2</sup> [TPD Section E10.1.1\(a\): http://www.gasgovernance.co.uk/TPD](http://www.gasgovernance.co.uk/TPD)

<sup>3</sup> [TPD Section E10.1.1\(f\): http://www.gasgovernance.co.uk/TPD](http://www.gasgovernance.co.uk/TPD)

and Reconciliation reform. However, with the exception of the risk identified below it is not anticipated that either of these modifications would impact Project Nexus delivery.

Some participants consider there is a risk that the introduction of Modification 0473 may inadvertently produce an incentive for sites to migrate sooner and in larger volumes than currently predicted, from Product Class 3 and 4 into Class 2. This may require a review of the Project Nexus Product Class 2 design arrangements as current User product Class predicted volume estimates might not be robust. Some workgroup members believe that the risk is not material, on the basis that Nexus is being built (as described in Modification 0432) for the volumes likely to be affected based on current DECC figures (18 Sept 2014):

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/355786/Smart\\_Meters\\_Great\\_Britain\\_Quarterly\\_report\\_FINAL.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/355786/Smart_Meters_Great_Britain_Quarterly_report_FINAL.pdf)

## 2 Why Change?

The proposed energy allocation framework identified within Modification 0432 presently does not identify a methodology for the redistribution of Unidentified Gas between the Smaller Supply Point (SSP) and Larger Supply Point (LSP) market sectors over and above the simplistic approach which would occur as part of the proposed 'Allocation Scaling Adjustment mechanism.

For the purposes of avoiding unnecessary delay to the development of Modification 0432, separate modifications have been raised to propose mechanisms by which the allocation of unidentified gas can be shared should the industry determine that this be necessary. The benefits of this approach is that the Transporter's agent (Xoserve) can proceed to develop relevant supporting systems and processes with certainty and with sufficient flexibility to accommodate determination in Unidentified Gas allocation should this ultimately be required.

The new individual supply point reconciliation arrangements being introduced by Project Nexus are significantly different to the incumbent RbD arrangements; therefore it is not appropriate to take a simplistic approach to settlement as proposed in Modification 0432 and both Modifications 0473 and 0473A offer options for the allocation of unidentified gas.

Modification 0473 proposes to continue with an AUGE type process as now and adopt a methodology for the year ahead. Modification 0473A the independent expert will make an assessment based on actual evidence after the event and to recommend an adjustment if required.

## 3 Solution

### Modification 0473

The purpose of this Modification Proposal is to develop an Unidentified Gas determination and sharing methodology utilising the services of an AUGE.

Modification of the UNC is required is required to incorporate appropriate arrangements to permit the sharing of Unidentified Gas between market sectors by an AUGE post Nexus implementation. Rather than as an 'after the event' adjustment process as is presently the case, this would occur as part of the process of deriving and applying the 'Allocation Scaling Adjustment' developed within the remit of Modification Proposal 0432.

### Business Rules

- 1) A person, the Allocation of Unidentified Gas Expert (AUGE), shall be appointed and engaged by the Gas Transporters through an AUG Expert Contract for the purposes of:

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- a) developing an AUG Statement or (as the case may be) a modification of the prevailing AUG Statement and recommending it to the Committee; and
  - b) by applying the AUG Statement, preparing and recommending to the Committee an AUG Table;
- 2) The AUG table, is incorporated into the UNC, which shall be used by the transporters in determining the allocation factors applicable to each meter point class and band by LDZ.

Supply Meter Point Classification	Allocation Factor			
	Class 1	Class 2	Class 3	Class 4
EUC Band 1				
EUC Band 2				
EUC Band 3				
EUC Band 4				
EUC Band 5				
EUC Band 6				
EUC Band 7				
EUC Band 8				
EUC Band 9				

- 3) The Transporters be required to publish a Framework Document “Framework for the Appointment of an Allocation of Unidentified Gas Expert”.
- 4) The initial content of the Framework Document be that which is provided as an Appendix to this modification proposal (Appendix 1 below).
- 5) The Framework Document may be modified if The Committee votes by majority vote in favour of a proposed change.
- 6) For the avoidance of doubt, the current AUGE process will continue until the implementation of Project Nexus.

#### **Modification 0473A**

The purpose of this modification is to introduce a new Independent Expert, known as the Unidentified Gas Independent Expert (UGIE) in readiness for Project Nexus Go Live date. The UGIE will be responsible for assessing the quantity of Unidentified Gas, based on the actual evidence/data following the implementation of Project Nexus. The output of the UGIE will be to make a recommendation as to whether any further intervention to the incumbent allocation of unidentified gas is required. If required the UGIE will recommend any adjustment required to the incumbent arrangements. During the transitional period between Project Nexus Go Live Date and the new Independent Expert’s findings and recommendations, Transitional Arrangements will be used to make an “offline” amendment to the incumbent allocation of Unidentified Gas process. (See Appendix 1.1) The overall aim of this proposal is to introduce an independent,

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evidenced-based assessment, for the correct allocation of Unidentified Gas, to ensure that all industry participants are equally incentivised to reduce it.

For the avoidance of doubt, this proposal does not seek to amend current pre Project Nexus implementation arrangements, the current AUGGE process will continue until the implementation of Project Nexus.

### **Business Rules**

- 1) The Unidentified Gas Independent Expert (UGIE), shall be appointed and engaged by the Gas Transporters through an UGIE Contract for the purposes of:
  - a) each year, utilising actual evidence and data, to develop an Unidentified Gas Allocation (UGA) Statement or (as the case may be) a modification to the prevailing UGA Statement, and recommending it to the Committee.
  - b) by applying the UGA Statement, preparing and producing indicative and final Unidentified Gas Allocation Factors to the Transporters for inclusion in a UGA Table and publication.
- 2) For the initial year following Project Nexus implementation, undertaking a review of the incumbent Mod 432 arrangements in addition to any transitional arrangements in place and assessing whether any further intervention is required.
- 3) Where under Business Rule 1 the UGIE produces a UGA Statement and subsequently produces Unidentified Gas Allocation Factors for publication in a form which enables the UGA Table as detailed below to be fully populated. The UGA Table will subsequently be populated by the Transporters and used to determine the Allocation Factors applicable to each meter point class and band by LDZ for the next UG Year. The Transporters will be responsible for publishing the UGA Table in accordance with timescales detailed within the new Framework Document “Framework for the Appointment of an Unidentified Gas Independent Expert (UGIE)”

*See table set out in Modification 0473 Solution above.*

- 4) For the purposes of transitional arrangements, (which is the period between Project Nexus Go Live Date and the approval and implementation of the UGIE’s recommendation) as set out within their initial UGA Statement, there will be an offline adjustment undertaken to correct for the Directly Measured Components, as identified by the prevailing AUG Table in place immediately preceding Project Nexus go live date. This adjustment will be applied to Users by Larger DM SPCs, Larger NDM SPCs and Smaller SPCs, as defined under the previous AUGGE arrangements, in the proportions identified by the most recently published AUG Table. Further description of the proposed transitional arrangements, are detailed within Appendix 1.2.
- 5) The process for appointing the UGIE is set out in a new UNC Related Document “Framework for the Appointment of an Unidentified Gas Independent Expert (UGIE)”. See Appendix 1.1.
- 6) The Transporters shall be required to publish a Framework Document “Framework for the Appointment of an Unidentified Gas Independent Expert (UGIE)” and publish annually the Unidentified Gas Allocation Statement”.
- 7) The initial content of the Framework Document shall be that which is provided as an Appendix to this modification proposal.
- 8) The Framework Document may be modified if The Committee votes by majority vote in favour of a proposed change.
- 9) For the avoidance of doubt the UGIE will be required to publish a UGA Statement each year regardless of whether any intervention or changes are required from the previous iteration.

- 10) The methodology for implementing the proposed Transitional Arrangements will mirror the existing 'Allocation of Unidentified Gas Invoice Process' currently undertaken by Xoserve.
- 11) Based upon the working assumption that Project Nexus Go Live Date will be 1<sup>st</sup> October 2015, under this proposal the UG Year will commence from 1st October each year.

User Pays
Classification of the modification as User Pays, or not, and the justification for such classification.
These modifications propose to introduce new arrangements for the introduction of a new allocation of unidentified gas expert, which will result in the Transporter Agency (Xoserve) incurring costs associated with procurement and appointment, thus resulting in User Pays charges.
Identification of Users of the service, the proposed split of the recovery between Gas Transporters and Users for User Pays costs and the justification for such view.
100% Users
Proposed charge(s) for application of User Pays charges to Shippers.
Modification 0473/0473A - the charge for managing the process to be allocated in proportion of shipper AQ, as of the 1 April each year.
Proposed charge for inclusion in the Agency Charging Statement (ACS) – to be completed upon receipt of a cost estimate from Xoserve.
An ACS will be published on the Joint Office website.

## 4 Relevant Objectives

Impact of the modification on the <b>Relevant Objectives</b> :	
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 – 0473 and 0473A
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

The implementation of the changes identified within these modifications would be expected to impact Relevant Objective d): the securing of effective competition between Users. The changes are expected to lead to more accurate allocation of Unidentified Gas costs between Shipper Users by implementing the recommendations of an industry expert rather than is currently stated under 0432 using an allocation scaling adjustment.

### Modification 0473

The proposer and some Workgroup participants believed that the 0473 transition process is consistent with the current view of Unidentified Gas arrangements under the AUGÉ and that this represents the most accurate and appropriate mechanism to deal with unidentified gas.

Some participants consider the 0473 transition may introduce a perverse incentive, which offers protection from Unidentified Gas costs to sites within Product Class 2. This may lead to sites migrating from Product Class 3 and 4 into Class 2 to avoid Unidentified Gas costs and that this could be detrimental to Relevant objective d) Securing of effective competition.

Some Workgroup participants believe that the risk is not material, on the basis that Nexus is being built (as described in Modification 0432) for the volumes likely to be affected based on current DECC figures (18 Sept 2014):

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/355786/Smart\\_Meters\\_Great\\_Britain\\_Quarterly\\_report\\_FINAL.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/355786/Smart_Meters_Great_Britain_Quarterly_report_FINAL.pdf)

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Some participants believed that the 0473 transition does not, in practise, replicate the current AUGE process arrangements because it would only work if the measured unidentified gas is equal to the estimated seasonal normal total from the AUGE. These participants also don't believe that 0473 is the most accurate and appropriate mechanism to deal with unidentified gas.

### **Modification 0473A**

The Proposer and some participants consider the 0473A transition would result in a more appropriate and accurate allocation of costs between Shippers as the allocation of Unidentified Gas will be based upon the 0432 Project Nexus settlement mechanism and retains the 'known source' unidentified gas elements of the existing AUGE arrangements. These participants believe that this more accurately allocates costs during transition and that using matured data generated from the new settlement regime allows the new Independent Expert to provide a more accurate assessment of the value and allocation of unidentified gas which would further Relevant Objective d).

Other participants disagree, believing that 0473A transition does not more accurately represent previous allocation of unidentified gas on the basis that daily settled sites will be allocated significant unidentified gas. These participants believe that the additional 6 months of transition to achieve this matured position imposes a prolonged exposure to the transition rules.

## **5 Implementation**

No implementation timescales are proposed. However, implementation as soon as possible after an Authority decision to do so would maximum the time available for the tender process ahead of the Project Nexus implementation date.

Xoserve have indicated that they will need at least two months between the modification being approved and the tender being issued.

## **6 Legal Text**

### **Text**

The Text published alongside this report has been prepared by Northern Gas Networks at the request of the Modification Panel. The workgroup has reviewed this text for 0473 and is satisfied that it achieves the intent of the modification.

The text for 0473A is at an advanced stage of development but may not be available in time for a Panel decision on whether to issue for consultation. It is proposed that the text is finalised with both Proposers before issuing to Consultation and workgroup members are happy with this approach since they have been involved in its development.

## **7 Consultation Responses**

### **0473**

Of the 20 representations received 10 supported implementation, 1 provided comments and 9 were not in support.

### **0473A**

Of the 20 representations received 12 supported implementation, 1 provided comments and 7 were not in support.

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## Preference

Of the 20 representations received 7 expressed a preference for 0473 and 11 expressed a preference for 0473A.

Representations were received from the following parties:				
Organisation	Response	Prefer	Relevant Objectives	Key Points
British Gas	0473 Oppose  0473A Support	0473A	0473 d) negative  0473A d) positive	<ul style="list-style-type: none"> <li>Support the intention of 0473, however they believe the time allowed for the expert to complete its analysis and produce a statement is insufficient, that the output will not be robust and that there will be an unacceptable level of volatility in the result.</li> <li>Arbitrarily setting unidentified gas (UG) allocation factors to zero to Product Classes 1 and 2 during transition has no evidential basis and will introduce a 'safe-haven' for a select number of sites to optionally avoid their fair allocation of UG charges. This will disproportionately increase the cost base of some users whilst unfairly reducing the costs for others. This approach is regressive and does not help to secure effective competition between relevant shippers or suppliers and will prevent effective competition from bearing down on prices. 0473 transition arrangements are so detrimental to the Relevant Objective d) that they negate any positive impact of the introduction of an expert.</li> <li>Under 0473 transition it is not possible to attribute any UG charges to sites in these categories regardless of the source. No Product Class should be shielded from UG that is created from factors such as LDZ measurement errors, shrinkage estimate errors, leakage and any other unknown source.</li> <li>Believe the legal text for 0473 is incomplete and provide detailed comments.</li> <li>Support the intention of 0473A to determine the appropriate allocation of UG and the appointment of an expert to do this.</li> <li>0473A allows sufficient time and matured data to enable the expert to determine the requirement for and nature of any intervention.</li> <li>During transition 0473A allocates known-source UG to the sector from which it originates. All residual UG; which has no identifiable source and cannot be reliably allocated to sector is allocated via the Nexus mechanism.</li> <li>0473A provides a mechanism for the identification and removal of sources of UG and ensures that all parties are appropriately and proportionally</li> </ul>

				incentivised to do so, furthering the Relevant Objective d) Securing of effective competition between relevant Shippers and Suppliers.
Co-Operative Energy	0473 Support 0473A Oppose	0473	0473 d) positive	<ul style="list-style-type: none"> <li>• Believe it would be a retrograde step to remove the existing AUGE process and implement a less accurately targeted approach to unidentified gas (UG) cost allocation on the basis of share of gas market throughput.</li> <li>• The AUGE process to be reinstated post Project Nexus delivery by 0473 avoids the cross-subsidy by daily read and settled sites of non-daily read sites and the allocation process which exists for these.</li> <li>• Implementation of 0473A would codify cross-subsidy and potentially lessen the incentive for customers to have smart meters installed and be settled on the basis of actual reads, thus delaying the benefit that Government expects to be delivered by this.</li> <li>• 0473 would avoid the cross subsidy of non-daily read sites by daily read sites which would potentially be created by implementation of 0473A and would result in appropriate allocation of costs thus furthering relevant objectives (d) (i) and (ii) - securing of effective competition between shippers and suppliers.</li> <li>• Although implementation of 0473A would result in a lower level of cash flow impact around UG for Co-Operative Energy in the mid-term than the implementation of 0473, they believe that the benefit would only be temporary as implementation of 0473A would ultimately delay the greater benefit that wide spread smart meter rollout would bring to consumers and competition as the incentive to install these would be significantly weakened and the ability to properly quantify and allocate UG cost would be hindered.</li> </ul>
Corona Energy	0473 Support 0473A Oppose	0473	0473 d) positive 0473A d) negative	<ul style="list-style-type: none"> <li>• While both modifications seek to re-establish the third party assessment of unidentified gas (UG) and both propose a transition process which will operate until a third party has been appointed, Modification 0473 builds on existing work undertaken by the current AUGE while 0473A ignores it.</li> <li>• 0473 represents the most equitable and least disruptive transition from the current arrangements to the new process that does not result in a cross-subsidy between market sectors.</li> <li>• Settlement error is currently not applied to daily read sites on the justifiable basis that the consumption of that site is known with certainty, based on its meter readings. Under Project Nexus this settlement error will continue. The rolling AQ process will result in a</li> </ul>

				<p>lag in consumption estimates for non-daily metered sites. Allocating this lag to daily read sites will result in a cross-subsidy between those sites that are accurately settled from the start (with the attendant additional costs and risks that the shipper incurs) and those that rely on estimates (and so incur a lower operational cost). This is inequitable and every effort should be made to ensure that the correct market sector accounts for any settlement error. The transition arrangements for 0473 does this, but 0473A does not and instead relies on a retrospective process to correct any such issues at some point in the future. As a general rule retrospective adjustments should be avoided.</p> <ul style="list-style-type: none"> <li>• 0473 builds on the current AUGE table as it reflects the most accurate view of the sources of UG calculated by a third party, and does not create a retrospective process for allocating costs. In addition it also proposes a shorter transition period to the enduring regime (18 months compared to 24 months that 0473A supports).</li> <li>• 0473A continues the uniform smear for a period of at least two years, with a retrospective process for correcting allocations based upon the findings of the UIGE. This introduces significant uncertainty for suppliers and would therefore lead to cost increases for suppliers and customers.</li> <li>• 0473 transition process is consistent with the current view of Unidentified Gas arrangements under the AUGE and that this represents the most accurate and appropriate mechanism to deal with Unidentified Gas and further the relevant objective.</li> <li>• The transition process for 0473A, by perpetuating the current inaccurate process for allocating settlement error and UG to market sectors it does not originate from, is detrimental to relevant objective (d).</li> </ul>
DONG Energy	0473 Support 0473A Oppose	0473	0473 d) positive	<ul style="list-style-type: none"> <li>• Modifications 0473 &amp; 0473A support a need for an independent expert to determine the allocation of unidentified gas (UG).</li> <li>• 0473 provides a mechanism to utilise the data from the current AUGE process during the transition period to allocate UG.</li> <li>• 0473A will utilise the uniform smear of UG introduced by Modification 0432 until a party is appointed and determines whether the allocations should be adjusted across the different classes. We believe this approach will apply disproportionate levels of UG on DM sites which the AUGE believes accounts for little or no UG.</li> </ul>

EDF Energy	0473 Support 0473A Support	-	0473 d) positive 0473A d) positive	<ul style="list-style-type: none"> <li>• Believes both modifications ultimately provide a more appropriate mechanism to distribute unidentified gas (UG) amongst market participants than the methodology introduced via the implementation of Modification 0432.</li> <li>• 0473 proposes to apply a different allocation factor for the different Project Nexus product classes from Day 1 of the new regime and is a continuation of the application of principles established under the existing UG regime.</li> <li>• The transition rules under 0473 is more closely aligned with the allocation of unidentified usage in the electricity market than 0473A.</li> <li>• The legal text for 0473 commits all parties to having an annual review of the methodology and so changes can be made to reflect industry developments and amend existing assumptions. However, 0473 does not take into account the increased granularity of data that would be made available from smart metering in the future and its impact on UG. 0473 may not effectively incentivise shippers to ensure that consumers are in the correct product class if you can effectively avoid UG by nominating as class 2 rather than class 3 as an example.</li> <li>• 0473A proposes to utilise actual historical Project Nexus data to derive a methodology rather than predict behaviour in the new regime and creates a clean break from the past allocation of UG process, which has had problems since its inception. Moving away from Reconciliation by Difference (RbD) is a fundamental shift in the way gas is settled and allocated and in the absence of any hard data it may be more appropriate to wait and see what happens starting with a standardised approach as the default. However, this standardised approach may lead to greater settlement error for over a year while waiting for enough data to be gathered than taking a view that Daily Metered (DM) sites should not receive as much UG allocation as Non-Daily Metered (NDM) sites; DM sites are daily metered and therefore provide more accurate data.</li> <li>• Challenge the appropriateness of attributing significant UG to Product Class 1 and Class 2 sites which are metered every day with a high degree of certainty of their actual usage.</li> </ul>
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E.ON	0473 Oppose  0473A Support	0473A	0473 d) negative  0473A d) positive	<ul style="list-style-type: none"> <li>It is in the interests of all parties to ensure that customers are fairly charged for the gas consumed, and that where the gas can't be attributed to an individual supply point that there is a fair and reasonable mechanism to allocate the costs of the unidentified gas (UG) to the market.</li> <li>0473A would have a more positive impact on competition by applying costs of UG more accurately to customers when the evidence of the new arrangements have allowed.</li> </ul>
ENI	0473 Support  0473A Oppose	0473	0473 d) positive  0473A d) negative	<ul style="list-style-type: none"> <li>The current market regime does not smear errors caused by the estimation process onto daily read sites as they are settled using actual meter reads on a daily basis; This error is currently allocated to those sites that rely on estimates for initial allocation (either through Annual Quantity calculated annually or via Reconciliation By Difference). Such sites bear this error as collectively they are causing it.</li> <li>Smearing allocation error across customers that do not cause it (and incur higher costs by being daily settled) is inequitable, not only reducing settlement accuracy across the market but creating a cross-subsidy between market sectors. As such it represents a reduction in market efficiency.</li> <li>0473 restores the current equitable allocation process, which Project Nexus seeks to remove and bases its transition process on this. By contrast 0473A proposes to maintain the proposed smear process and uses relies on a retrospective process to correct any such issues at some point in the future. Retrospective adjustments will result in inefficient gas purchases and be detrimental to the customer.</li> </ul>
First Utility	0473 Oppose  0473A Support	0473A	0473 d) negative  0473A d) positive	<ul style="list-style-type: none"> <li>Considers that all classes should attract unidentified gas (UG) costs; each class potentially has different types of issues that can contribute to UG volume. No class should be excluded or disproportionately included and that 0473A delivers a fair and equitable method of UG allocation.</li> <li>It is important that UG is allocated fairly and equitably to ensure that all parties, regardless of their product class and portfolio mix are fairly and equitably motivated to detect, investigate and resolve issues (including theft) that lead to UG being created in the first place. It must be in all parties' interests to reduce the volume of UG such that all parties benefit fairly and equitably from that reduced volume.</li> </ul>

Gas Plus	0473 Oppose  0473A Support	0473A	0473 d) negative	<ul style="list-style-type: none"> <li>0473 opens a gateway for suppliers to opt out of unidentified gas (UG) allocation through a 'safe haven', resulting in the disproportioning and redirecting of UG costs to SSPs that are not able to provide reads daily.</li> <li>0473A proposes a more appropriate and accurate allocation of costs between Shippers and Suppliers as well as secures effective competition between Users.</li> </ul>
Gazprom	0473 Support  0473A Oppose	0473	0473 d) positive  0473A d) negative	<ul style="list-style-type: none"> <li>0473 will reinstate the AUGE process as soon as possible and use data provided by the AUGE for the transition allocation mechanism, expected to be in place for less than two years. This represents the most accurate and equitable mechanism for allocating unidentified gas (UG).</li> <li>0473A proposes to utilise the smear process already identified by Ofgem as a sub-optimum solution. This places both settlement error and disproportionate levels of UG on daily read sites and represent a significant barrier to both competition and the rollout of daily settlement to smart and advanced metering customers.</li> <li>Examining data provided by the AUGE the transition allocation factors proposed by 0473 are the most equitable process to allocate UG rather than uniformly smear such gas across the daily settlement sector which it does not originate from, as proposed by 0473A.</li> <li>Is concerned about the negative impact that the proposed process for allocating UG under Modifications 0432 and 0473A will have on the rollout of daily read settlement in the gas market.</li> </ul>
Good Energy	0473 Oppose  0473A Support	0473A	0473 d) negative  0473A d) positive	<ul style="list-style-type: none"> <li>0473A proposes a balanced approach building on the principles and evolving knowledge that the AUGE has evidenced in recent years. The premise within 0473 that sites within Nexus meter reading classification 1 and (particularly) 2 is flawed. Both of these classes would avoid unidentified gas (UG) costs completely, which of course would shift 100% of the UG costs onto class 3 and 4 sites. It is critically important to recognise that there is no difference in the site characteristics of a class 2 or class 3 sites. Therefore the establishment of a 0473 regime that created a direct incentive to avoid UG costs by site classification would be detrimental.</li> <li>0473A better facilitates competition between Users, as the changes lead to a more accurate allocation of UG between suppliers. By contrast 0473 would distort competition and serve to load inappropriate costs onto SSP Users and domestic customers.</li> </ul>

National Grid Distribution	0473 Support 0473A Support	No view	0473 d) positive 0473A d) positive	<ul style="list-style-type: none"> <li>• Broadly supportive of both modifications on the basis that each identifies a sustainable mechanism to adjust the allocation of unidentified gas (UG) across product Classes involving use of an expert to determine the allocation of UG.</li> <li>• Clarifies that all references within the relevant Modification 0432 legal text are to LDZ only: UG will be calculated by LDZ (unlike today's UG arrangements, which are national) and will be apportioned based on the AULOQ: the User's User Adjusted LDZ Offtake Quantity for the LDZ and the Day</li> <li>• As NTS Supply Points will not be assigned to an LDZ if they are connected from the NTS, they will not count towards LDZ offtake and cannot be assigned any LDZ UG.</li> <li>• It is important to note that in the event of non-implementation of either modification the integrity of the UNC legal text as identified under Modification 0432 would not be compromised and implementation can proceed under the planned timescales.</li> <li>• Notes that if either modification were implemented in line with the Modification 0432 implementation timescales, there would be nothing in UNC until the Project Nexus Implementation Date, being 1st October 2015 to place an obligation on GTs to appoint an AUGIE/UGIE.</li> <li>• Have a number of concerns regarding the accuracy of the Legal Text and have provided detailed comments.</li> </ul>
National Grid NTS	0473 Support 0473A Support	0473A	0473 d) positive 0473A d) positive	<ul style="list-style-type: none"> <li>• There should be no such attribution of unidentified gas (UG) costs to NTS direct- connected sites under 0473 and 0473A since the quantity of UG is determined from the amount of gas metered at the various points of entry of the gas into the Distribution Networks and therefore cannot include any losses associated with NTS connected loads or the NTS network.</li> <li>• Given the confusion over whether NTS direct-connected sites were covered by 0473/0473A or not, it would be helpful if the legal text for both modifications could be amended such that the term 'Transporter' is replaced by 'relevant Transporter' as this would clarify that these arrangements apply, in turn, to the network to which the customer's site is connected.</li> </ul>



RWE npower	0473 Oppose  0473A Support	0473A	0473 d) negative  0473A d) positive	<ul style="list-style-type: none"> <li>Is concerned that 0473 could, if implemented, provide opportunity for some market participants to take steps to avoid their fair share of the unidentified gas (UG) costs (by making use of Product Class 2), which would impact some customers unfairly and negatively impact competition.</li> </ul>
Scotia Gas Networks	0473 Comments  0473A Comments	0473A	0473 d) positive  0473A d) positive	<ul style="list-style-type: none"> <li>Supports the premise of an independent unallocated gas (UG) review. The reason they stated a preference for 0473A is that they feel that using actual data to make a determination appears most pragmatic especially following a major change to the settlement arrangements under Project Nexus.</li> <li>Not sure that the transitional exclusion of UG allocations to a certain class under the original modification is appropriate as there is no current evidence that these particular sites do not add to UG volumes.</li> <li>Both modifications can be seen to further objective d) more or less in comparison to each other. The original can exceed the alternative in that the costs are allocated in a more timely fashion. However, the alternative could be seen to exceed the original as the allocation is based on actual settlement data under the new settlement regime.</li> </ul>

Scottish Power	0473 Oppose 0473A Support	0473A	0473 d) negative	<ul style="list-style-type: none"> <li>• Believe 0473 to be flawed, as it seeks to allow an application of 0% unidentified gas (UG) to Class 1 (DM sites) when the latest AUGÉ Table has assigned 5GWh of UG to this market segment.</li> <li>• 0473 opens up opportunity for parties to actively seek to avoid UG costs for DMV, LSP and SSP sites (by the utilisation of ‘class 2’) and would be a retrograde step from the current AUGÉ arrangements.</li> <li>• 0473 seeks to extend past the current AUGÉ methodology by incorporating ‘unmeasured’ elements.</li> <li>• 0473 seeks to utilise a methodology that does not take cognisance of the new Nexus regime. They do not see the benefit in utilising a methodology that refers to a pre-Nexus regime, and feel that this adds further inaccuracy and uncertainty to Industry participants</li> <li>• 0473A looks at facilitating a regime that is forward looking, taking into account the Nexus changes, and seeks to incorporate these in a new methodology that is fit for purpose, utilising robust and relevant data, and incorporating the changes, rather than shoe horning methodologies that may no longer be relevant.</li> <li>• 0473A will undertake a full assessment of the market and therefore will give industry participants robust analysis that underpins the allocation of UG.</li> <li>• Are concerned that legal text for 0473A is still draft.</li> </ul>
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SSE	0473 Oppose 0473A Support	0473A	0473A d) positive	<ul style="list-style-type: none"> <li>• 0473A allows more time for the independent expert to consider the output from the Nexus arrangements. Whereas 0473 require the expert to consider the figures too soon after Nexus go live before an amount of data is available that can be reliably used to reallocate unidentified gas (UG) accurately. Either the straight throughput allocation method approved under Modification 0432 or the transitional arrangements under 0473A should apply until enough time has elapsed in order for the expert to have at least one full year of consumption analysis under Nexus with which to form an opinion.</li> <li>• Believe that all customers should pick up a share of UG based on the allocation scaling adjustment as was implemented in Modification 0432. There are known inaccuracies e.g. shrinkage that should be allocated across the market.</li> <li>• Furthermore, shippers should not be able to avoid UG by placing sites in product class 2 as this spreads the UG across a smaller proportion of sites and that this is anti-competitive as it potentially discriminates against smaller shippers that cannot offer a class 2 product, but would be able to put customers into class 3.</li> <li>• Agree that neither of these modifications attribute any UG costs to NTS direct-connected sites and that these sites should be excluded from any allocation of UG.</li> </ul>
Total Gas & Power	0473 Support 0473A Oppose	0473	0473 d) positive 0473A d) negative	<ul style="list-style-type: none"> <li>• Currently, the AUGER has excluded Daily Metered (DM) sites from a share of unallocated gas (UG) and this principle should be carried forward into the new arrangements. It is therefore unacceptable that Daily Metered sites should attract a volume based smear following Project Nexus implementation. DM sites have more closely monitored metering and consumption data and as such daily read sites are not exposed to the settlement error caused by the non-daily metered estimation process. As such they should not be subject to the uniform smear proposed under Modification 0432.</li> <li>• DM sites that are NTS connected are exempt from the universal smear, therefore sites that are connected to the Distribution networks should be treated in the same way.</li> </ul>

Winchester Gas	0473 Oppose 0473A Support	0473A	0473 d) negative	<ul style="list-style-type: none"> <li>• Support the intent of both modifications to appoint an expert to determine the allocation of unidentified gas (UG). However, due to the transitional rules in 0473 they are only able to support 0473A.</li> <li>• To not allocate UG to Class 2 sites is essentially giving Shippers the option of opting out of UG allocation for any supplies for which they are able to provide daily reads to the Transporter. If Shippers are able to opt out of UG allocation this could affect competition within the market during the transitional period.</li> <li>• All Classes should be subject to an allocation of UG as this is an industry issue and as such not allocating UG to certain Classes could be a disincentive to Shippers, whose portfolio is mainly in that Class, from actively detecting UG.</li> </ul>
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Wingas	0473 Support 0473A Oppose	0473	0473 d) positive 0473A d) negative	<ul style="list-style-type: none"> <li>Both modifications recognise that a uniform smear process is inadequate and that the third party assessment will bring benefits to the market in terms of equitable allocation of both unidentified gas (UG) and settlement error.</li> <li>It is important that any transition process to this third party process is the most equitable and transparent possible, 0473 does that, basing its transition process for UG on the latest confirmed AUGE table and continues the practice of not allocating balancing error to daily settled sites. UNC Modification</li> <li>0473A continues to utilise the inequitable smear process (so resulting in a cross-subsidy of non-daily read sites by daily read sites) that was implemented by Modification 0432.</li> <li>Examining the two sources of residual gas (Settlement Error and unallocated gas), it is clear that it is inequitable that the uniform smear process is used to allocate gas to all sectors evenly and represent a departure from the principle that has operated in the retail gas market since its inception that sites that incur the costs of ensuring accurate settlement are not exposed to the errors originating from other sectors.</li> <li>Considers that the UNC, as currently drafted, will not result in any residual gas being allocated to NTS sites. It is discriminatory that daily read sites that happen to be connected to the NTS are exempt from any UG and daily read sites that are connected to the DN networks are.</li> <li>Do not agree with the concerns raised under 0473 that large number of sites will be reclassified as daily read to avoid balancing error. This perceived issue only exists for the transition period, as the reinstated AUGE process will be able to adjust UG to take into account market developments.</li> </ul>
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Representations are published alongside the Final Modification Report.

## 8 Panel Discussions

Members noted that these modifications are seeking to address the concerns raised in the Authority's decision letter for Modification 0432 - Project Nexus – Gas Demand Estimation, Allocation, Settlement and Reconciliation reform, that the use of a single scaling factor would offer a less accurate means of allocating unidentified gas than is currently offered by the Allocation of Unidentified Gas Expert (AUGE), and that these modifications identify changes to provide expert determination in the energy allocation process to enable a more appropriate distribution of unidentified gas.

Members agreed the implementation of the changes identified within these modifications would be expected to impact Relevant Objective d): the securing of effective competition between Users. The changes are expected to lead to more accurate allocation of unidentified gas costs between Shipper Users by implementing the recommendations of an industry expert rather than is currently stated under 0432 using an allocation scaling adjustment.

Members received a verbal update referring to some of the responses, whereby it was

stated that the UAG allocation to Daily Metered sites in the current draft AUG table had been resolved and would not necessarily flow through to the final version of the table. Some Members believed this answered the concerns raised in the responses to this modification.

### **Modification 0473**

Some Members considered that the 0473 transition process is consistent with the current view of unidentified gas arrangements under the AUGE and that this represents the most accurate and appropriate mechanism to deal with unidentified gas. Some Members preferred this approach as it maintains the current AUGE process, which has had time to establish and mature and reduces the period of transition following the implementation of Project Nexus. They also considered that modification 0473 introduced an incentive for customers to take on smart meters.

However, some Members were concerned that 0473 transition may lead to the introduction of a perverse incentive to take advantage of the protection from unidentified gas costs afforded to sites within Product Class 2. They believed this may lead to a risk of significant numbers of sites migrating from Product Class 3 and 4 into Class 2 and that this volume could cause system problems that would be detrimental to the securing of effective competition. Some Members challenged whether evidence had been provided that demonstrated that this risk is material, on the basis that Nexus is being built for the volumes likely to be affected based on current DECC figures (18 Sept 2014).

Some Members were concerned that 0473 seeks to utilise a methodology that is not reflective of the new Nexus regime. They do not see the benefit in utilising a methodology that refers to a pre-Nexus regime, and feel that this adds further inaccuracy and uncertainty to Industry participants.

Some Members were concerned that the governance of transitional arrangements was through the Uniform Network Code Committee approval of the AUGE guidelines and they did not think this was appropriate as it may be possible to amend the transition approach without full industry scrutiny.

### **Modification 0473A**

Some Members agreed that the 0473A transition would result in a more appropriate and accurate allocation of costs between Shippers as the allocation of unidentified gas will be based upon the 0432 Project Nexus settlement mechanism and retains the 'known source' unidentified gas elements of the existing AUGE arrangements. They believed that this more accurately allocates costs during transition and that using matured data generated from the new settlement regime allows the new Independent Expert to provide a more accurate assessment of the value and allocation of unidentified gas.

Other Members disagreed, believing that 0473A transition does not more accurately represent previous allocation of unidentified gas on the basis that daily settled sites will be allocated significant unidentified gas. These Members were concerned that the additional 6 months of transition to achieve this matured position imposes a prolonged exposure to the transition rules and increases the settlement risk.

Some Members were concerned that 0473A could potentially introduce a cross-subsidy and lessen the incentive for customers to have smart meters installed and be settled on the basis of actual reads, thus delaying the benefit that Government expects to be delivered by this initiative.

Some Members challenged the appropriateness of attributing unidentified gas to Product Class 1 and Class 2 sites, which are metered every day with a high degree of certainty of their actual usage. However, other Members disagreed with this view as they felt it should be down to the expert to make this judgment based on the available evidence for unidentified gas distribution.

### **Legal Text**

Members noted that concerns had been raised about the status, accuracy and appropriateness of the Legal Text provided for these modifications. With one Member expressing a view that further clarity was required about the exclusion of NTS directly

connected sites from the proposed regimes.

Members then voted and, with 8 votes in favour, determined to recommend that Modification 0473 be implemented. Members also determined, with 8 votes in favour, to recommend that Modification 0473A be implemented.

Members then considered which of Modification 0473 and 0473A would, if one were to be implemented, better facilitate the achievement of the Relevant Objectives. Members voted and, with 7 votes in favour, of the two modifications, Modification 0473A would be expected to better facilitate achievement of the relevant objectives.

## 9 Recommendation

### Panel Recommendation

Having considered Modification Report 0473/0473A the Panel recommends:

- that proposed Modification 0473A better facilitates the Relevant Objectives than proposed Modification 0473.
- that proposed Modification 0473 could be made; and
- that proposed Modification 0473A could be made.

## 10 Appendix one – AUGE Framework

### Modification 0473

Framework for the Appointment of an Allocation of Unidentified Gas Expert and the provision of the Allocation of Unidentified Gas Statement is published alongside this report

## 11 Appendix two – UGIE Framework

### Modification 0473A

Framework for the Appointment of an Unidentified Gas Independent Expert and the provision of the Allocation of Unidentified Gas Statement is published alongside this report.

## 12 Appendix three – 0473A Transitional Arrangements

The Transitional Arrangements are designed to adjust the straight throughput based Modification 0432 arrangements for the Directly Measured Components identified by the incumbent AUGE arrangements (see red highlighted area of example table below).

Unidentified Gas source	Aggregate Quantity of Unidentified Gas/GWh	Unidentified Gas Quantity/GWh		
		Larger DM SPCs	Larger NDM SPCs	Smaller SPCs
iGT CSEPs	288	0	0	288
Shipperless/Unregistered	417	0	321	96
- Shipper Activity	0	0	0	0
- Orphaned	33	0	28	5
- Unregistered <12 Months	57	0	49	7
- Shipperless PTS	25	0	14	11
- Shipperless SSrP	291	0	223	68
- Shipperless <12 Months	11	0	5	5
Meter Errors	21	0	21	0
Balancing Factor (Theft + Other)	3779	0	962	2817
Total (inc Independents)	4506	0	1304	3202

[Worked example:](#)

The method proposed to do this is to take the total Aggregate Quantity of Unidentified Gas/GWh as defined by the most recent AUG Table at the point of Project Nexus Go Live Date (highlighted green in the above example table).

In this example this would equate to  $288 + 417 + 21 = 726\text{GWh}$

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It should be noted that this is for a full year and therefore to apply the adjustment monthly the calculation would be  $726/12 = 60.5\text{GWh}$  (subject to UNC value rounding rules)

For this example (as per the example table above), according to the AUG Table above, the 60.5GWh would be allocated along the following proportions:

Larger DM SPCs =  $0/726 = 0\%$

Larger NDM SPCs =  $342/726 = 47.1\%$

Smaller SPCs =  $384/726 = 52.9\%$

Under the proposed transitional arrangements, the 60.5GWh will have been allocated by Modification 0432 arrangement in-line with throughput rather than as per the AUG Table above. Therefore to correct for this, the 60.5GWh is removed each month from the UG allocation in proportion to throughput. Assuming the following market shares as an example:

Larger DM SPCs = 17% throughput =  $60.5 * 0.17 = 10.3\text{GWh}$

Larger NDM SPCs = 23% throughput =  $60.5 * 0.23 = 13.9\text{GWh}$

Smaller SPCs = 60% throughput =  $60.5 * 0.60 = 36.3\text{GWh}$

This 60.5GWh is then allocated to the sectors each month as per the AUG Table above.

Larger DM SPCs = 0% Directly Measured Components =  $60.5 * 0.0 = 0\text{GWh}$

Larger NDM SPCs = 47.1% Directly Measured Components =  $60.5 * 0.471 = 28.5\text{GWh}$

Smaller SPCs = 52.9% Directly Measured Components =  $60.5 * 0.529 = 32.0\text{GWh}$

Therefore the net effect of this transaction is:

Larger DM SPCs =  $-10.3\text{GWh} + 0\text{GWh} = -10.3\text{GWh}$

Larger NDM SPCs =  $-13.9\text{GWh} + 28.5\text{GWh} = 14.6\text{GWh}$

Smaller SPCs =  $-36.3\text{GWh} + 32.0\text{GWh} = -4.3\text{GWh}$

The methodology for implementing the proposed Transitional Arrangements will mirror the existing 'Allocation of Unidentified Gas Invoice Process' currently undertaken by Xoserve.