

Stage 01: Proposal

0379:

Provision for an AQ Review Audit

What stage is this document in the process?



This Proposal will obligate the Network Owners to audit Shipper's use of the AQ Review window under certain circumstances.



The Proposer recommends that this self-governance modification should be sent to a Workgroup for assessment for two months



High Impact:
Shippers



Low Impact:
Network owners

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Modification

08 April 2011

Version 1.0

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About this document:

This document is a proposal, which will be presented by the Proposer to the Panel on 21 April 2011. The Panel will consider the Proposer's recommendation, and agree whether this self-governance modification should proceed to consultation or be referred to a Workgroup for assessment.



3 Any questions?

5 Contact:

6 **Joint Office**



7 enquiries@gasgovernance.co.uk



12 **0121 623 2115**

13 Proposer:

David Watson



14 dave.a.watson@centrica.com



07789 570501

Transporter:

Insert name



...@...



0000 000 000

xoserve:

Insert name



commercial.enquiries@xoserve.com



0000 000 000

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1 Summary

Is this a Self Governance Modification

We believe this proposal is self-governance because it only seeks to provide transparency over Shippers actions in the AQ Review process and not to change the process itself, thus meaning it has no material impact in itself. To that end we consider it fulfils the UNC Self-Governance criteria.

Why Change?

The AQ Review process helps assign £billions of cost in the gas market and any issues or misuse of it can therefore have a material impact on the accuracy of cost allocation and therefore consumer's bills. We believe that the current controls on Shipper's use of the AQ Review process are not proportionate to the potential damage that would be done to competition were the process to be misused.

Solution

This proposal will obligate the Network Owners to direct an audit of any Shipper's use of the AQ Review process in the event that the aggregate kWh reduction in AQ values resulting from the AQ Review process is more than 1% over the mean in any one AQ Review year, and / or the difference between the total number of AQ reductions compared to AQ increases is more than 7.5% over the mean.

We also propose that in the event that the audit identifies any misuse of the AQ Review process, financial liabilities will apply on Shippers such that they do not profit from any misuse of the process.

Impacts & Costs

This Proposal will place an obligation on Network Owners to make arrangements for an audit of Shipper activity during the AQ Review process and will therefore impact their resources.

All NDM Shippers will be required to fund this audit provision, regardless of whether they themselves are audited, with those facing audits facing specific resource impacts required to support the audit.

Implementation

This Proposal should be implemented before 1st November 2011 so that this audit ability is available immediately following the 2011 AQ Review Process.

The Case for Change

We believe that by improving the control and assurance framework around the AQ appeal process the industry will have more confidence that the process is working effectively, Shippers will be dissuaded from any potential misuse of the process and the industry will be better able to identify and resolve any misuse.

We consider that this in turn will ensure that cost allocation in the gas market will be as accurate as possible thus facilitating effective competition between Shippers. In addition, we consider this Proposal will provide greater transparency over the degree to which Shippers are compliant with the existing Code obligations not to misuse the



Where can I find more information about how the AQ appeals process works?

The rules which govern the AQ appeals processes can be found in UNC section G, from paragraph 1.6 onwards. Link [here](#).

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AQ appeal process, thus facilitating efficiency in the implementation and administration of the Code. This Proposal will therefore facilitate Relevant Objectives (d) and (f).

Recommendations

We recommend that this Proposal be sent to a Workgroup for assessment for two months.

2 Why Change?

Context

In the Non-Daily Metered (NDM) market the allocation of gas costs are allocated based on an estimate of how much gas a site has used. These estimated costs are then aggregated up for all the sites on a Shipper's portfolio to calculate the charges that Shipper is liable for.

The estimate referred to above is known as the Annual Quantity (AQ) value, and it is derived from historic consumption at a site. As with any other estimate, the AQ is not absolutely accurate and therefore the AQ Review process exists to allow Shippers to correct any material variations between the AQ and the consumption they see at the site.

The rules around the AQ Review process provide for the Network Owners to advise the Shipper, for each of the NDM sites in their portfolio, a provisional AQ value by 31st May in each year. Shippers then have until 13th August in each year to appeal any AQ value which they consider to be inaccurate by submitting meter readings which substantiate the revised AQ it is seeking. Importantly, Shippers have an obligation to ensure that in the AQ Review they have applied a methodology which is consistent across their Supply Points, they have been even handed in their submission of AQ amendments – whether they be increases or decreases – and that it has not been selective over the AQs which it has finally appealed.

The risk arising from misuse of this process is material: £billions of cost is allocated through the AQ process each year and we calculate that were a Shipper with a 10% NDM market share to avoid just 1% of their costs through misuse of the AQ Review process, the misallocation of costs would be worth ~£6.5m¹.

The Issue

Despite the significant impact of the AQ Review process, and the impact that would arise from any misuse of it, the controls around it are inappropriately weak. We consider it a major flaw in industry governance that, given the amount of cost which the process allocates in the NDM market, there is no provision for an audit of Shipper behaviour.

¹ Assuming approximate SSP aggregate AQ of 328 TWh at an average cost of approximately £20m p/TWh, or £6.5bn total value. 10% share of this cost is therefore approximately £650m, with 1% of that cost valued at approximately £6.5m.

3 Solution

This Proposal will obligate the Network Owners to provide for an audit of a Shipper's use of the AQ Review process in the event that Shipper's aggregate kWh reduction in AQ values resulting from the AQ Review process is more than 1% over the mean in any one AQ Review year, and / or the difference between the total number of AQ reductions compared to AQ increases is more than 7.5% over the mean.

These levels have been chosen as they signify what we consider to be material variations in those two metrics which are worthy of further scrutiny.

The audit will be tasked with assessing compliance with all rules relevant to the operation of the AQ Review Process and include an assessment of the degree to which any AQ movement was inappropriate.

Furthermore, this Proposal will also introduce a new obligation on the Network Owners to ensure that, in the event that a Shipper has been found to have breached the provisions of the UNC relating to use of the AQ Review process and financially benefited as a result of erroneous cost reallocation, to the detriment of other Shippers, they will arrange for the auditor to quantify the extent of that benefit and then raise an ad-hoc correction to correct the misallocation of costs. The audit and any subsequent corrections must be made before the end of the subsequent Gas Year in which an offence took place in.

4 Relevant Objectives

The Proposer believes that implementation will better facilitate the achievement of **Relevant Objectives d and f.**

| 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. |
| c) Efficient discharge of the licensee's obligations. | None. |
| d) Securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers. | Yes, see below. |
| e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers. | None. |
| f) Promotion of efficiency in the implementation and administration of the Code | Yes, see below. |

We consider this Proposal facilitates UNC Relevant Objectives (d) and (f). Our reasoning is given below.

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.

We believe that the provision of an audit mechanism around the AQ review process will give the industry more confidence that the process is working effectively, dissuade Shippers from any potential misuse of the process and better enable the industry to identify and resolve any misuse.

We consider that this in turn will ensure that cost allocation in the gas market will be as accurate as possible thus facilitating effective competition between Shippers.

f) Promotion of efficiency in the implementation and administration of the Code

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In addition, we consider this Proposal will provide greater transparency over the degree to which Shippers are compliant with the existing Code obligations not to misuse the AQ appeal process, thus facilitating efficiency in the implementation and administration of the Code.

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5 Impacts and Costs

Impacts

This Proposal will impact both Shippers and Network Owners. Network Owners will need to procure or provide the audit service and Shippers will bear the costs associated with that.

Costs

| |
|--|
| Indicative industry costs – User Pays |
| Classification of the proposal as User Pays or not and justification for classification |
| User Pays |
| Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification |
| Shippers will pay 100% of the costs associated with this. We believe that this is justified as the anticipated benefit will be entirely in the Shipper market. |
| Proposed charge(s) for application of Users Pays charges to Shippers |
| TBC |
| Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve |
| |

Impacts

| Impact on Transporters' Systems and Process | |
|---|---|
| Transporters' System/Process | Potential impact |
| UK Link | <ul style="list-style-type: none">TBC |
| Operational Processes | <ul style="list-style-type: none">TBC |
| User Pays implications | <ul style="list-style-type: none">TBC |

| Impact on Users | |
|--|--|
| Area of Users' business | Potential impact |
| Administrative and operational | <ul style="list-style-type: none">Shippers facing an audit will need to provide operational support and other resource, as necessary, for the duration of the audit. |
| Development, capital and operating costs | <ul style="list-style-type: none">TBC. |

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| Impact on Users | |
|---|---|
| Contractual risks | <ul style="list-style-type: none"> • None. |
| Legislative, regulatory and contractual obligations and relationships | <ul style="list-style-type: none"> • None. |

| Impact on Transporters | |
|---|---|
| Area of Transporters' business | Potential impact |
| System operation | <ul style="list-style-type: none"> • TBC |
| Development, capital and operating costs | <ul style="list-style-type: none"> • TBC |
| Recovery of costs | <ul style="list-style-type: none"> • TBC |
| Price regulation | <ul style="list-style-type: none"> • TBC |
| Contractual risks | <ul style="list-style-type: none"> • TBC |
| Legislative, regulatory and contractual obligations and relationships | <ul style="list-style-type: none"> • TBC |
| Standards of service | <ul style="list-style-type: none"> • TBC |

| Impact on Code Administration | |
|-------------------------------|---|
| Area of Code Administration | Potential impact |
| Modification Rules | <ul style="list-style-type: none"> • None. |
| UNC Committees | <ul style="list-style-type: none"> • None. |
| General administration | <ul style="list-style-type: none"> • None. |

| Impact on Code | |
|----------------|------------------|
| Code section | Potential impact |
| | |
| | |

| Impact on UNC Related Documents and Other Referenced Documents | |
|--|------------------|
| Related Document | Potential impact |
| Network Entry Agreement (TPD I1.3) | None. |
| Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4) | None. |
| Storage Connection Agreement (TPD R1.3.1) | None. |

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| Impact on UNC Related Documents and Other Referenced Documents | |
|--|-------|
| 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 | None. |

6 Implementation

This Proposal should be implemented as soon as possible after an Ofgem direction. We believe it is important that the implementation date should be before 1st November 2011 so that audits can be carried out on the 2011 AQ Review.

7 The Case for Change

Advantages

1. Provides greater transparency over Shipper behaviour during the AQ appeal process, deterring any non-compliance and ensuring that any non-compliance can be identified and addressed.
2. Liabilities provision ensures that any misuse of the AQ Review process does not ultimately lead to a misallocation of costs.

Disadvantages

None identified.

8 Legal Text

None provided

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9 Recommendation

The Proposer invites the Panel to:

- DETERMINE that Modification 0379 progress to a Workgroup for assessment.