

Stage 04: Final Modification Report

0326VV:

Allocation of unidentified gas following the appointment of the Allocation of Unidentified Gas Expert (AUGE)

This modification will ensure any issue(s) identified by the AUGE is reconciled back to the period to which it relates, irrespective of when the issue was identified by the AUGE. Such issues would only be reconciled back to the Application Date of 1st April 2012, where it can be demonstrated that the issue was prevailing at that time.



Panel did not recommend implementation



Low Impact: Shippers and Gas Transporters

What stage is this document in the process?



0326VV

Final Modification Report

19 January 2012

Version 2.0

Page 1 of 21

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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	

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About this document:

This document is a Final Modification Report, presented to the Panel on 19 January 2012.

The Authority will consider the Panel's Recommendation and decide whether or not this change should be made.



Any questions?

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0326VV

Final Modification Report

19 January 2012

Version 2.0

Page 2 of 21

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1 Summary

Is this a Self-Governance Modification?

The Modification Panel determined that this modification should not follow Self-Governance procedures.

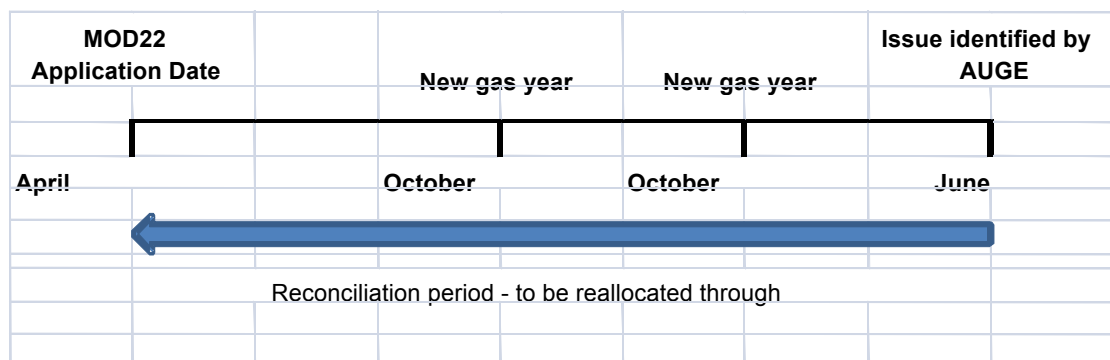
Why Change?

The UNC does not ensure that the impact of new issues identified and established by the AUGÉ are reflected in relevant invoices for the historic period to which the issues relate.

Solution

It is proposed that the Application Date is set at 1 April 2012, but that coupled with this, any future issue, with the exception of any previously agreed methodologies, identified by the AUGÉ is reconciled back to the period to which it relates, irrespective of when the issue was identified by the AUGÉ. Such issues would only be reconciled back to the Application Date of 1st April 2012, where it can be demonstrated that the new issue was prevailing at that time. We believe that the additional incentives require to be put in place to ensure that newly discovered issues that contribute to the level of unidentified gas are recognised and brought to the attention of the AUGÉ at the earliest possible opportunity. For the avoidance of doubt, the application date will roll forward in line with the invoicing rules set in accordance with UNC i.e. Section S 1.4.4.

This principle is demonstrated below:



This proposal will allow newly discovered issues, such as Transporter notified metering errors, to be allocated to both the LSP and SSP sector, where the unidentified gas has involved both market segments. It also represents a rebasing of the risk to ensure that the LSP and SSP markets face the same risks of unidentified gas.

This proposal would apply to both credit and debits. If the proposal were not accepted, then it would remain that the SSP market is cross-subsidising the LSP market, if issues go beyond a one year period. Therefore, potentially significant amounts of energy will continue to be allocated to the incorrect sector. This is not an

effect that was contemplated within modifications 229 and 317/A, which look to ensure energy costs are appropriately and correctly assigned to the relevant market sector.

Impacts and Costs

Xoserve estimates that implementation costs would be at least £30k, but probably not more than £80k. In addition, the costs of the AUGÉ may be increased.

Xoserve anticipate that there will be additional operational costs associated with managing reconciliation charges each year. These costs can be considered to be in the range of £0 (no reconciliation charges to be processed) to £20,000 (a complete reconciliation of charges for all periods).

Implementation

An implementation date of 1 April 2012 is proposed if an Authority decision is received before 20 March 2012.

An implementation date of 1 April 2012 is proposed if an Authority decision is received before 1 April 2012.

An implementation lead time of one business day is proposed if a later Authority decision is received.

The reasons for these dates are to deliver implementation with effect from 1 April 2012, and are presented in this format to comply with the Modification Rules.

The Case for Change

Implementation would ensure that newly discovered issues identified and established by the AUGÉ are backed through the period to which they relate. This could be expected to more appropriately allocate costs between Shippers over the period concerned and so facilitate the securing of effective competition, but this would be at the expense of introducing retrospectivity. There was no Workgroup agreement on which of these impacts would be greatest and hence whether the Relevant Objectives would be positively or adversely impacted if the modification were implemented.

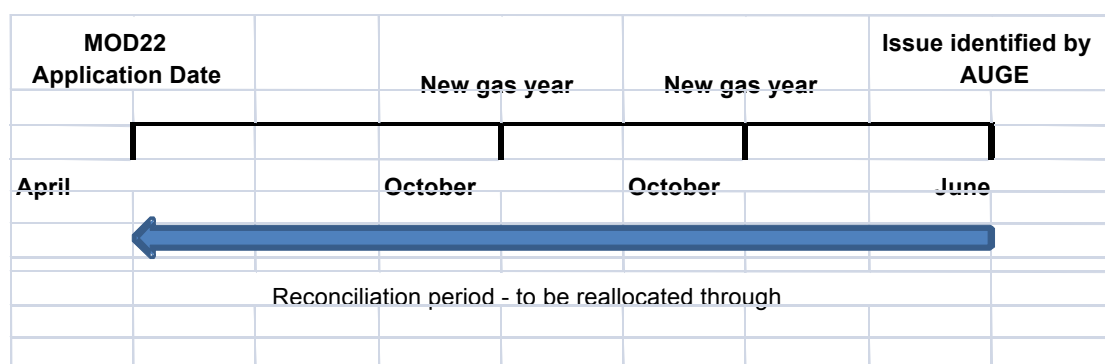
2 Why Change?

At present, the AUGE process delivers a fixed allocation of costs, which applies prospectively. Some Shippers are concerned that there is potential for new issues to be identified that would have applied in the past. The UNC does not provide for such issues that are identified and established by the AUGE to be applied retrospectively over the period to which they relate.

3 Solution

This Proposal seeks to ensure that any future issue identified by the AUGÉ can be retrospectively adjusted to the AUG Application Date of 1st April 2012 or the maximum invoice date as set out in UNC Section S 1.4.4. It is proposed that any future newly discovered issue identified by the AUGÉ is reconciled back to the period to which it relates, irrespective of when the issue was identified by the AUGÉ. Such new issues would only be reconciled back to the Application Date of 1st April 2012, where it can be demonstrated that the issue was prevailing at that time. We believe that the additional incentives require to be put in place to ensure that any new issues that contribute to the level of unidentified gas are recognised and brought to the attention of the AUGÉ at the earliest possible opportunity. For the avoidance of doubt, the application date will roll forward in line with the invoicing rules set in accordance with UNC i.e. Section S 1.4.4 and any previously agreed methodologies will be outside of the scope of this proposal, whereas new metering errors are not.

This principle is demonstrated below:



This proposal will allow new issues, such as Transporter notified metering errors, to be allocated to both the LSP and SSP sector, where the unidentified gas has involved both market segments. It also represents a rebasing of the risk to ensure that the LSP and SSP markets face the same risks of unidentified gas.

This proposal would apply to both credit and debits. If the proposal were not accepted, then it would remain that the SSP market is cross-subsidising the LSP market, if issues go beyond a one year period. Therefore, potentially significant amounts of energy will continue to be allocated to the incorrect sector. This is not an effect that was contemplated within modifications 229 and 317/A, which look to ensure energy costs are appropriately and correctly assigned to the relevant market sector.

4 Relevant Objectives

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

The benefits against the Code Relevant Objectives	
Description of Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	No
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.	No
c) Efficient discharge of the licensee's obligations.	No
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
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.	No
f) Promotion of efficiency in the implementation and administration of the Code	No
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	

Standard Special Condition A11.1 (d):

Some parties believe that the apportionment of unidentified gas costs associated with issues over the period in which these costs have been incurred, rather than just prospectively, could result in additional unallocated gas costs being attributed to the appropriate Shippers. Accurate allocations of costs support the development of competitive markets, and hence implementation would be consistent with facilitating the securing of effective competition between Shippers.

Other parties believe that allowing retrospective cost allocations creates risk and uncertainty, potentially reducing the benefits introduced through the establishment of fixed annual values, applied prospectively, via the AUGÉ process. The increased risk and uncertainty would be counter to facilitating the securing of effective competition between Shippers, and may be particularly difficult for smaller shippers to manage since they do not have portfolios that provide an effective hedge.

Some parties are concerned that introducing the ability to implement retrospective financial adjustments may incentivise a delay in new issues being brought to the attention of the AUGÉ, thereby creating less accurate cost allocations initially - notwithstanding more accurate final allocations. This would be because parties may

build the evidence in support of their case before submitting an issue, thereby increasing the chance of acceptance by the AUGS as a new issue and implementation within the AUGS. The short-term reduction in accuracy of cost allocations could be counter to securing effective competition between Shippers. However, having the best possible case built and evidence presented could also be regarded as positive which would benefit cost allocations and hence competition.

National Grid Distribution believe that unnecessary complexity could be introduced to the UNC leading to inefficiency and uncertainty in the operation of the AUGS regime.

Wales & West Utilities do not believe that the implementation will have a positive impact on the achievement of the relevant objectives.

5 Impacts and Costs

Consideration of Wider Industry Impacts

Implementation of this modification should have no impact upon wider industry developments.

Costs

Indicative industry costs – User Pays

Classification of the Proposal as User Pays or not and justification for classification

The development and implementation of the reconciliation systems and processes for the management of unidentified gas reconciliations will cost Xoserve at least £30k, but probably not more than £80k, to deliver.

The broadness of the range reflects the unknowns associated with the business rules and the data required to be held and when in the Modification 0229 development life cycle Modification 0326 is approved.

Xoserve has appointed the AUGÉ based upon the scope of Modification 229 - Mechanism for the Correct Apportionment of Unidentified Gas. Modification 229 does not have a retrospective invoicing concept.

The contract between Xoserve and the AUGÉ contains a mechanism to request additional services in the event of a change in scope of the Modification 229 service e.g. as a result of a further UNC Modification. Xoserve will await approval of Modification 326V prior to approaching the AUGÉ for a quotation for the services envisaged by the modification.

It is anticipated that there will be additional ongoing operational costs associated with managing reconciliation charges each year. These costs can be considered to be in the range of £0 (no reconciliation charges to be processed) to £20,000 (a complete reconciliation of charges for all periods). Any costs would be incurred in the relevant year and added to the costs to be recovered by the GTs for the provision of ongoing services for unidentified gas.

Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification

On a User Pays basis as provided for in Modification 0229.

Proposed charge(s) for application of Users Pays charges to Shippers

On the same charging basis for Modification 0229, as defined in the ACS:

http://www.gasgovernance.co.uk/sites/default/files/AgencyChargingStatement_live%201%20July%202010.pdf

Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from Xoserve

Awaited.

0326VV

Final Modification Report

19 January 2012

Version 2.0

Page 9 of 21

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Impacts

Impact on Transporters' Systems and Process	
Transporters' System/Process	Potential impact
UK Link	<ul style="list-style-type: none">• Changes will be required to the systems being developed to support implementation of Modification 0229.
Operational Processes	<ul style="list-style-type: none">• None identified
User Pays implications	<ul style="list-style-type: none">• This is a User Pays Modification.

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	<ul style="list-style-type: none">• Some Users are likely to face small administrative and operational costs to manage additional invoices from GTs and the contractual requirement to pass these costs through to consumers. This modification will expand the timescales that these additional bills can be applied from.• Implementation of this modification may also result in the subsequent recovery of these costs through contractual terms with their customers. Additional administration may be introduced in order to manage these processes.
Development, capital and operating costs	<ul style="list-style-type: none">• Some Shippers may need to make changes to their systems.
Contractual risks	<ul style="list-style-type: none">• None identified
Legislative, regulatory and contractual obligations and relationships	<ul style="list-style-type: none">• None identified

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

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

Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	• None identified
Development, capital and operating costs	• As above
Recovery of costs	• As above
Price regulation	• None identified
Contractual risks	• None identified
Legislative, regulatory and contractual obligations and relationships	• None identified
Standards of service	• None identified

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
TPD Section E	

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact
Network Entry Agreement (TPD I1.3)	None
Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4)	None
Storage Connection Agreement (TPD R1.3.1)	None
UK Link Manual (TPD U1.4)	None
Network Code Operations Reporting Manual (TPD V12)	None
Network Code Validation Rules (TPD V12)	None
ECQ Methodology (TPD V12)	None

Impact on UNC Related Documents and Other Referenced Documents	
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

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7 The Case for Change

None in addition to that identified the above.

8 Legal Text

Text provided by National Grid Distribution

TPD Section E; DAILY QUANTITIES, IMBALANCES AND RECONCILIATION

Amend paragraph 10.4.4 as set out below:

10.4.4 For the purposes of the Code:

- (a) the AUG Methodology and AUG Table...and (subject to paragraph 10.5.5 below), shall not be subject to modification...
- (b) ...the Code.

The amendments here identify the principle that a previously closed out AUGE Year can be reopened 'retrospectively' under certain conditions.

Add new paragraphs 10.5.5 and 10.5.6 as set out below:

10.5.5 In circumstances where a new Unidentified Gas Source (which for the avoidance of doubt shall not include any source of unidentified gas which has previously been used by the AUGE for the purpose of determining an AUG Methodology) is identified by the AUGE in any particular AUG Year (the "Current AUG Year") and leads to a quantity of Unidentified Gas to apply to prior AUG Years in addition to the Current AUG Year, paragraph 10.5.6 shall apply for each applicable prior AUG Year back to and including 1 April 2012 (where relevant and subject to Section S 1.4.4) as set out in paragraph 10.5.6 below.

This paragraph sets the terms whereby 'new' unidentified gas can be identified an industry allocation of gas expert (the AUGE) and that this can be applied 'retrospectively' to previously closed out years (back to 2012 being the first effective year for the Mod 0229 regime). The reference to Section S refers to the relevant reconciliation 'close out' period. This 'overrides' the retrospective' applicability of the Mod 0326VV terms such that changes cannot be made in respect of any AUGE Year which predates the relevant reconciliation 'backstop' date (being the Code Cut Off Date as defined in TPD E1.3.9 and GT C1)'. Consequently, over time the 2012 date will 'roll forward' given the existing 4-5 year period.

10.5.6 As soon as reasonably practicable following the adoption of the AUG Table for the Current AUG Year, where applicable in accordance with paragraph 10.5.5 above, a reconciliation and adjustment shall be made, for each User and each Reconciliation Billing Period in each prior AUG Year between:

This paragraph establishes that previously closed out 'AUGE Years' can be reopened.

- (a) the User Unidentified Gas Amount as determined on the basis of the AUG Table for the Current AUG Year; and
- (b) the User Unidentified Gas Amount as determined on the basis of the revised AUG Table (taking into account the new Unidentified Gas

0326VV

Final Modification Report

19 January 2012

Version 2.0

Page 15 of 21

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Source) as applicable for each prior AUG Year in which such new Unidentified Gas Source is deemed to apply;

and the net adjustment amount shall be calculated and paid by or to such User (and shall be invoiced and payable in accordance with TPD Section S), without interest in respect of the period prior to the due date of the relevant invoice for such adjustment amount.

The above paragraphs set out how adjustments are made, applied and invoiced once a new unidentified gas source has been identified.

9 Consultation Responses

Representations were received from the following parties:

Respondent	
Company/Organisation Name	Support Implementation or not?
British Gas	Support
Corona Energy	Not in Support
E.ON UK	Support
Gazprom Marketing & Trading Retail	Not in Support
National Grid Distribution	Not in Support
RWE npower	Neutral
Scotia Gas Networks	Comments
Scottish Power	Support
SSE	Support
Wales & West Utilities	Neutral

Of the 10 representations received 4 supported implementation, 1 provided comments, 3 were not in support and 2 remained neutral.

Summary Comments

British Gas considers that this modification will allow any identified inaccuracies in the methodology to be subsequently corrected. This will mean they will not be “locked in” and thus prevent them from forever distorting competition. This in turn will mean Shipper’s share of unidentified gas costs will be more accurate, and thus their ability to compete fairly will be improved.

Corona Energy advises that the current process is not retrospective, but Modification 0326VV would create a retrospective element to it. Retrospective payments are an inherently unfair mechanism of allocating Unidentified Gas costs. Payments after the costs were incurred mean that LSP consumers would pay more or less than is fair (owing to the fluctuations in market share of their Supplier) and that SSP Suppliers would instead receive a windfall profit, instead of passing their reduced costs to their consumers through their tariffs. It also fundamentally undermines the principles of the AUGÉ process (to ensure that costs are predictable) and is likely to add cost to the industry were it to be used.

E.ON UK advises that the AUGÉ carries out their analysis based upon information available at the time, should information subsequently become available that can be clearly demonstrated to better reflect the true situation then this should be used subject to prevailing limitations on the invoice reconciliation period. The work of the AUGÉ is technical in nature and there already exists precedent in the area of offtake meter errors, which become identified and following analysis the adjustments are then applied retrospectively to better reflect true gas flow over the period. It should be noted that offtake metering is inferential, i.e. it ‘infers’ flow rather than positively

measures it. Any corrections are by nature an estimation albeit a better estimation. This seems a very similar process to the AUGÉ analysis and so EON believe the principle is already established.

Gazprom considers that any new issue, which is identified, would not change the overall value of the AUGÉ statement but would have the impact of altering the volume of energy associated with the Theft of Gas component. It is therefore unclear to what extent this modification would be of value in terms of moving the values, which have already previously been determined by the methodology. It is also worth noting that during the AUGÉ consultation process no new issues have been identified.

National Grid Distribution considers the modification, which provides for a previously 'closed out' AUG Year to be retrospectively reopened in lieu of completely new unidentified gas topics being forthcoming undermines the fundamental principles behind the Allocation of Unidentified Gas Expert - AUGÉ regime as implemented under UNC Modification 0229 'Mechanism for correct apportionment of unidentified gas' and is inefficient and unnecessary.

National Grid Distribution note that there is a lack of detail on how precisely an energy 'future issue' reallocation would be reapportioned back to the relevant year; they anticipate that there may be some unforeseen implications should the appointed AUGÉ change over the period whereby a retrospective reallocation of energy occurs and the retrospective period appertaining to Users who have since exited the market. They also consider that the contract price for the services from the AUGÉ would increase regardless of whether any new 'issues' are identified.

RWE npower is unconvinced, given the uncertainty that this modification will cause for financial processes by giving the ability to open a previous gas year, whether the benefits case is clear. It does however acknowledge that wherever AUGÉ methodology is applied, historically or not, it is more accurate than previous cost allocation.

Scotia Gas Networks (SGN) observe that the modification makes reference to metering errors as the main future issue, which could be addressed by this modification. SGN point out that, following industry discussions, it has now been clarified that this issue will not have an impact on the AUGÉ allocation of costs. As such, at this point in time, SGN are uncertain as to which types of errors could utilise this proposed reconciliation process if implemented.

Scottish Power advises that during the development phase a party noted that the industry had employed an AUGÉ and that they should be aware of all issues relating to unidentified gas. It is perfectly reasonable however to expect that shippers and or transporters may identify a previously unknown issue and there should not be any deterrent in reporting this to the AUGÉ. Indeed the AUGÉ themselves acknowledge that their own methodology is based upon incomplete data and assumptions have been required.

As an example of this Scottish Power highlight the fact that modification 0403 has since been raised to address the gas offtaken at new connections which it describes as a "significant source of Unidentified Gas" – the need for this modification demonstrates that there are issues that Shippers are aware of that the AUGÉ has not identified.

In supporting the principle of ensuring the most accurate and appropriate allocation of unidentified gas, it would be wrong to restrict parties from being able to raise previously unknown issues to the AUGE as, and if, they are unidentified and for the volumes of gas associated with those issues to be fully reconciled for the time for which they were an issue.

SSE considers the process of identifying unallocated costs by the AUGE is a very complex one and the AUGE can only allocate based on information known at a point in time. It is entirely feasible that at a later date information comes to light that changes the AUGE's view of unidentified gas, and thus would change the reallocation that should be applied to a previous period. It is a very similar principle to other errors such as large metering errors, where once the information is known then there is a reallocation of energy and costs for previous time periods based on this new information.

Throughout discussions on this modification Wales & West Utilities have been unable to identify the clear benefit of implementation and in particular how implementation will facilitate the relevant objectives.

10 Panel Discussions

The Panel Chair summarised that the impact of specific new issues identified and established by the AUGÉ (Allocation of Unidentified Gas Expert) are not specifically reflected in adjustments for the historic period to which the issues relate – although, while a top down methodology is used, the impact will have been accounted for in the theft of gas allocation. This modification proposes that, in future, any issue identified by the AUGÉ is reconciled back to the period to which it relates, irrespective of when the issue was identified by the AUGÉ.

Some Members felt that reconciling issues back to the time when they first had an impact would be consistent with accurate apportionment of costs. As such they felt that implementation could facilitate the securing of effective competition by securing the allocation of costs to the appropriate party. However, other Members felt that retrospective adjustments are inappropriate and create risk and uncertainty for market participants. As such, implementation could work against the securing of effective competition.

Members then voted and, with 2 votes in favour and 8 opposed, did not determine to recommend implementation.

11 Recommendations

Panel Recommendation

Having considered Modification Report 0326VV, the Panel recommends:

- that proposed Modification 0326VV should not be made.