

Stage 01: Proposal

What stage is this document in the process?

- 01 Proposal
- 02 Work Group Report
- 03 Draft Modification Report
- 04 Final Modification Report

0354 Alternative to MODs 0339, "Clarification of the AUG Year in respect of UNC Modification 0229"

An alternative to MOD0339, which seeks to change the Application Date of the Allocation of Unidentified Gas Expert's methodology to 1st October each year.



The Proposer recommends
That this modification is sent directly out for consultation.



High Impact:
Shippers, Suppliers



Low Impact:
Network Owners

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06 January 2011

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About this document:

This document is a modification, which will be presented by the Proposer to the Panel on 20th January 2011. The Panel will consider the Proposer's recommendation, and agree whether this modification should proceed to consultation or be referred to a Workgroup for development.



3 **Any questions?**

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1 Summary

Why Change?

The process introduced by Modification Proposal 0229 provides for the Allocation of Unidentified Gas Expert, or AUGÉ, to provide a methodology for the reallocation of unidentified gas and for that reallocation to take place in April 2012. The current misallocation of costs distorts competition between Suppliers and therefore anything which can reasonably be done to bring this date forward would have a large benefit for the market.

Solution

The effect of the AUGÉ's methodology will be backdated to 1st October in each year, starting on 1st October 2011.

Impacts & Costs

There are no additional costs associated with this modification over MOD0339. This modification will however provide for an increase in the accuracy of Shipper operating costs from 1st October 2011, and act as an incentive for all Shippers to ensure that the AUGÉ's initial methodology is delivered in line with the timeline considered by MOD0229.

Implementation

This modification should be implemented immediately following a direction from Ofgem.

The Case for Change

The inaccurate allocation of costs associated with unidentified gas distorts competition and whilst MOD0229 will correct this, there is concern that the current application date for the process introduced by that MOD does not strike the right balance between providing certainty of costs for Large Supply Point (LSP) sector Shippers or accuracy of charges for Small Supply Point (SSP) sector Shippers. This modification seeks to address that by applying the AUGÉ's methodology from the earliest point at which Shippers can have a reasonable level of certainty about their costs, and in doing so aligns the notice period Shippers receive for new charges they will incur with the notice period afforded to them elsewhere, for example Gas Network pricing changes.

Recommendations

We have not raised this modification as an "official" alternative to MOD0339 as under the transitional UNC Modification rules that would necessitate us waiting until MOD0339 had been issued out for consultation before raising it, potentially limiting Parties' ability to assess the impacts of the modification on their businesses. We have therefore raised this as a separate modification, explicitly referencing it as an alternative solution to MOD0339 and therefore expect it to follow the same path as MOD0339; a modification which we consider sufficiently developed to be issued to consultation at the January Panel meeting.

Were our modification be de-coupled from MOD0339 without good reason we wish to make clear that we would then re-raise it as an "official" alternative to MOD0339 once



Where can I find details of related Proposals?

All Proposals referred to in this document can be found on the Joint Office website. The Ofgem Decision Letter on MODs 0317, 0317A and 0327 are stored alongside the relevant Proposals. Links are provided below.

[MOD0229.](#)

[MOD0317 & 0317A.](#)

[MOD0327.](#)

[MOD0339.](#)

[MOD0340.](#)

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the window allows us to so that both modifications can be considered by the industry alongside each other.

2 Why Change?

On 26th May 2010 Ofgem directed the implementation of MOD0229, “*Mechanism for Correct Apportionment of Unidentified Gas*”. This modification was raised by Shell Gas Direct in order to provide a mechanism through which unidentified gas could be more accurately allocated between the Small Supply Point (SSP) sector and Large Supply Point (LSP) sector. Currently all unidentified gas is allocated to the SSP sector.

The process through which the new split of allocation between the SSP and LSP sectors would be arrived at involved both a tendering process to procure an Allocation of Unidentified Gas Expert (AUGE) and subsequent work by that AUGE in order to create an Allocation of Unidentified Gas Statement (AUGS) - the determination on how unidentified gas should be allocated between the SSP and LSP sectors.

A number of recent modifications have sought to establish the optimal Application Date for the AUGS (the date from which any reallocation of costs will take place from), so that it strikes the right balance between all Shippers’ need for cost certainty and SSP Shipper’s need for early relief from the inaccurate costs they currently face. In their decision letter on one such Proposal, MOD0317, Ofgem reaffirmed their view that “*the arrangements for the allocation of Unidentified Gas should be reformed such that each market segment makes an appropriate contribution to these costs*”¹, but went on to say that Proposals which provided for the reallocation of costs to be backdated to a point before the scale of reallocation was known may create “*significant uncertainty for small shippers and LSP shippers may have a detrimental impact on competition, in particular in relation to shippers operating only or predominantly in the LSP sector*”².

We aware that National Grid has also raised two further modifications which seek to address these points by amending the application date of the AUGS. MOD0339 seeks to set the application date to 1st April 2012 whereas MOD0340 seeks to set it to 1st April 2011. We consider that the former modifications will leave SSP Shippers facing inaccurate charges for an unreasonable and unnecessary length of time, without regard for the fact that all Shippers will have had certainty about the scale of cost reallocation for some time by that point. Whilst we support the latter modifications, we recognise the concerns Ofgem have over the level of uncertainty this may create for the LSP sector, and thus believe that an alternative Application Date may be required to find the appropriate balance between cost certainty for LSP Shippers and early relief from inaccurate costs for SSP Shippers.

3 Solution



What is the materiality of this issue?

British Gas believe that approximately £121m of cost is misallocated each year between the SSP and LSP sectors. The rationale behind this figure is provided in the Proposal document for [MOD0327](#).

¹ Ofgem Decision Letter for MODs 0317, 0317A and 0327 (18th November 2010), page 5.

² Ofgem Decision Letter for MODs 0317, 0317A and 0327 (18th November 2010), page 6.

In determining the most appropriate solution, we have given consideration to both (a) other areas of regulation where Shippers are notified of new costs, such as Gas Network Pricing Changes, (b) Electricity Network Charges and (c) the process for approving the AUGS itself.

Gas Network Pricing Changes

We consider that there is a need for consistency between the way in which volatility in Network charges are treated and the way in which the reallocation of unidentified gas costs is treated in terms of providing industry parties with certainty about the costs they will incur. When Network Owners announce changes to Distribution prices, an initial indication of proposed changes is made not less than five months prior to the implementation with a final notification of the changes not less than two months prior to implementation. The precedent created is that an acceptable level of cost certainty will be afforded to Shippers if they receive at least five months notice of indicative changes to their costs. As the initial draft of the AUGS will be presented on 1st May 2011, an Application Date of 1st October 2011 is reasonable.

Electricity Network Charges

As above, we consider that there is a need for consistency between the way in which volatility in Network charges are treated and the way in which the reallocation of unidentified gas costs is treated in terms of providing industry parties with certainty about the costs they will incur. Following an Ofgem review of the impact of settlement data adjustments on the Network Owners losses incentive schemes, Suppliers in the electricity market have been given four months notice of significant changes to their Electricity Network Charges. We are therefore comfortable that the five months notice that this Proposal affords Shippers of charges they will incur following the publication of the AUGS is more than sufficient, and provides all parties with sufficient certainty of their costs.

The AUGS Creation Process

As above, the process introduced by MOD0229 includes a requirement for the AUGS to publish their draft methodology by 1st May each year³. A "Query Process" will then commence allowing industry Party's to challenge or clarify the methodology before a final version is published no later than 1st August each year⁴. This methodology will then be approved or rejected by the UNC Committee (UNCC) "on or around the 1st September"⁵. Immediately following this decision of the UNCC, we believe that Shippers will have a reasonable level of certainty of the costs which they will incur when the reallocation is completed in the following May. Our view is that again therefore, by 1st October 2011 all Shippers will have sufficient certainty over their costs, and therefore this date is an appropriate Application Date.

Proposed Application Date

As above, both the illustrations above demonstrate that were the Application Date for the AUGS to be 1st October in each year, Shippers would have sufficient certainty about the costs they would incur. This modification will therefore amend the UNC so

³ [AUGE Guidelines Document](#), paragraph 6.1.1.

⁴ [AUGE Guidelines Document](#), paragraph 6.1.6.

⁵ [AUGE Guidelines Document](#), paragraph 6.1.8.

that the AUGE Year is defined as the period starting 1st October in each year, commencing on 1st October 2011.

For clarity, it is the intent of the Proposal that this impacts *all* AUGE years and not just the initial year.

Other Considerations

We also consider that by aligning the Application Date with the start of the Gas Year, this modification will complement other processes well; reconciling costs between the SSP and LSP sectors at the same date as the new Annual Quantity (AQ) values take effect.

Finally, we also consider that 1st October each year is a common start date for new LSP contracts, thus mitigating some of the need to either exercise contractual rights to pass on new regulatory charges or to socialise costs received against new customers only.

4 Relevant Objectives



Where can I find out more information about what is currently in Code regarding the reallocation of unidentified gas costs?

The relevant Code provisions are found in [UNC TPD E, section 10](#). The "[AUGE Guidelines Document](#)" supports the process.

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The Proposer believes that MOD0354 will better facilitate the achievement of **Relevant Objectives (d) and (f)**.

Proposer's view of the benefits of 0354 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 believe that this modification will facilitate Relevant Objectives (d) and (f). Specific detail on this is provided below.

Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs (a) to (c) the 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;

Implementation of this modification would allocate costs more accurately to the relevant LSP and SSP market sectors at a point in time which strikes the right balance between providing cost certainty to the LSP sector and accurate charges for the SSP sector. In doing so, this will in turn achieve the earliest removal of the cross subsidy that is currently present between the sectors. It is generally recognised that cross subsidies are not beneficial to competition and so removing them will have a positive impact.

In addition, this modification introduces an incentive to appoint an AUGÉ in a timely manner and ensure that an appropriate methodology is not unduly delayed. In doing so, this ensures that the benefits above are introduced sooner than would otherwise be the case.

Furthermore, as this modification removes the uncertainty over when the methodology considered under MOD0229 will be effective from, we consider that this modification will improve Shippers ability to plan effectively, thereby improving their ability to compete.

Standard Special Condition A11.1 (f): so far as is consistent with subparagraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

The modification will facilitate better-informed decision taking with regard to the allocation between market sectors of unidentified gas, and ensures that the level of contribution by the LSP sector to the SSP sector is set in a fair and transparent manner. As above, this proposal introduces an incentive to appoint an AUGÉ in a timely manner and ensure that an appropriate methodology is not unduly delayed. In doing so, this ensures that the benefits above are introduced sooner than would otherwise be the case.



What costs does the Proposer expect to be?

During previous debates on this issue, the Network Owner's Agent, xoserve, has stated that there may be an implementation cost associated with the application of charges for the period preceding the invoice date, i.e. for any period before 1st May in each year. These costs have not been established at the time of writing.

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5 Impacts and Costs

Costs

Indicative industry costs – User Pays

Classification of the modification as User Pays or not and justification for classification
No changes to User Pays Services are proposed. Consequently this modification is not classified as User Pays.
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification
No User Pays charges applicable.
Proposed charge(s) for application of Users Pays charges to Shippers
No User Pays charges applicable to Shippers.
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve
No charges applicable for inclusion in ACS.

Impacts

Impact on Transporters' Systems and Process

Transporters' System/Process	Potential impact
UK Link	• None.
Operational Processes	• None.
User Pays implications	• None.

Impact on Users

Area of Users' business	Potential impact
Administrative and operational	• None.
Development, capital and operating costs	• This modification will provide for an increase in the accuracy of operating costs from 1 st October 2011.
Contractual risks	• None.
Legislative, regulatory and contractual obligations and relationships	• None.



Why does the Proposer consider this Proposal has no costs?

During the Development of MOD0339 and 0340, xoserve confirmed that there were no implementation costs associated with the reallocation of costs for a period pre-dating that reallocation.



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.com/networkcodearchive/551-575/>

Impact on Transporters	
Area of Transporters' business	No impact
System operation	• None.
Development, capital and operating costs	• None.
Recovery of costs	• None.
Price regulation	• None.
Contractual risks	• None.
Legislative, regulatory and contractual obligations and relationships	• None.
Standards of service	• None.

Impact on Code Administration	
Area of Code Administration	Potential impact
Modification Rules	• None.
UNC Committees	• None.
General administration	• This modification incentivises all UNC Parties to ensure the AUGS is developed as per the timeline considered by MOD0229.

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.
UK Link Manual (TPD U1.4)	None.

Impact on UNC Related Documents and Other Referenced Documents	
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. For clarity, this modification will amend the Code document itself and not the "AUGE Guidelines Document".

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.
Transportation Pricing Methodology Statement	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 modification is able to be implemented immediately following a direction to do so from Ofgem. Given the likely materiality of the scale of any cost reallocation, were this modification to be approved, we propose that it be implemented without delay.

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7 The Case for Change



Advantages

1. Provides for relief from inaccurate unidentified gas allocation costs for SSP Shippers at the earliest possible point in time, without exposing the LSP community to uncertainty.
2. Aligns the reallocation of unidentified gas costs from the AUGS with the start of the Gas Year, simplifying industry processes.
3. Provides a similar level of cost certainty as Shippers currently receive under the process for managing Gas Network Pricing Changes.

Disadvantages

1. Exposes the SSP Shipper community to known inaccurate charges for five months over and above the date considered by MOD0340, allowing a distortion in the competitive markets to be perpetuated and for domestic customers to continue to be exposed to exaggerated prices.

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8 Recommendation

The Proposer invites the Panel to:

- DETERMINE that Modification 0354 progress directly to consultation.

Please note that we have not raised this modification as an “official” alternative to MOD0339 as under the transitional UNC Modification rules that would necessitate us waiting until MOD0339 had been issued out for consultation before raising it, potentially limiting Parties’ ability to assess the impacts of the modification on their businesses. We have therefore raised this as a separate modification, explicitly referencing it as an alternative solution to MOD0339 and therefore expect it to follow the same path as MOD0339; a modification which we consider sufficiently developed to be issued to consultation at the January Panel meeting.

Were our modification be de-coupled from MOD0339 without good reason we wish to make clear that we would then re-raise it as an “official” alternative to MOD0339 once the window allows us to so that both modifications can be considered by the industry alongside each other.