

Modification Report
Proposed change to the AQ Review Amendment Tolerance for SSP sites
Modification Reference Number 0292
Version 1.0

This Modification Report is made pursuant to Rule 9.3.1 of the Modification Rules and follows the format required under Rule 9.4.

1 The Modification Proposal

Background

The current Network Code rules in relation to the allowed amendment activity relates back to the early years of the SSP AQ Review Process. In the initial years of the AQ Review, there was some Shipper behavior where the process was used to “shave” AQs to provide volume and cost allocation benefits to their portfolio. This introduced additional costs to other Shippers operating in the SSP market, through the Reconciliation by Difference process.

With this in mind a modification proposal (Transco Network Code Modification No. 624) was implemented to put in place a tolerance for amendment activity, whereby a Shipper could only propose a Small Supply Point amendment, where they could demonstrate that the AQ was materially incorrect, based on meter reading history. The modification proposed that only amendments where the AQ would change by not less than 20%, in an either upward or downward direction, would be accepted.

Coupled with this it was proposed that the Shipper must use and be able to demonstrate a consistent amendment methodology, in both an upward and downward direction.

The modification was accepted and the rules were put in place to stop Shippers gaming. ScottishPower fully supported the introduction of the rules, at the time, as the best means of addressing gaming opportunities. Modification 81 which was implemented on 1/10/06 enhanced the AQ review reporting information published by Transporters by providing an overview of Users’ performance at various stages within the AQ review process in an anonymous format. Should Modification 292 be implemented, the transparency of Industry behaviour within the AQ review process would be retained through Mod 81 reporting. The AQ value assigned to SSP supply points is key to the charges faced by Shippers in relation to their portfolio, for both gas and transportation charges. In addition it plays into the tariffs offered to domestic customers and the profitability of a domestic gas portfolio.

However since the introduction of DNPC003 the effect of the AQ has become ever more pronounced in determining the amount of transportation costs allocated to individual supply points.

It therefore no longer seems appropriate that there should be such a restriction on the Shippers ability to alter Small Supply Point AQs and their ability to manage the costs associated with them. In addition, it would appear inefficient to continually keep SSP

AQ values at a level of 20% over/under statement against potential amendment values, when these are also used by the Transporters to assess available network capacity and investment needs.

At the same time information from Xoserve suggests that AQs are going down by 5% per annum and as such, the restriction on the amendment activity of Shippers limits the ability for the market to recognise this reduction at meter point level.

If a more practical amendment process were therefore adopted it would address all of these issues and bring some of the benefits outlined in the Rolling AQ modification, which has stalled due to the Project Nexus discussions.

In support of the proposal, it is worth noting that Xoserve do not apply any tolerance to the proposed AQs that they put forward, prior to the amendment period, and therefore it would seem in equitable that such a restriction is placed on Supplier proposed amendment values.

Proposal

Overstated AQs have the potential to significantly impact on the profitability of a Supply business, however this impact has become much more pronounced since the distribution transportation charging changed to be more capacity (AQ/SOQ) focused. In past the capacity charges were 50% of the transportation bill whereas now they represent 95% of it. This means that Suppliers face transportation charges that are much more fixed in nature and are determined by the AQ value set for the site. The resultant issue is that if there is not sufficient throughput by the customer, to reflect the AQ value there is potentially not enough units to bill to recover the fixed (capacity based) transportation charges, thus impacting Supplier profitability.

For this reason this proposal seeks to reduce the SSP AQ amendment tolerance to 5%. This change will allow more cost reflective values to be applied and also aid in the Transporters understanding of network capacity needs.

Although this proposal will open up the amount of amendments that can be lodged for the SSP market, we believe that this is something that can be managed by Xoserve, as in the initial phases of the SSP AQ process an amendment could be lodged for any change to an AQ value. In addition as Xoserve charge for using the speculative calculator, a pre-cursor to amendment, they will be able to recover any additional administrative costs seen.

In addition, it is proposed to extend the current provisions within the UNC Section G 1.6.4 to provide that prior to the start of the AQ Review amendment window (31 May) that the Transporters will issue to each User a volume cap for the number of AQ Amendments that can be submitted in each Business Day during the window (up to 13 August), together with the total number of Industry amendments that can be submitted per Day. This volume cap will be calculated by Transporters based on a Shippers meter point count as at 1st April in each Gas Year, subject to a de minimus level of 500 amendments per Shipper per day or to a value equal to the meter point count of the Shipper portfolio if less than the de-minimus level. For the avoidance of doubt the volume cap calculated for each User will apply in each Business Day for

the duration of the AQ amendment window, but will have the de minimus level set, so as not to place an unnecessary operational burden on small suppliers. Users may submit AQ amendments in a manner that exceeds their volume cap on any day throughout the period of amendment phase of the AQ review process, but there would be no obligation for more than the volume cap to be processed if in doing so the industry cap would also be breached. This requirement is intended to reduce any potential impact on xoserve systems and to mitigate the risks associated with Users submitting the majority of AQ amendments towards the end of the amendment window. The Transporter will be entitled to reject AQ amendments, which are non-compliant with any of the requirements of UNC (and the applicable xoserve guidance document) including manual referrals which fall out of validation. The Transporters Agent will be required, following consultation with Users, to produce and publish a guidance document which will set out how amendments should be submitted and will be processed, including how amendments submitted in excess of the volume cap will be processed.

2 User Pays

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

User Pays – implementation of this proposal would incur costs for the Transporters' Agency as their systems would need to be modified.

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

Development costs: £31k to £71k

Operational Costs: It is not clear whether any incremental operational costs will be incurred. However should this be the case, the current User Pays charge applied for use of the speculative calculator would be adjusted accordingly.

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

User Pays charges applicable to Shippers: allocated based on each User's share of Supply Point count (SSP only) on 1 April 2011.

EDF Energy disagree with the allocation of 100% costs to Shippers and 0% to Transporters as implementation of this modification would benefit the Transporters through avoided investment and as such, they should fund some of the implementation costs associated with this proposal.

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

To be confirmed.

3 Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Standard Special Condition A11.1 (a): *the coordinated, efficient and economic operation of the pipe-line system to which this licence relates;*

British Gas considers this modification increases the risk of gaming, or the artificial adjustment of AQ values for the benefit of an industry participant, which will result in less accurate AQ information being held in the industry about SSP and thus negatively impact the Network Owners' ability to accurately see where demand is throughout the country.

EDF Energy considers that if this proposal were implemented so that all Shippers had sufficient notice to develop and implement the associated system changes, then this would result in the ability for Shippers to register more accurate AOs. As the AOs are fundamental to the allocation of energy and are the basis of transportation charges, then they believe that they do have an impact on the development and planning of the system. Therefore more accurate AOs will result in investment being more accurately undertaken and so have a beneficial impact on the coordinated and efficient operation of the pipeline system.

Standard Special Condition A11.1 (b): *so far as is consistent with sub-paragraph (a), the (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (c): *so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;*

British Gas consider that the push to implement this proposal for the 2011 AQ Review will leave some Shippers able to make the necessary system changes to use the process and other Shippers unable to. They believe this will distort competition in favour of those Shippers who have either already made a decision to start system development in expectation of an Ofgem decision to implement the modification, or have sufficiently small systems to be able to accommodate a change of this magnitude within less than five months. British Gas consider that this will result in the Network Owners being obligated to provide services which discriminate between Shippers in a way which contravenes their Licence obligations.

EDF Energy also highlight within their representation that Gas Transporters have a Licence condition to not unduly discriminate between users.

Standard Special Condition A11.1 (d): *so far as is consistent with sub-paragraphs (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;

This proposal would ensure more accurate allocation of costs, with AQs being set that are more reflective of customer usage. This is because AQs will be using more accurate data and potentially be more up to date. This would have the benefit of meeting the Relevant Objective of securing effective competition between Shippers and Suppliers. However, some Shippers are concerned that less AQ amendments may be able to be submitted than at present such that AQs may be less accurate than at present. This is because of the daily limit imposed by the Proposal, coupled with issues regarding the time taken to implement systems changes and the time it takes to process the files received from xoserve prior to submitting amendments, which potentially discriminates against larger Shippers. Additionally, some Shippers suggested there would be an increased risk of misuse within the AQ amendment process as a result of reducing the 20% threshold to 5%, a threshold which was in part introduced in response to concerns about Shipper behaviour. This was not accepted by all Shippers since existing reports, and other Code controls, will continue to reflect and influence behaviour regardless of the level at which the amendment tolerance is set.

National Grid Distribution challenge whether implementation would have a material impact on cost allocation at an individual customer level, certainly in the SSP sector, where it is expected that most of the AQ amendments would originate, on the basis that both transportation and energy allocation is undertaken on an aggregate and scaled basis in the NDM sector.

Wales & West Utilities consider that by reducing the materiality threshold from 20% to 5% it is likely to result in all Shippers being compelled to process amendments so as not to be disadvantaged. This is likely to result in a classic case of ‘money-go-round’ with the only benefits being realised by those Shippers that can participate prior to all Shippers being able to. Once all Shippers are carrying out these additional processes, for no benefit, they will continue to operate this way for future years (to retain the status quo). By creating this additional workload for all Shippers (and xoserve) it could be argued that, if there is no ongoing benefit, that the additional costs that implementation would place on the industry will have the opposite impact and is a detriment to competition.

British Gas considers that the proposal would lead to less accurate AQs through an increased risk of abuse of the system and a weakening of the controls, which allow scrutiny of Shipper performance. They are concerned that the proposal seeks to remove the controls introduced by modification 0624 to prevent abuse in the AQ Review process and in doing so, Shippers who use the process honestly will be exposed to a large increase in gas allocation costs, distorting competition in the process.

British Gas also consider that Shippers will have a varying ability to make use of the process for the 2011 AQ Review, with the effect that competition will be distorted in favour of those Shippers who are able to make system changes at short notice.

EDF Energy considers that were this proposal to be implemented in 2011, then it would create winners and losers amongst Shippers depending on whether they were able to replicate the system changes required to support this proposal. Those Shippers who were unable to implement this proposal would see an increase in their cost base, and the loss of a competitive advantage in the allocation of energy. As the SSP market is not corrected for energy allocation on the submission of meter readings, as the LSP market benefits from, this would represent a hit to the bottom line for those Shippers.

Standard Special Condition A11.1 (e): *so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers’ licences) are satisfied as respects the availability of gas to their domestic customers;*

Implementation would not be expected to better facilitate this relevant objective.

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

Implementation would not be expected to better facilitate this relevant objective.

4 The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

5 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) implications for operation of the System:

No implications for operation of the system have been identified.

b) development and capital cost and operating cost implications:

No costs have been identified other than those to be recovered through User Pays.

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

Additional costs would be recovered through User Pays as detailed above.

d) Analysis of the consequences (if any) this proposal would have on price

regulation:

No such consequence is anticipated.

6 The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

EDF Energy highlighted within their representation that currently the UNC does not place any limit on the amount of AQ amendments that Shippers can submit on any day. However, it is clear that the current systems do not support this activity. Implementation of this proposal will therefore reduce the Transporters contractual risk as the UNC will be modified to reflect an artificial constraint created by the systems.

7 The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

It is envisaged that there will be system impacts for Transporters, which are documented in the ROM. The impact on Users systems is unknown.

8 The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

Administrative and operational implications (including impact upon manual processes and procedures)

Users would have the ability to facilitate the opportunities presented by the proposal. However there will be no requirement for them to do so, but they may still be impacted by the introduction of a cap. Therefore the extent of the impact on individual Users is unknown.

Development and capital cost and operating cost implications

Users systems are expected to be impacted, although quantified cost estimates are not available. Increased rejection numbers are also expected as a result of removal of the referral, which may lead to Users employing additional resources to deal with rejections.

Consequence for the level of contractual risk of Users

The level of a User's contractual risk will be reduced by the introduction of this proposal, as Users will be able to amend AQs to be more accurate in relation to customer usage. However, if Users are unable to implement the change in line with the xoserve timetable, this could increase contractual risk for the User involved

relative to other Users since domestic AQs have demonstrated a downward trend in recent years.

9 The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

No such implications have been identified.

10 Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

The cost reflectivity would be improved.

11 Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- Addresses the inequitable nature of the AQ Review process, where an LSP can be amended by any value, whereas a SSP has a 20% tolerance (UNC Section G 1.6.4).

Disadvantages

- Shippers may need to take a view as to whether this Proposal will be implemented prior to the Ofgem decision being issued. This could lead to inappropriate behaviours.
- If all amendments are evenly implemented across all Shipper portfolios, the net change in costs could be zero.
- Gives validity to xoserve systems constraints.
- The short implementation lead time for shippers will mean that in year 1 some shippers are able to make use of the new process, whereas others are not.
- There is no visibility or control for shippers on how spare capacity will be treated and therefore, no guarantee the process will work equitably.

12 Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Representations were received from the following parties:

Organisation	Position
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British Gas	Not in Support
EDF Energy	Not in Support
E.ON UK	Supports
First Utility	Supports
National Grid Distribution	Comments
Northern Gas Networks	Comments
RWE npower	Supports
Scotia Gas Networks	Comments
Scottish Power	Supports
SSE	Supports
Wales & West Utilities	Not in Support

In Summary, of the eleven responses received, five representations supported implementation of the modification, three representations offered comments and three were not in support.

British Gas considers that implementation of this modification will both distort competition and unduly discriminate between Shippers in their ability to use the Annual Quantity (AQ) Review process. They believe that as the daily capacity limits are to be calculated from a Shippers' market share of Supply Points, a piece of information which bears no relation to the volume of AQ amendments they submit and those Shippers who currently submit more than their market share suggests, will be disadvantaged. They also consider that the inability of large Shippers such as themselves to submit AQ amendments early in the AQ Review window due to the sheer number of files and records to be processed, means that this modification will allow smaller Shippers to use the process more efficiently than others. They cannot accept this discrimination in application of the AQ Review process, and believe that it will inevitably distort competition in the Small Supply Point (SSP) sector in favour of those Shippers with smaller systems.

British Gas considers that by moving towards a process where many more AQs can be appealed, Shippers will be incentivised to cut back on the expensive business of obtaining regular meter readings, and simply rely instead on the annual AQ Review to manage their costs.

British Gas also express concern that the guidance notes for the process were only

agreed on 07 January 2011, which has not enabled Shippers to fully assess the impacts on their business and systems.

Although EDF Energy support the intent of this modification, they do not consider that it has been sufficiently developed to enable implementation by all Shippers. They have expressed concern particularly about the capacity allocation methodology, which will determine how any unutilised capacity in xoserve's system is made available to Shippers based on demand. They acknowledge that a suggested methodology has been developed but this does not form part of the proposal. EDF Energy also believe that further advice and views should be sought on the legality of stipulating a 17:00 hours cut off date for file submission, as this is not aligned with the UNC definition of a Business Day, and could have implications regarding code communications.

EDF Energy also highlight that they would require at least six months to undertake the required system changes and secure additional resources to support the manual processes and additional volumes associated with implementation of this proposal. They therefore do not support a 2011 implementation date, however they would support a 2012 implementation.

RWE npower considers a 2012 implementation date would be more appropriate, this would allow Shippers time to make necessary system and process changes, carry out any required testing and result in an equitable scenario for the industry.

However E.ON UK, Scottish Power and SSE prefer a 2011 implementation.

E.ON UK considers inaccurate AQs lead to increased requirement for reconciliation both in energy and transportation charge terms, resulting in increased unpredictability and hence increased risk. This is regardless of whether AQs subsequently prove to be too high or too low. They do not see this as simply a case for reducing costs to shippers but see it as helping to ensure that costs are allocated to the right parties.

E.ON UK felt the key to accurate AQs is more frequent meter reads and more frequent and up to date AQ calculation. The current xoserve AQ calculation takes place once per year and can only use the latest read available at the time. If shippers have subsequent reads then there seems to be little ground for objection to them being utilised subject to system capacity.

RWE Npower advises that Shippers/Suppliers are facing increasing costs to supply consumers due to commercial and regulatory factors. In this climate, it is important to take advantage of all methods of better aligning costs and revenue. This modification will help us to mitigate this risk by bringing AQs more in line with customer consumption. They state a preference for the Transporter business rules governing submission and capacity handling. They consider these are the most supportive of competition as they give market participants fair access to the capacity available.

National Grid Distribution (NGD) appreciate that Users may come into possession of more accurate and up-to-date Meter Readings particularly in the AQ Review period which could improve the accuracy of the derived AQ, however they have a concerns

that the root cause of inaccurate AQs may not be addressed by implementation of this modification in isolation.

They also felt there is a concern that this may provide an opportunity for Users to inappropriately reduce AQs by ensuring that the Relevant Metered Period utilised to determine the AQ at a Supply Point, is calculated based largely on a summer 'lower demand' period. However it will be noted that the effects of this in terms of 'skewing' the accuracy of the AQ are to a limited degree mitigated by the application of a Daily Adjustment Factor (DAF) and Annual Load Profile (ALP) in accordance with TPD Section H2.2.1.

NGD point out that TPD Section G1.6.4(b) identifies that AQ amendments should only be undertaken as a consequence of:

- incorrect Meter Readings (we interpret this as Meter Readings provided to the Transporter which are, despite User validation, submitted in error – for example as a consequence of digit transposition, etc), or
- Meter Readings procured before the User became registered to the relevant Supply Point, or
- incorrect Meter Asset details, Isolation, or the previous years AQ being 'rolled over'.

The UNC does not currently contemplate or indeed permit AQ amendment being undertaken as a consequence of more recent Meter Readings becoming available to the User (which we understand is a key driver for reducing the 20% value in this modification).

Northern Gas Networks (NGN) is expecting a significant increase in the quantity of AQ Amendments being submitted by shippers as a result of this modification. However, they highlight that the materiality in terms of energy has not been considered during the development of this modification. The impact on each individual SSP site is likely to be marginal, and as AQ Amendments should be submitted for both decreases and increases, there will be an element of netting out within any portfolio. While NGN is cognisant of the perceived benefits to shippers that the increased accuracy of AQs that this modification will deliver, they felt that this change to the tolerance level will only deliver benefit to shippers who can take immediate advantage of the reduced tolerance if implemented in time for the 2011 AQ Review. In subsequent years it would be anticipated that all parties would have in place amended processes to utilise the reduced tolerance, thereby having no impact. This eventual neutral position will have been achieved only by incurring implementation costs and increasing the workload of all parties to participate fully in the process.

Scotia Gas Networks would support a process, which would result in the calculation of more reflective Supply Point AQs, they recognise, that procedures already exist within the UNC to permit the provision of Supply Point meter readings, which permit and may result in the calculation of AQs in this manner. They further highlight that were all Users to participate in the submission of AQ amendments in the manner

required in terms of submitting both increases and decreases to the Provisional Annual Quantity, there is likely to be a minimal impact to the overall User's portfolio quantity.

Scottish Power advise the performance of the AQ Review Process is a time related event and as such modifications to enhance the process generally require to be implemented more urgently than other modifications. Indeed when Modification 624 (20% tolerance) was introduced, the lead time provided was only 6 weeks prior to the start of the AQ Review Process. All indications are that Ofgem will make an implementation decision on Modification 0292 at the earliest opportunity. With this in mind, there is the potential for there to be a period of approaching 4 months (Feb to May) implementation prior to the commencement of the AQ Review Process for 2011. ScottishPower believe in the circumstances that implementation is therefore achievable in time for this year's review

Wales & West Utilities are unconvinced that issues raised within the proposal lead to more Meter Points requiring to utilise the AQ amendment process. They explain that the AQ Review process uses optimal reads, which have been submitted by Users to the Transporters, for calculation of AQs. If AQs are reducing on an annual basis then this will be reflected in the AQ Review process if sufficient valid meter readings are submitted. They also highlight that the existing UNC regime requires Users to place equal importance on processing amendments that will increase or decrease the AQ. The proposal is only focused on 'overstated' AQ values and does not seem to follow this principle.

13 The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

14 The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence.

15 Programme for works required as a consequence of implementing the Modification Proposal

No programme for works has been identified.

16 Proposed implementation timetable (including timetable for any necessary information systems changes and detailing any potentially retrospective impacts)

It is recommended that this proposal be implemented as soon as possible after a decision from Ofgem.

17 Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

18 Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

19 Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas and Electricity Markets Authority in accordance with this report.

20 Text

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters