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Your Reference:UNC Modification Proposal 0473/0473A

UNC Modification Proposal 0473/0473A - Project Nexus – Allocation of Unidentified Gas

Dear Bob,

Thank you for your invitation seeking representations with respect to the above Modification Proposals. National Grid Gas Distribution (NGD) would like to support both Proposals.

Do you support or oppose implementation?

0473 Support

0473A Support

If either 0473 or 0473A were to be implemented, which would be your preference?

We have chosen not to express a preference.

Please summarise (in one paragraph) the key reason(s) for your support/opposition:

We are broadly supportive of both Modification Proposals on the basis that each identifies a sustainable mechanism to adjust the allocation of Unidentified Gas (UG) across product Classes involving use of an expert to determine the allocation of UG. As proposers of UNC Modification 0432 NGD were mindful of the industry's view, albeit identified late in the overall development of the gas settlement regime, that there was a need for intervention in the energy allocations. Therefore it was necessary for a 'default' throughput based solution to be incorporated within the 0432 settlement framework to ensure integrity of the arrangements pending identification of an appropriate model.

We note the differences between each Proposal and given the balanced nature of the 'pros' and 'cons' we have been unable to identify sufficient reason for us to express a clear preference. We have set out our reasons for this view within this representation.

Modification Panel Members have indicated that it would be particularly helpful if the following question(s) could be addressed in responses:

Q1: Please provide as much information and analysis to support your response, particularly any justification for why any particular class should, or should not, attract unidentified gas costs.

We have elected not to undertake analysis on the extent to which each product Class contributes to UG as we believe this to be the responsibility of the industry expert which would be appointed under each Modification Proposal. Essentially the allocation of UG has a direct financial impact on Shipper Users rather than Transporters who are neutral to such effects and we anticipate each such User would have undertaken, or may well find it beneficial to perform an analytical assessment of the impacts which might arise from implementation of each Modification Proposal.

Q2: We welcome views on the attribution of unidentified gas costs under these modifications to NTS direct-connected sites.

We would clarify that all references within the relevant UNC Modification 0432 legal text (which establishes the gas settlement principles) are to LDZ only: UG will be calculated by LDZ (unlike today's UG arrangements, which are national) and will be apportioned based on the AULOQ: the User's User Adjusted LDZ Offtake Quantity for the LDZ and the Day.

Since NTS Supply Points will not be assigned to an LDZ if they are connected from the NTS (even if they sit physically adjacent to LDZ sites), they will not count towards LDZ offtake and cannot be assigned any LDZ UG. NTS UG is a completely different process, where NTS bears the costs. Although relevant NTS and LDZ sites will both be Class 1, the reference to LDZ differentiates these sites into 2 sub-sets.

We have previously issued a written statement, setting out the above to the UNC Modification Panel and to the wider industry.

Are there any new or additional issues that you believe should be recorded in the Modification Report:

From the inception of Project Nexus NGD has been closely involved in development of the UNC regime which culminated in our raising of UNC Modification 0432 'Project Nexus – Gas Demand Estimation, Allocation, Settlement and Reconciliation reform'. At all stages of Modification development, while identifying that the Nexus energy allocation arrangements provide significantly greater transparency and granularity of information across the gas market, it was always recognised by parties that they do not remove the propensity for UG to exist

Consequently as part of preparation of the Business Requirements Documents (BRDs) which formed the foundation of Modification 0432, the matter of allocation of UG was considered by the relevant Workgroup. At an early stage it was generally understood that UG could be equitably allocated across all Shipper portfolios and that no intervention by an expert, as is presently the case under the Allocation of Unidentified Gas Expert (AUGE) arrangements, was necessary. However, as development proceeded, parties determined that this view was premature and that on reflection intervention in UG allocation would be beneficial and essential. This culminated in the raising of Modification Proposal 0473 and subsequently after a period of time, the alternative Modification Proposal 0473A.

It is important to note that in the event of non-implementation of either Modification Proposal the integrity of the UNC legal text as identified under Modification 0432 would not be compromised¹ and implementation can proceed under the planned timescales.

Relevant Objectives:

Standard Special Condition A11.1 (d): Securing of effective competition between relevant Shippers and relevant Suppliers.

NGD's opinion is that both Modifications facilitate relevant objective (d). We believe an informed, objective and considered approach whereby UG allocations to the relevant product Classes can be apportioned as accurately as possible enables costs to be targeted appropriately to relevant sources of those costs. Improved cost targeting can be expected to be consistent with this relevant objective.

We note that the Modification Proposals are alternates; i.e. that both cannot be implemented concurrently.

Enduring solution

Both Modification Proposals feature the appointment of an allocation expert whose purpose would be to undertake various investigative and analytical activities. These would lead (or may lead in the case of Modification Proposal 0473A) to the production of a methodology and statement which may or may not propose changes to the UG allocation factors. The principal difference in the Modification Proposals is that under Proposal 0473 an 'Allocation of Unidentified Gas Expert' (AUGE) would each year produce a statement whereas, under Proposal 0473A, an 'Unidentified Gas Industry Expert' (UGIE) would in the first year undertake analysis and review activity which may or may not lead to intervention in the 'default' allocations identified in Modification 0432 (which provides that each factor across each Class is set to 1). Subsequent to this step, the UGIE would perform an essentially similar role to that of the AUGE in Modification Proposal 0473 if the Expert determined that a set of different factors would improve cost reflectivity.

Other than the process time delay to production of the first statement, with respect to the enduring solution we are not minded to express a preference with respect to either Modification Proposal. We can see merit in the more analytical, considered approach identified within Modification Proposal 0473A, particularly as we anticipate the proposed Performance Assurance regime would hopefully be embedded and contribute positively to data quality and transparency. Conversely, with respect to Modification Proposal 0473 we do not believe there is any fundamental reason why an appropriately skilled industry expert may not proceed at an early stage in identifying allocations to each product Class given that the nature and structure of the regime is clear albeit that the extent of likely User portfolio 'take up' or Supply Point 'spread' in each product Class is unknown.

Transitional elements

Both Modification Proposals feature so called 'transitional' arrangements. We note that the essential differences between the two Modification Proposals are:

0473: For a minimum of 18 months, the solution uses a table populated by predetermined allocation factors across each product Class.

0473A: For a minimum of 24 months, applies the 'directly measured' components of UG to the most recent AUGE table prior to Modification implementation to the specific market sectors associated with

¹ <http://www.gasgovernance.co.uk/E1.1.6> refers

them (rather than the specific product Classes). All other 'non-measured' UG components distributed to all Classes are via the Modification 0432 methodology.

As with the proposed enduring arrangements, the arguments for and against each 'transitional' solution are finely balanced. For Modification Proposal 0473 we observe the principle is that until the new allocation factors are identified, the 'status quo' should be applied (i.e. approximating to the allocations prevailing prior to implementation of Project Nexus). This is notwithstanding that the Project Nexus arrangements are based on 4 distinct product Classes as opposed to the prevailing Daily Metered (DM)/Larger Supply Point (LSP), Smaller Supply Point (SSP) Non-Daily Metered (NDM) definitions. Conversely, Modification Proposal 0473A is predicated on the balance of UG not identified to a specific source by the existing AUGE being allocated on an equitable basis to all product Classes as per the Modification 0432 'throughput based' UG allocation methodology.

Under Modification 0432 the new Project Nexus product Classes are defined in UNC as DM/NDM². Classes 1 and 2 are DM and 3 and 4 are NDM. The principal difference in settlement arrangements is that all energy is individually reconciled. Consequently, provided there is a satisfactory level of Meter Reading performance, over time the total volume of UG should be largely transparent.

One perspective of Modification Proposal 0473 is the principle that as the AUGE has not been appointed and established in the transition period it would be inappropriate to seek to change the prevailing allocation methodology given that there is no apparent analytical basis for doing this. Furthermore, advocates of this Proposal might argue that, given that an expert is not intervening in UG allocations in the transition period, it would be inappropriate to seek to replace such with a new or revised allocation across product Classes as these would not have been determined by an industry expert.

However, proponents of Modification Proposal 0473A may alternatively argue that where the sources of UG are unknown the only fair and logical conclusion is that energy allocations should be equitably attributed across all product Classes. This would be on the basis that the new allocation, settlement and reconciliation arrangements differ markedly from the present regime and therefore it would be inappropriate to seek to 'carry over' existing allocation factors.

Having considered the above, our conclusion is that in the transitional period pertaining to both Modifications, as with the enduring solution described above we are not persuaded that there is a clear reason or sufficient evidence as to why the solution in Modification Proposal 0473 facilitates relevant objective (d) any better than the solution in Modification Proposal 0473A or vice versa.

Ultimately this will be a matter for Ofgem to consider and determine upon.

Impacts and Costs:

NGD concurs with the proposal for treatment of costs as set out in the Draft Modification Report.

Implementation:

We note the statement in the Draft Modification Report that implementation of either Modification Proposal as soon as possible after an authority decision to do so would be beneficial. Notwithstanding this it is important to note that Modification 0432 is not due for implementation until 1st October 2015. However, if either Modification Proposal were implemented in line with the Modification 0432 implementation timescales, there would be nothing in UNC until the Project Nexus Implementation Date, being 1st October 2015 to place an obligation on GTs to appoint an AUGE/UGIE.

² UNC TPD A4.3

We are advised by our agent, Xoserve that implementation of Modification Proposal 0473A would require an offline adjustment process and supporting offline system to enable calculation of the required adjustments which would apply within the proposed transition period. It is important to note that this is not within the scope of the Project Nexus requirements and consequently the solution would not be delivered until sometime after the Project Nexus Implementation. It is anticipated that the impact of this is that the invoice adjustments envisaged by Modification Proposal 0473A would not be issued until such time as the relevant systems and processes are in place and consequently it is expected that there would be some delay in Shipper Users receiving relevant invoice charges.

Legal Text:

NGD has a number of concerns regarding the accuracy of Legal Text as published by the Joint Office and the extent to which it meets the requirements of both Modification Proposals. We have identified these below:

TPD Section E

9.1.1(f) refers to the AUG Year starting in April. We have scrutinised that latest proposed AUG Guidelines and noting that while not specific, the timetable appears to be leading up to the AUG Year commencing on 1st October, as the final Table is required to be published by 1st July.

9.4.1(d) the reference to the Methodology being modified in all years after the first year may not be consistent with the fact that the first year is using a Transition arrangement? In the second year there would not be a previous Methodology to modify.

9.4.2(c)(iii) there are two semi-colons at the end of the sentence "where: (iii) AF is the allocation factor;,"

Annex E1. In the table it is unclear whether Unidentified Gas Source should be one of the columns as the new arrangements have a single Allocation Factor. UG cannot be broken down by sources on any given day.

Transition Document 1.7.14 the cross-reference should be to paragraph 8.3 in the AUGE document, as there is no 9.3 in the latest version.

Also in Transition, there is a reference to the date of effectiveness of the first Table. It is unclear whether the AUGE Document or the legal text actually specifies when the Table would be effective, there's just mention of it being published on July 1st.

For the 0473A text in addition to some of the comments referred to above, the following should also be considered:

General: We note this text is incomplete and includes square brackets in a number of places.

There are several references in the text to 'Project Nexus Go Live Date'. This is the incorrect defined terms and should be 'Project Nexus Implementation Date' as identified in the Mod 0432 text GTC Paragraph 1.

9.4.1(d) subsequent years as above

Transition Document 1.1 our view is that it is inappropriate and unnecessary to refer to a specific contract or name non-UNC parties in UNC. Also the current Table is not a table of factors.

Transition 1.1(d) doesn't make sense as worded

Transition 1.2 we are concerned that Transporters would be obliged to comply with a clause which compels them to appoint a UG Expert no later than Project Nexus implementation. This does not contemplate circumstances where the Modification is approved at a late stage.

Transition 1.4 appears to be a circular reference at present.

Is there anything further you wish to be taken into account?

It is assumed that the principal driver for allocation of UG to product Classes must be the propensity for the relevant Supply Point Class to be a root cause of UG.

Mindful of the above, there is a perspective from some parties that Class 1 and 2 sites should not attract a UG allocation (and indeed it is the case under the present AUGE arrangements that UG has not yet been found to be attributable to DM Supply Points) on the basis that they are read daily and therefore UG sources such as gas theft are less likely to occur.

One of the main benefits of the Project Nexus regime due to be implemented by Modification 0432 is that it provides the ability for many more DM Supply Points to exist than is presently the case (albeit noting that the DME 'elective' provisions under the present UNC arrangements, while facilitating a large scale DM opportunity, have to date not been adopted by Shipper Users). If there is a large 'take up' of Class 2 sites then it can be reasonably assumed that the accuracy of gas settlement and allocation under the UNC is improved and opportunities arising from the use of Automatic Meter Reading (AMR) or Smart Metering equipment are maximised. It could be argued that this leads to more accurate targeting of costs which is ultimately better for gas consumers and by definition facilitates relevant objective (d).

Given this premise then a contractual solution which advocates a low allocation of UG to Class 1 and 2 Supply Points could be deemed to be a form of incentive for Shipper Users to reclassify Supply Points to these classes thus avoiding all of or a proportion of UG charges.

However, a counter view is that all product Classes should bear a fair and equitable proportion of UG and it would be inappropriate for Users to be able to avoid UG by simply reclassifying Supply Points to product Class 2. In an extreme scenario, if there were to be a large scale movement of Supply Points to product Class 2 then this could lead to a wholly disproportionate allocation of UG to Class 3 and 4 Supply Points. Furthermore, this could run counter to the principle that it may be more efficient for a Shipper User to make greater use of the product Class 3 facility (which enables daily reads to be procured albeit submitted to the Transporters periodically as opposed to daily).

We believe the above may be worthy of consideration in determining the most appropriate solution.

We trust that this information will assist in the compilation of the Final Modification Report.

Please contact me on 01926 653541 (chris.warner@nationalgrid.com) should you require any further information.

Yours sincerely,

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