



Corona Energy Response to consultation on UNC modifications 442 and 442A

22 February 2013

Introduction

1. Corona Energy (CE) welcomes this chance to participate in the consultation on UNC modifications 0442 and 0442A. The matters addressed by these modifications are critically important to our business. As a smaller company than those proposing the modifications CE is far less able to mitigate the uncertainty that would be introduced by these modifications or to adjust to the mid-year changes proposed by them. We are strongly opposed to these modifications.

Key considerations

2. At the outset Corona would like to articulate a number of factors that must shape decision making relating to the AUG process:
 - a. The AUG process controls the flow of tens of millions of pounds across the industry.
 - b. AUG costs form a critical role in the pricing of customer contracts and in Shippers' financial planning.
 - c. Shippers need certainty over AUG costs for a twelve month period in order to ensure that customer contracts are appropriate over the full duration of those contracts.
 - d. Certainty over the AUG costs over a twelve month period is therefore critical to the mitigation of financial risk both to customers and Shippers.
 - e. The AUG process has a clearly defined set of processes to deal with a range of eventualities.
 - f. These processes were determined after a long and thorough process of consideration by the industry and the regulator.
 - g. Any uncertainty over AUG costs, or mid-year fluctuation in those costs, will have a more significant impact on Suppliers that do not have access to a large domestic portfolio that can absorb those costs.
 - h. The UNC is a contract between Transporters and Shippers. In any contract, certainty of terms is critical. While the parties to the contract accept that the UNC change process will alter the terms, it is expected that critical clauses relating to key cost sensitive processes will not be altered at short notice or retrospectively in unpredictable ways.

Adherence to the AUG Rules and the UNC

3. The AUG process was formulated after a long process of discussion, debate, consideration and deliberation amongst industry participants and with Ofgem. This process took place with full



observation of the UNC change processes. The culmination of this process was the insertion of para 10 into the UNC Transportation Principles Document (TPD) at Section E.

4. UNC Section E para 10.4.4 (b) states that the AUG Methodology and AUG Table shall be binding for the purposes of the Code.
5. Para 10.4.3 of Section E of the UNC TPD sets out at a high-level the procedure to be followed by the AUG Expert. Importantly, the UNC states that para 10.4.3 is subject to the timetable set out in the Allocation of Unidentified Gas Document and sub-para 10.4.3 (g) is clear that “such steps set in the AUG Document shall be taken in relation to the AUG Table, following which the AUG Expert shall submit a final AUG Table to the Committee.”
6. The Allocation of Unidentified Gas Document at para 9.5 clearly prescribes a course of action should the AUG not produce volumes: “If, for whatever reason, the AUGS does not produce volumes, The Committee will meet as soon as possible and to [sic] either decide by unanimous vote to apply volumes that The Committee decides as appropriate or to roll over any previous Unidentified Gas volumes from a Previous Year.” Clause 9.5 is, therefore, clear that there are two choices for the “The Committee” (the UNC Network Code Committee) in the event that there are no volumes produced in the AUGS: one, apply the volumes that The Committee decides are appropriate; and two, roll over the previous years’ volumes.
7. In this provision there is absolutely no role created for the UNC Change Processes in such a scenario, nor is there any scope for The Committee, or any other entity for that matter, to alter the timetable associated with the AUG process or the setting of the AUG figures. Therefore, para 9.5 of the Allocation of Unidentified Gas Document, coupled with the express statement in para 14.4.4 (b) that the AUG Methodology is binding for the purposes of the code, shows that the use of UNC changes processes to change the AUG methodology at an advanced stage of the AUG process for the upcoming AUG Year is completely inappropriate.
8. The AUG process was established to provide a clear figure for unallocated gas that every Shipper could factor into its decisions over a 12 month period. Providing a single figure for unallocated gas over a 12 month period is intended to create the certainty that Shippers require in order to provide customers with the certainty that they want and need over a twelve month period. If Shippers wanted a more variable regime with more frequent changes to the AUG costs they would have created one when the AUG process was initially established.
9. This year the AUG process experienced some significant problems relating to its attempts updating its methodology used for allocating Unidentified Gas. Throughout the process the AUG encountered a number of obstacles that have contributed to it failing to create a robust methodology within the established timescales of the AUG process. Because of this, the AUG decided that instead of using an untested and unproven methodology to allocate material and irreversible Unallocated Gas costs, it would revert to the previously used and proven methodology, as is envisaged by para 9.5 of the AUG Guidelines Document.

10. The AUGE's independence, and close adherence to its agreed-upon rules and procedures, is critical to achieving its goals of allocating Unidentified Gas, free from industry pressures. Moreover, a clearly defined and respected AUGE process underpins the central aim of the UNC as a contract seeking to provide all parties in the market with the certainty that they require to operate in that market. Ensuring the AUGE maintains its independence and adherence to its procedures is therefore critical to achieving the aim of facilitating effective competition across the market.

Retrospective nature of the changes proposed in the modification

11. Ofgem has stated in official guidance that “retrospective modifications should be avoided as they undermine market confidence”.¹ It is clear that these modifications will not pass through the full UNC changes processes and the required Ofgem consideration and determination in advance of the date that the new AUG figures are supposed to apply from (1 April 2012) or in advance of the UNC Network Code Committee making its decisions on the AUG figures for 2013-2014. The key decisions that the modifications' impact will therefore be in the past by the time the modifications have passed. The changes to the AUG processes proposed by these modification will therefore apply retrospectively.
12. Both any retrospective change to AUG decision making resulting from the modifications and the *possibility* of such retrospective change that the modifications would introduce – altering the previously set AUG figures – will introduce significant market instability and will undermine market confidence – as Ofgem anticipate would happen.

Industry reliance on the AUG procedures being followed

13. The AUGE process makes provision for consultation with industry at appropriate stages during which industry parties may provide feedback. These formal arrangements create a procedural legitimate expectation (in a public law sense) and contractual reliance, across industry participants that the defined processes will be followed at all times and that they will not be subject to ad-hoc or last minute alterations through UNC change processes.
14. The options for “The Committee” set out in the AUGE guidelines document at paragraph 9.5 also creates a substantive legitimate expectation as to the nature of the figures that the AUG process will generate. As set out above the Committee will either determine a set of figures or rollover the previous year's: there is no scope for a decision to be made that there will be changes to the AUG figures midway through the AUG Year.
15. The AUG Year is clearly defined in UNC TPD section E 10.1.1 (i) as the twelve month period from April 1 each year. To allow a mid-year change to the AUGE figures would conflict with and undermine the definition of the “AUG Year” in the UNC. Individual Shippers and participants across the industry set up systems and processes to respond to a change in AUGE

¹ **Ofgem Guidance on Code Modification Urgency Criteria**
(<http://www.gasgovernance.co.uk/sites/default/files/Ofgem%20Guidance%20on%20Code%20Modification%20Urgency%20Criteria.pdf>)



figures on April 1 and to then work with that set of figures for the following 12 month period. In other words a large number of processes depend on the AUG Year remaining as per the definition in the UNC. To alter the AUG Year to allow mid-year alterations would therefore have a large number of knock-on ramifications across industry. This could cause a great deal of disruption across Shippers, Suppliers, Transporters and crucially customers.

16. Introducing the changes proposed by the modification will cause short notice changes in costs, which are very difficult for industry parties to manage and subsequently factored into their businesses models. It is, for example, difficult to factor in unallocated gas costs to a 12 month supply contract when the level of those costs is not known. This may lead to significant pecuniary and reputational loss for a number of market participants.
17. Any contract currently under negotiation may have to include a risk premium in order to factor in the potential impact of the changes proposed in the modifications. They will have to continue to include such a risk premium until these mods are rejected. If, on the other hand, the mods were to be approved by Ofgem, such a risk premium may have to remain in place until a change, if any, was to be made to the unallocated gas costs during the course of the AUGE Year 2012-2013. Such a situation is not acceptable.
18. The AUGE processes do not and should not involve the UNC modification process midway through an iteration of the AUGE's work with respect to an upcoming AUG Year. If parties wish to seek to change the AUG process for future iterations of the AUGE's work it may be arguable that they should be allowed to do so. However, it seems entirely inappropriate to allow UNC parties to make changes through modifications to a process that will have run its full course and generated the unallocated gas figures by the time the modifications can be implemented.
19. It is clear that these modifications have been launched because the proposing parties simply do not like the figures that the AUGE is to recommend. These parties had ample opportunity to amend the AUG processes at some previous date long before the AUGE had advanced so far with its processes for the 2013-14 AUG Year.

Impacts of allowing Mod 442 or 442A to succeed

20. To allow such modifications to succeed would incentivise others to forward modifications seeking to make short notice changes to both the AUG process and other key industry processes simply in order to reduce the cost of such processes to them. The impact would be both uncertainty across the market and an unwelcome clogging of UNC change processes.
21. It will have been with these considerations in mind that the UNC was drafted to explicitly state, as explained above, that the AUG Methodology and Guidelines Document are binding on all parties.
22. To allow these modifications to alter the timetable and agreed AUGE methodology would breach the legitimate expectation, and contractual commitment, that the processes clearly

defined in the AUG Document would be followed by all parties in determining the final AUG figures.

23. Shippers have collectively pushed in recent years to reduce the variability and volatility of non-gas costs across the industry. It was with this in mind that Ofgem made its recent decisions on volatility which introduced increased information requirements and a time lag in how certain costs feed into transportation charges. Both of these modifications, by proposing mid-year changes to unallocated gas costs will have the contrary impact. They increase uncertainty by creating the possibility of an as yet unknown mid-year change in unallocated gas costs. The option of rolling over last year's costs would, on the other hand, significantly reduce uncertainty as industry is used to dealing with that set of figures and understands what they mean for individual shippers, customers and other players in the industry. Moreover, any such figures would provide certainty over the full 12 month duration of the AUG Year.
24. Industry has had a good-deal of advanced notice as to the possibility of last year's figures being rolled over given that the AUG Guidelines Document states this clearly as an option and that the AUG has made it known for a number of months that doing so was a likely eventuality.
25. The proposers draw attention to the extra cost that may fall on the Small Supply Point (SSP) sector if a mid-year change is not implemented. They further argue that a key argument for the institution of the AUG process in the first place was to ensure that the SSP sector was not asked to cover a disproportionate amount of the unallocated gas costs.
26. We agree that the introduction of the AUG was a necessary step to ensure that the SSP sector was not unfairly or unduly burdened. Having recognised this shortcoming in how the costs of unallocated gas were met, the AUG process was drawn up to reallocate the costs properly. Having formulated these rules they must be adhered to. While it is understandable that some Shippers with large SSP portfolios are not happy with the rules being properly applied, the prospect of greater costs than may otherwise be the case for the SSP sector cannot be adequate justification for an ad-hoc change to the AUG rules very late into the process that will significantly destabilise the activities of every Shipper in the market and lead to significant detriment for their customers.
27. We are also concerned that the process for these proposals, for which urgent status was rejected by Ofgem, has been subject to a shortened development phase with two short notice meetings on a Friday followed by exceptional modification panel meetings convened the following working day. The abbreviated process for this modification is particularly unfair on smaller industry parties, who do not have the level of resource to adequately deal with it at such short notice.

Conclusion

28. For the reasons set out above we are strongly opposed to the implementation of these modifications.



29. CE is happy to discuss any of the points made in this response or any related matter.
Please email regulations@coronaenergy.com to discuss any of the points made.