

Modification proposal:	Uniform Network Code (UNC) 442 and 442A: Amendment to the implementation date of the Allocation of Unidentified Gas Statement (AUGS) for the 2013/14 AUG Year		
Decision:	The Authority ¹ has decided to reject both of these proposals ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	21 March 2013	Implementation date:	N/A

Background to the modification proposal

Reconciliation by Difference ('RbD') is the method of reconciling the difference between the initially allocated (estimated) measurements of gas and actual (metered) consumption. RbD was introduced in 1998 in order to facilitate competition in the Smaller Supply Point ('SSP') sector, as at the time it was not considered practical or economically efficient to individually reconcile all such supply points (which number in excess of 20 million) based on actual meter readings.

Once the metered consumption at Daily Metered and Larger Supply Points ('LSPs') sector is taken from the amount of gas known to have been put into a given Local Distribution Zone ('LDZ'), the remainder is allocated across the SSP sector based upon the Annual Quantity ('AQ') of each supply point. The AQ is an estimate of annual consumption based upon historic meter readings received by the Gas Transporter ('GT').

RbD was established to manage errors in the allocation of gas to shippers in the SSP market, to the extent that the residual amount of gas may differ from the initial SSP allocation. Such differences may be caused by issues such as theft, unregistered sites, erroneous meter readings, etc. Any gas that cannot be directly attributed to a shipper is known as Unidentified Gas.

The costs of Unidentified Gas were previously smeared across all shippers operating in the SSP market; no volumes were attributed to the LSP sector. This was considered to be an inequitable process; a point acknowledged by Ofgem in its decision on UNC115³. Further to our decision on UNC115 several modification proposals were raised which sought to allocate a proportion of the costs of unidentified gas to LSP shippers, culminating in the implementation of UNC229⁴ in June 2010.

UNC229 established the principle of an independent Allocation of Unidentified Gas Expert ('AUGE') who would be tasked with the production of an evidence based methodology for the allocation of costs each year. This allocation would be set out in an Allocation of Unidentified Gas Statement ('AUGS') Table to be produced once the methodology had been accepted by the Uniform Network Code Committee ('UNCC'). These procedures and the associated timelines are set out in an AUGE Guidance Document⁵.

The AUGE informed the UNCC in May 2012 that it was working towards a revised methodology for the 2013/14 AUGE year that would take greater account of available data on consumption and theft than its previous RbD-based methodology. It was noted

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of Gas and Electricity Markets.

² This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ [UNC115: 'Correct apportionment of NDM error'](#)

⁴ [UNC229: 'Mechanism for Correct Apportionment of Unidentified Gas'](#)

⁵ www.gasgovernance.co.uk/sites/default/files/AUGE%20Guidelines%20v3.1%20approved.pdf

that the extended scope of work may necessitate an extension to the anticipated timetable⁶.

Throughout 2012 the AUGE corresponded⁷ with the UNCC advising it of progress towards delivering its revised methodology, with the UNCC agreeing to deviate from the timetable set out in the Guidelines Document.

On 11 December 2012 the AUGE wrote to the UNCC⁸ advising it of operational issues that compromised its ability to meet the deadline for production of the final AUGS. The AUGE set out three options:

1. reduce the consultation period from that previously advised, allowing the AUGS to be published at the end of January 2013 for UNCC approval in February 2013;
2. UNCC to approve the new AUGS in March 2013; or
3. roll forward the previous year's approach (RbD based methodology).

The UNCC subsequently met on 20 December 2012 and indicated⁹ its non-binding preference that the prevailing methodology should be carried over for the 2013/14 'AUGE year', which runs from 1 April 2013. Although the AUGE is not bound by the UNCC vote, in its further letter of 28 December 2012¹⁰ it indicated that given the outcome of that vote it would be unlikely that its proposed methodology would be approved for implementation on 1 April 2013. The AUGE therefore considered that it had no option but to carry over the figures from 2011.

The modification proposal

UNC442

UNC442 would require the AUGE to submit its methodology to the UNCC meeting of 21 March 2013 for approval. The methodology would be considered approved unless the UNCC unanimously supported a change to it, which would then be adopted immediately by the AUGE. There would be no option for the UNCC to reject the methodology in its entirety, or to conduct a further consultation.

This proposal was initially raised with a request that it follow an urgent timetable. That request for urgency was subsequently rejected as we were of the view that it could be progressed in a timely manner through the normal modification process¹¹.

UNC442A

This alternative proposal seeks to introduce the same methodology as UNC442, though the proposer based the timescales on the dates referenced in the AUGE letter of 8 January 2013¹². It was therefore proposed that the AUGE would issue its methodology on 12 March 2013. The subsequent dates were intended by the proposer to be flexible in order to allow for more consultation if necessary, but nonetheless sought for the AUG Table to be published by 1 June 2013 and implemented two calendar months later.

⁶ www.gasgovernance.co.uk/sites/default/files/Minutes%20UNCC%2091%20V2.2.pdf

⁷ www.gasgovernance.co.uk/auge/comms2

⁸ See: www.gasgovernance.co.uk/sites/default/files/2012%20AUGS%202013_14%20UNCC%20Letter%2011122012.pdf

⁹ See: www.gasgovernance.co.uk/sites/default/files/Minutes%20UNCC%2099%20v1.pdf

¹⁰ See: www.gasgovernance.co.uk/sites/default/files/AUGS%20Table%202012%2028122012.pdf

¹¹ See: www.gasgovernance.co.uk/sites/default/files/Ofgem%20decision%20on%20urgency%20for%20UNC442%20REJECT.pdf

¹² See: www.gasgovernance.co.uk/sites/default/files/AUGS%20timescales%20update%2008012013.pdf

UNC Panel¹³ recommendation

At the UNC Panel meeting held on 28 February 2013, UNC442 received four votes in favour of implementation, while only three were in favour of UNC442A. Therefore, neither proposal attracted the majority support required to recommend implementation.

The Authority's decision

The Authority has considered its statutory duties and functions in reaching its decision. The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 28 February 2013. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR¹⁴. The Authority has concluded that implementation of either of the modification proposals will not better facilitate the achievement of the relevant objectives of the UNC¹⁵.

Reasons for Authority decision

Following receipt of the FMR on UNC442 and UNC442A we have been in direct contact with the AUGE to establish whether the dates set out in the proposals could be achieved. The AUGE suggested that it had not been consulted upon the dates and that UNC442A was based on a misunderstanding of what it had committed to in its 8 January letter¹⁶. In particular, the AUGE suggested that it had committed to no more than to publish the responses to its own consultation on 12 March 2013. That consultation had closed out on 1 March 2013. The AUGE further confirmed that it would not be possible to issue a revised methodology by 12 March 2013. Given that the prescribed dates in UNC442A could not be met by the AUGE and have now passed, we consider UNC442A to have lapsed and that we are therefore unable to give it further consideration.

However, it was not immediately clear to us whether the later dates set out in UNC442 could be met. Further conversations and correspondence with the AUGE have now confirmed that it will not be able to complete its work on the revised methodology by 21 March 2013 if it is to give full consideration to the issues raised in response to its consultation. The AUGE has suggested that some of these points may result in changes that could significantly change the effect of its methodology.

We note that while UNC442 allows for the prevailing rules set out in Section E10 of the UNC to be disapplied and replaced with the suggested rules set out in the the legal text, the methodology to be submitted remains at the discretion of the AUGE. The AUGE has suggested that if UNC442 was to be implemented, notwithstanding that it is not itself bound by the UNC, it could meet the proposed dates by submitting the December 2012 version of the methodology. It is also possible that, consistent with its view set out in the 28 December 2012 letter, the AUGE could simply re-submit the prevailing RbD based methodology in preference to one that remains incomplete.

¹³ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

¹⁴ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

¹⁵ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: <http://epr.ofgem.gov.uk/EPRFiles/Gas%20Transporter%20Standard%20Licence%20Conditions%20-%2010-11-2011%20-%20Current%20Version.pdf>

¹⁶ www.gasgovernance.co.uk/sites/default/files/AUGS%20timescales%20update%2008012013.pdf

Notwithstanding the procedural concerns with UNC442 set out above, to the extent it may be capable of implementation in some form we have given due consideration to that proposal against the relevant objectives. We note that the proposer, respondents and the UNC panel focused on the potential impacts of UNC442 upon effective competition and agree that it is most appropriately assessed against relevant objective d). We consider it would be neutral upon the other objectives.

Relevant Objective d) – the securing of effective competition between relevant shippers

The majority of respondents considered that this proposal would have an impact upon effective competition. However, views were divided on whether this would be a positive or a negative impact. It is notable that shipper views were divided between the LSP and predominantly SSP shippers.

In considering whether a revision should be made to both the AUG methodology and the AUG table outside of the anticipated timescales, a balance must be struck between the improved accuracy that may result from that revision and the increased uncertainty and risk that may be created. This risk is compounded if the notice periods do not give sufficient notice for shippers to react appropriately to their allocation of cost, for instance by factoring them into their tariffs or planning to absorb them.

Accuracy

We welcome the work of the AUGE in developing a more accurate and equitable methodology for the allocation of costs associated with previously unidentified gas. From the UNCC minutes there seems to be a consensus that the approach currently being developed by the AUGE will be more accurate than the prevailing RbD-based methodology. However, in the absence of a final methodology that rigourously addresses all of the issues raised in the recent consultation, we cannot conclude whether it would be a more accurate and equitable allocation of costs. We are also concerned that the proposed timetable and rules to be adopted under UNC442 would restrict the ability of the UNCC to effectively consider the methodology and inhibit it from conducting any further work or consultation upon it.

We further consider that it is premature to assess the scale of this cost redistribution and whether it is therefore justified to give them effect part way through the AUG year rather than await the usual 1 April effective date.

Certainty

The value placed upon the independent expert is in part contingent upon it meeting the industry's expectations over the transparency and timeliness of its process, as well as the accuracy and rigour of its findings. We therefore sympathise with the concerns raised by some shippers that a relatively small delay in the AUGE's delivery of the revised methodology may result in the benefits of that revised approach being delayed for a whole year.

However, as noted above the AUGE's work on this revised methodology will not be completed in time for it to submit it to the UNCC meeting on 21 March. In order to meet the dates set out in UNC442 the AUGE may therefore be required to submit the version it first circulated in December 2012. It is clear from the responses to the AUGE's recent consultation¹⁷ and its acknowledgment of certain points within those responses that the December version contains a number of issues including potential errors that remain to

¹⁷ see: www.gasgovernance.co.uk/auge/comms2

be resolved. We understand that the AUGE will work through these issues and expects to complete its revision around the end of April 2013.

It is possible that the implementation of UNC442 would bring into effect a revised methodology which is almost immediately superseded by a further version. This would not only undermine its credibility but create uncertainty while the relevant parties anticipate a further change to the level of allocated costs. We acknowledge the concerns of those respondents who suggested that allowing the implementation of either of these modification proposals could undermine the independence of the AUGE and the degree of acceptance of its findings. This prospect of iterative and countervailing modification proposals was one of the reasons we decided to accept UNC229 over the competing proposals. Whilst both UNC442 and UNC442A were raised on procedural grounds rather than questioning the values placed in the AUG table, they would have the similar effect of replacing a methodology that the AUGE considers should be carried over for 2013/14 in favour of one which some shippers consider to be more favourable.

Distributional effects

Although the change in methodology *may* result in a significant change to the distribution of AUGE costs, the AUGE itself has been keen to play down the reliance that is being placed on the provisional numbers it presented to the UNCC in late 2012. It is possible that the final AUGE table will be substantially different. However, we consider that whichever end of the likely range the number ends up being, it will be a small proportion of the shippers overall energy costs. Given that shippers typically purchase gas 12-24 months ahead it is not clear what, if any, impact the AUGE's final figures may have upon tariffs for 2013/14. We therefore share the concern of those respondents who suggested that these proposals may potentially result in a windfall gain (or loss) for shippers.

While the AUG methodology and table remain incomplete we are unable to conclude whether early implementation of that methodology and table would offset the detrimental impacts to competition caused by increased uncertainty. In order to be more confident that the benefits of bringing forward the effective date of the revised methodology would offset the increased uncertainty and risk, we would also want to see more information from shippers on the extent to which, and when, this change would be reflected in tariffs.

Further issues

We consider that the development of the methodology for the 2013/14 AUG year has unearthed a number of shortcomings with the existing process. It is extremely disappointing that despite the deadlines for implementation of a revised 2013/14 AUG methodology and Table being well known and the risks of missing those deadlines being signalled well in advance, adequate contingencies were not put in place. We would encourage the UNCC to conduct a lessons learnt exercise at the soonest practical opportunity, in order to give interested parties greater confidence in the rigour of the process and more specifically to ensure that such delays cannot be repeated in future years.

Colin Sausman
Partner, Retail Markets and Research

Signed on behalf of the Authority and authorised for that purpose.