

Stage 02: Workgroup Report

0388:

Fixed parameters for determining Shipper contribution to Unidentified Gas

This modification proposes to move to fixed annual gas price and market share for determining Shipper contribution to Unidentified Gas.



The Workgroup recommends that this modification should now proceed to Consultation



High Impact:
Shippers



Medium Impact:
Customers



Low Impact:
Transporters

What stage is this document in the process?

01

Proposal

02

Workgroup Report

03

Draft Modification Report

04

Final Modification Report

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Workgroup Report

05 August 2011

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About this document:

The purpose of this report is make a recommendation to the Panel, to be held on 18 August 2011, on whether Modification 0388 is sufficiently developed to proceed to the Consultation Phase and to submit any further recommendations in respect of the definition and assessment of this modification.



3 Any questions?

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1 Summary

Is this a Self Governance Modification

The Panel determined Self Governance procedures were not appropriate for this modification.

Why Change?

The AUGÉ process will determine a fixed quantity of Unidentified Gas that is attributable to the LSP NDM sector, but the resulting financial calculation will use varying monthly SAP and market shares. This has resulted in suppliers having difficulty in pricing the Unidentified Gas adjustment into their market offerings, increasing uncertainty and risk to shippers and making it difficult to pass the costs through to LSP NDM customers.

Solution

To remove this uncertainty it is proposed to:

- Replace the rolling SAP calculation with a fixed annual reference price created using industry prices.
- Replace the rolling market sector volume calculation for the LSP NDM and DM sector with an annual market sector volume calculation as of 1st October.
- Make consequential adjustments to the SSP NDM Unidentified Gas process to ensure that all of the resulting credit from the LSP NDM and DM sectors is passed through to the SSP NDM sector.

For the avoidance of doubt individual shipper market shares would not be fixed for the year and individual shipper contributions would still vary proportionally on a monthly basis.

With these two parameters fixed it will be possible for shippers to create a fixed p/kWh charge for their DM and LSP NDM customers that can be applied to a LSP NDM customer's contract.

Impacts & Costs

The resulting process will be simpler to administer for both the transporters and shippers, in particular removing the need to undertake reconciliation of Unidentified Gas costs contained in pass through supply contracts. There will also be less uncertainty to shippers on what the financial impact of the Unidentified Gas process will be. This will reduce costs to customers as no additional risk premiums will need to be built into prices. Finally, the Unidentified Gas cost will be readily transparent to customers, ensuring straight forward pass through to LSP NDM customers.

In terms of implementation costs, it is not considered there would be any material change in costs associated with this modification, as it proposes a replacement of rolling variables with fixed parameters. If Xoserve indicate that any costs are involved, however, these should be met by those organisations that benefit from this change and should be targeted at the LSP NDM and DM sectors through the User Pays mechanism.

Some Workgroup members consider that as a consequence of SAP being removed from the UAG calculation, results in price risk being passed from LSP Shippers to SSP Shippers. Under this modification LSP Shippers will be able to fix a variable cost and any risk due to a variation in SAP is passed onto SSP Shippers. This risk is in addition to the usual risks faced by the RbD market. The Proposer believes that this will sometimes result in windfall profits for SSP shippers if LSP shippers pay for UAG above the SAP price.

Implementation

In order to avoid duplicated costs from varying parameters applying for a period and then fixed parameters, and to give shippers time to incorporate the new processes into their contracts, the proposer considers that this modification should be implemented in time to allow the new calculation methodology to be used in determining the estimated rates to be published by 1st November 2011.

The Workgroup recognises that implementation would be beneficial sooner to avoid additional system development costs should Ofgem direct implementation of the modification.

The Case for Change

This modification will remove uncertainty in the current process, reducing overall risk to customers and promoting transparency.

Some Workgroup members consider that as a consequence of SAP being removed from the UAG calculation, results in price risk being passed from LSP Shippers to SSP Shippers. Under this modification LSP Shippers will be able to fix a variable cost and any risk due to a variation in SAP is passed onto SSP Shippers. This risk is in addition to the usual risks faced by the RbD market. The Proposer believes that this will sometimes result in windfall profits for SSP shippers if LSP shippers pay for UAG above the SAP price.

Recommendations

The Workgroup considers that the modification is sufficiently developed and should now proceed to the Consultation Phase.

2 Why Change?

By the end of September, the AUGE will determine a fixed amount of Unidentified Gas attributable to the DM and LSP NDM sectors. This volume of gas will then be converted into a financial amount using a rolling averaged SAP for the applicable reconciliation period. As shown in section 3 below, this SAP value can vary significantly (for example in 2009-2010 it varied from 32p/th to over 60 p/th). The total market sector volume will also vary for each reconciliation period, though to a much lesser extent.

The variability of these two factors means it is difficult for shippers to determine a unit price for Unidentified Gas to be passed onto DM or LSP NDM customers. For customers supplied on the basis of contracts, which allow for the pass through of transportation costs this will mean that an initial estimate will need to be corrected over time as the actual Unidentified Gas charges become known. This is considered to affect a significant proportion of LSP customers (the proposer believes it impacts in excess of 75% of its LSP NDM customers). This results in significant additional risk and uncertainty for such customers, as well as significant costs for shippers in administering this reconciliation. More generally, this uncertainty also has a detrimental impact on DM or LSP NDM customers who do not operate on pass-through contracts as the current unpredictability makes it difficult for the financial cost to be accurately priced.

3 Solution

High Level Solution

It is proposed that the rolling monthly calculations of Unidentified Gas price and LSP NDM and DM SPC Class volumes are instead replaced with an annual process, undertaken after the AUGE has finalised the Unidentified Gas Quantity, but before the transporters have published the indicative unit rates (i.e. between October and November each year). These fixed volumes would be used for the forthcoming AUGE Year (i.e. starting from the following April). **For the avoidance of doubt individual Shipper market shares would not be fixed for the year and individual Shipper contributions would vary proportionally on a monthly basis in line with changes to their portfolio.**

The net effect of fixing these parameters would be to create a unit rate which will correspond to the debits shippers will receive (though we recognise that the detailed process the transporters operate does not involve applying a unit rate to the AQ of a shipper's portfolio). This unit rate would be published by the transporters in accordance with section 9 of the AUGE guidelines.

Proposed Unidentified Gas Changes

The changes needed to achieve this new process are threefold

- Use a commonly available forward reference price instead of a rolling average SAP calculated after the reconciliation period has concluded.
- Fix each market sector volume for LSP NDM & DM market sectors at the 1st October, rather than using a rolling monthly market volume.
- Consequential Change to the redistribution process for SSP NDM market sector.

Reference Price

At present, in order to convert an individual Shipper's Unidentified Gas Quantity into a financial value it is multiplied by the System Average Price, averaged over the previous reconciliation billing period.

It is proposed to replace this rolling average price with an average price derived from the forward prices published by ICIS Heren, specifically the daily average closing prices over the month of August for the 4 quarters for the period commencing 1st April of the following year as published by ICIS. (termed "Unidentified Gas Price"). In the event that prices are not available from ICIS, then we propose that the Transporters would be required to source a suitable alternative set of published information. It is further proposed that the AUGS should specify the source used for this calculation.

It is our view that ICIS Heren prices give a comparable value to rolling average SAP over the course of the year. To illustrate this a comparison of these prices with historic SAP prices for 2010-11 is shown below:

ICIS Heren Prices (p/th)					Rolling SAP prices (p/th)		
Date	Q2-10	Q3-10	Q4-10	Q1-11	Month Av	Quarter Av	
03/08/09	41.87	41.22	55.05	62.40	30/04/10	32.76	
04/08/09	42.06	41.40	55.49	62.68	31/05/10	39.82	
05/08/09	41.92	41.3	55.36	62.55	30/06/10	41.85	38.14
06/08/09	43.50	42.83	56.75	63.95	31/07/10	46.30	
07/08/09	42.90	42.19	56.41	63.50	31/08/10	42.90	
10/08/09	43.07	42.51	56.65	63.88	30/09/10	40.56	43.26
11/08/09	42.75	42.13	56.1	63.3	31/10/10	45.51	
12/08/09	42.69	42.06	56.22	63.26	30/11/10	49.50	
13/08/09	43.26	42.63	57.04	64.12	31/12/10	61.77	52.26
14/08/09	42.83	42.2	56.29	63.67	31/01/11	56.27	
17/08/09	41.95	41.23	55.19	62.22	28/02/11	53.83	
18/08/09	41.83	41.2	55.22	63.31	31/03/11	60.50	56.87
19/08/09	41.92	41.31	55.43	62.59	Average	47.63	
20/08/09	40.88	40.28	54.79	61.63			
21/08/09	40.04	39.56	54.08	61.44			
24/08/09	38.95	38.48	53.43	60.69			
25/08/09	38.08	38.31	53.21	60.49			
26/08/09	37.95	37.49	52.80	60.06			
27/08/09	37.58	37.23	52.82	59.98			
28/08/09	38.06	37.65	53.23	60.33			
Average Price				49.81			

As referenced in section 2 above, this information highlights the variability in rolling SAP over the course of the year.

Market Sector Volume

The current process determines an individual Shipper's share of total Unidentified Gas volume by dividing the Shipper's aggregate AQ for that sector by the total market volume for that sector for that month.

It is proposed for the LSP NDM and DM sectors that the total market volume is fixed for the forthcoming AUGE year by aggregating all AQs for each qualifying site in each SPC Class on 1 October each year. Each month, each Shipper's current aggregate AQ for the LSP NDM and DM sectors would be divided by the appropriate fixed market volume. Thus for each month, a User's percentage share of that AQ would be calculated, and that percentage would be their share of the Unidentified Gas to be apportioned for that month.

Redistribution of Unidentified Gas Amounts

The current Unidentified Gas process ensures that any resulting debits that are due from the LSP NDM and DM sectors are mirrored as corresponding credits to the SSP NDM market sector.

By fixing the market sector volumes for the LSP NDM and DM sectors, it will be necessary to make consequential amendments to the Unidentified Gas process to

ensure that all debits received from the LSP NDM sector are passed onto the SSP NDM sector.

It is proposed that the current process of determining each Shipper's SSP NDM market share is maintained (i.e. a shipper's SSP NDM market share for each reconciliation billing period is divided by the sum of the AQs for that sector for that month in order to give each SSP Shipper's proportional market share), but this market share will be used to determine the proportion of revenue from the LSP NDM sector that is redistributed to each shipper.

Worked Example

In order to illustrate the impact of these proposed changes on Unidentified Gas, and to assist in clarifying the intent of this modification, a worked example is provided:

Parameters

Whatfield Country Gas – supplier that concentrates exclusively on mid-size non-domestic customer (i.e. supplies LSP NDM customers only)

Hadleigh Energy – supplier that concentrates exclusively on small domestic properties (i.e. SSP NDM customers only)

Unidentified Gas LSP NDM Market	= 500 million KWh
Unidentified Gas DM Market	= 0 KWh (so ignored for this process)
Average ICIS Heren Forward Price	= 43.40 p/th (1.48 p/kWh)

April 2011

Whatfield Gas Portfolio Size	= 1 GWh
1 st October LSP NDM market	= 100 GWh
Current LSP NDM market (April 2011)	= 100 GWh

Whatfield Gas UG Cost for April	= Proportion of LSP NDM Market * Unidentified Gas volume/12 * ICIS Heren Forward Price = (1/100)* (500million/12)*1.48p/th = £6,166.67
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Total LSP NDM UG charges for April	= £616,666.67 (sum over 100 GWh)
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Hadleigh Town Energy Portfolio Size	= 10 GWh
Total LSP NDM portfolio (for April 2011)	= 1000 GWh
Hadleigh Energy UG Credit April	= Proportion of SSP NDM Market * Total LSP NDM UG charges for April = (10/1000)* £616,666.67 = £6,166.67

November 2011

Whatfield Gas Portfolio Size	= 2 GWh
1 st October LSP NDM market	= 100 GWh
Current LSP NDM market (November 2011)	= 105 GWh

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Whatfield Gas UG Cost for November	= Proportion of LSP NDM Market Unidentified Gas volume/12 * ICIS Heren Forward Price = $(2/100) * (500\text{million}/12) * 1.48\text{p/th}$ = £12,333.34
Total LSP NDM UG charges for November	= £647,500.35 (sum over 105 GWh)
Hadleigh Town Energy Portfolio Size	= 20 GWh
Total LSP NDM portfolio (for November 2011)	= 1100 GWh
Hadleigh Energy UG Credit November	= Proportion of SSP NDM Market * Total LSP NDM UG charges November = $(20/1100) * £647,500.35$ = £11,772.73

4 Relevant Objectives

Implementation is expected to better facilitate the achievement of **Relevant Objective d.**

Proposer's view of the benefits 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	None

Relevant Objective (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.

Fixing the parameters used to determine the apportionment of Unidentified Gas will allow a unit rate to be created that LSP shippers can apply to their own portfolio. This will provide certainty to LSP customers with regard to the Unidentified Gas costs they will be charged in pass through contracts and will reduce potentially substantial shipper costs by avoiding reconciliation of estimated pass through costs. The administrative and bad debt costs avoided will be significant (the proposer estimates for its portfolio alone the cost saving will be around £100,000 a year). The increased certainty would also mean that shippers may adopt lower risk premiums. Reducing administrative and bad debt costs will improve competition between shippers.

Some Workgroup members consider the modification has detrimental impact on competition as it passes price risk from LSP shippers to SSP Shippers leading to inappropriate allocation of risk, by removing SAP prices from the LSP UAG calculation.

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The Proposer believes that when SAP prices are lower than the UAG price paid by LSP shippers, then SSP shippers will receive a higher payment than the SAP price. Conversely SSP Shippers, will receive a lower payment when the UAG price paid by LSP Shippers is lower than the SAP price paid by SSP Shippers.

5 Impacts and Costs

Costs

The Workgroup did not consider the development costs of this modification will significantly increase the overall costs for the implementation of Modification 0229. However, a ROM is required to understand the costing.

Indicative industry costs – User Pays	
Classification of the proposal as User Pays or not and justification for classification	
This change will alter the transporter agent’s processes and is likely to result in some change in costs, so should be classified as User Pays.	
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification	
This proposal will primarily benefit shippers with LSP NDM customers and it is therefore proposed that any cost should be aimed at that market sector.	
Proposed charge(s) for application of Users Pays charges to Shippers	
To be completed once an indication of costs is received from Xoserve.	
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve	
To be completed once an indication of costs is received from Xoserve.	

Impacts

Impact on Transporters’ Systems and Process	
Transporters’ System/Process	Potential impact
UK Link	None
Operational Processes	Some changes to the Unidentified Gas process have been identified (see section 3 for details).

User Pays implications	To be confirmed – see above
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Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	Users will be able to price Unidentified Gas charges into their products with greater certainty, so reducing risk costs. It will also reduce administrative costs as there will no longer be a need to reconcile Unidentified Gas costs for those parties with pass through contracts.
Development, capital and operating costs	None
Contractual risks	<p>Unidentified Cost charge variability will be removed for LSP NDM customers. This makes any cost pass through more predictable so reducing the risk of non-payment. It was also remove a barrier to customer switching as retrospective charges will not need to apply to such customers.</p> <p>Some Workgroup members consider as a consequence of SAP being removed from the UAG calculation, results in price risk being passed from LSP Shippers to SSP Shippers. Under this modification LSP Shippers will be able to fix a variable cost and any risk due to a variation in SAP is passed onto SSP Shippers. This would result in a higher risk premium or a higher cost for SSP customers if SSP Shippers decided to hedge this risk.</p>
Legislative, regulatory and contractual obligations and relationships	None

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:

www.gasgovernance.co.uk/sites/default/files/0565.zip

Impact on Transporters	
Area of Transporters' business	Potential 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	<p>Moving to a fixed parameter will simplify the administration undertaken by the Transporter's agent when administering the AUGE process, in particular when determining the indicative unit rate in accordance with Section of the AUGE process.</p> <p>Consideration should be given to the provision of data should ICIS Heren be removed, changed or unavailable for publication.</p>

Impact on Code	
Code section	Potential impact
TPD E10.5	Change to Unidentified Gas Amount apportionment calculations.

Impact on UNC Related Documents and Other Referenced Documents

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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
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

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

Other Impacts	
Item impacted	Potential impact
Security of Supply	None
Operation of the Total System	None
Industry fragmentation	None

<p>Terminal operators, consumers, connected system operators, suppliers, producers and other non code parties</p>	<p>The potential volatility in the Unidentified Gas charge apportionment process will be removed, so ensuring that gas costs will be more predictable and reducing the exposure LSP consumers have through their suppliers to volatile price variations.</p> <p>Some Workgroup members consider as a consequence of SAP being removed from the UAG calculation, results in price risk being passed from LSP Shippers to SSP Shippers. Under this modification LSP Shippers will be able to fix a variable cost and any risk due to a variation in SAP is passed onto SSP Shippers. This would result in a higher risk premium or a higher cost for SSP customers if SSP Shippers decided to hedge this risk.</p>
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6 Implementation

To allow sufficient time for the new fixed unit rate to be taken into account by suppliers for the start of the reallocation process in April 2012, the indicative rates need to be published by the transporters in November 2011. In accordance with the UNC Modification Rules Paragraph 6.2.1, the Workgroup therefore suggest the following:

- An implementation date of 1 October if an authority decision is received by 30 September.
- If no decision has been received by 30 September, an implementation date of 1 November if an authority decision is received by 31 October.
- If no decision has been received 31 October, then implementation will be one day after the authority decision has been received.

7 The Case for Change

Advantages

- Greater Transparency of the impact of Unidentified Gas on customers with pass through contracts.
- Reduction in bad debt risk on Unidentified Gas costs, reducing costs for LSP Shippers.
- Enables straight forward pass through of UAG costs to LSP NDM customers by fixing the parameters. However, some Workgroup members consider straight forward pass through of costs is possible with the current methodology.

Disadvantages

- Provides a free hedge for LSP shippers against UAG price movement at a cost to SSP Shippers.
- Some Workgroup members consider as a consequence of SAP being removed from the UAG calculation, results in price risk being passed from LSP Shippers to SSP Shippers. Under this modification LSP Shippers will be able to fix a variable cost and any risk due to a variation in SAP is passed onto SSP Shippers.

8 Legal Text

The Transporters have been requested to provide legal text in support of this modification.

9 Recommendation

The Workgroup invites the Panel to:

- AGREE that Modification 0388 be submitted for consultation without the provision of legal text due to the proposed implementation timescales.