

Draft Modification Report
Correct Apportionment of NDM Error
Modification Reference Number 0115/0115A

Version 1.0

This Draft Modification Report is made pursuant to Rule 9.1 of the Modification Rules and follows the format required under Rule 9.4

1 The Modification Proposal

UNC Proposal 0115:

Following presentation of the Reconciliation by Difference (RbD) verification information to the RbD Sub-Group in 2006, it became apparent that significant quantities of unreconciled energy exist at any time.

The indication given in the RbD verification presentation was that this has resulted in an over-allocation of as much as 3% of Smaller Supply Point (SSP) demand, which equates to an average of 540kwh per MPRN per year in recent Gas years. The composition of this over allocation derives from a number of sources including, but not limited to, unregistered sites, shipperless sites, undiscovered theft, AQ errors, deeming errors etc.

Whilst it is the case that some of this unreconciled energy is of a transient nature (AQ and deeming error for example), which will be corrected once meter point reconciliation has been completed within the Large Supply Point (LSP) market, a significant portion of this error relates to errors which are common across Non Daily Metered (NDM) supply points.

Under the existing arrangements for allocation of energy the burden of these errors, and the corresponding costs, are borne entirely by the Smaller Supply Point (SSP) market through RbD.

Notwithstanding that some element of this unreconciled energy is transient, owing to the interval between reconciliation and the quantities involved the proposer believes that it is appropriate for this to be managed within all the relevant supply point categories rather than being borne solely by the Smaller Supply Point market. It also follows that the non-specific error should also be spread equitably across both LSP and SSP markets.

By definition Daily Metered (DM) Supply Points are outside this process and the daily allocation of energy to these consumers is clear. Although there is reconciliation applied to DM Supply Points following annual check reads, these are generally of low materiality.

For clarity, it is considered that supply points with Automated Meter Reading (AMR) facilities should also be included within this Settlement exposure.

This Modification Proposal would require Transporters, through their common agency, to utilise existing RbD processes to charge the SSP market as usual. The following month, the smear would be re-allocated across all NDM Supply Points, charging the LSP element and the equal and opposite SSP element on the following

months online reconciliation invoice.

Proportions used in this allocation would not be adjusted by subsequent energy reconciliation's.

It is proposed that all energy charged under the revised arrangements detailed within this modification proposal, would be charged at the same rate across all market sectors, with the proposed rate to be used being the current SSP charge. This solution to charging provides consistency with the application of charges under the existing Mod640 mechanism and ensures that all market sectors receive equal treatment.

Further to discussions undertaken with xoserve during the development of this proposal, it is proposed that the invoicing solution that would be required to deliver the aims of this modification proposal, would be achieved by the utilisation of an offline invoicing system. This solution would utilise the current ad-hoc invoicing mechanisms and would not provide a significant impact upon systems, processes or procedures and therefore would be relatively straightforward to implement.

To ensure a clean transition from the current arrangements to those proposed within this modification proposal, it is recommended that a hard landing approach be taken to the implementation of this proposal. This would mean that the application of any subsequent debits or credits, calculated post the date of implementation of this proposal, would be applied to all Users and across market sectors under the terms of the new arrangements.

Consequences of not implementing this Proposal

By not implementing this proposal an inappropriate cross subsidy of costs will continue to exist across market sectors and between market participants with significant quantities of energy continuing to be allocated to the Smaller Supply Point Sector incorrectly which primarily comprises Domestic Supply Points.

Alternate UNC Proposal 0115A:

UNC Modification Proposal 0115 "Correct apportionment of NDM error" raised by British Gas Trading (BGT), proposes to apportion the costs of unreconciled energy, currently borne by Small Supply Points only, across all Non Daily Metered (NDM) Supply Points. The proposal by BGT is based on the assumption that all NDM market sectors should receive equal treatment with regard to unreconciled energy. Gaz de France ESS does not believe this to be an appropriate, proportionate or cost reflective solution.

Gaz de France ESS, as an alternative, proposes that unreconciled energy be apportioned only to the supply points where the unreconciled energy is likely to have arisen. Specifically, this proposal seeks to extend the apportionment of unreconciled energy to all non-monthly read meters in the NDM sector. For the avoidance of doubt, Daily Metered Supply Points and Monthly Read Meters as determined in UNC TPD Section M 3.1.7b are excluded from the scope of this proposal.

b) Transportation Pricing for unreconciled energy

This modification proposal differs to the original proposal in that it seeks to apply a banded transportation charge which mirrors the normal prices set for transportation charges in a particular sector.

| Market Sector | Normal Transportation Price (by LDZ) | Unreconciled Energy Transportation Price (by LDZ) |
|---|---|--|
| Small Supply Points <73,200kWh | Price (a) | Price (a) |
| Larger Supply Points (non-monthly) 73,200kWh to 293,000kWh | Price (b) | Price (b) |

Under the original proposal raised by British Gas Trading all supply points would pay a single price (price (a) in the above example) for the transportation charge element associated with unreconciled energy. Larger Supply Points (LSP) would thus face a disproportionately high transportation charge (up to 3.5 times) relative to normal charging arrangements.

This alternative modification proposal better aligns with Transporter’s Charging Methodology Objectives and removes an element of contractual risk between suppliers and customers in the Industrial and Commercial market. Transportation charges associated with unreconciled energy will be the same as the prevailing transportation charges for non-monthly read Large Supply Points.

Evidence supporting this proposal

The key components which comprise unreconciled energy which have been cited within the original proposal are unregistered sites, shipperless sites, undiscovered theft, AQ errors and deeming errors. Many of these are transient in nature and in the view of Gaz de France ESS inappropriate to apply to Monthly Read Meters. Our evidence to support this is proposal detailed below.

Theft of Gas

Table 1 below (source: Xoserve) shows reported theft of gas figures for the Large Supply Point (LSP) and Small Supply Point (SSP) markets in 2006. If these figures are to be used as a proxy for unreported theft of gas, this data illustrates that an insignificant amount of energy is taken from the LSP sector (1% by number of thefts, 8% by volume). Moreover there is an established process for reclaiming energy for theft of gas within the Industrial and Commercial sector (Theft of Gas Code of Practice) and so there are no perverse incentives that exist in this sector. In the SSP sector however, theft of gas is smeared across all RbD participants therefore the incentive to detect theft of gas is lessened, if not completely removed.

The pre-sales process and billing process inherent within the Industrial and Commercial community generally and monthly read market in particular; compares actual usage against predicted sales profiles and previous usage makes any theft of gas easily detectable and immediately apparent. Furthermore, the ethical behaviour demonstrated by business customers generally makes theft of gas in this sector unlikely and the economic consequences for both shipper and culprit are high.

Although not part of this proposal, should theft of gas be found to be an escalating problem, it may be appropriate to initiate a separate incentive scheme developed for theft of gas which relates to all suppliers. Actual detected theft could be matched against a target, based on a supplier's portfolio and appropriate credits/debits issued subsequently to incentivise market participants on a self governance basis.

Table 1 (Source: Xoserve)

**Theft Of Gas Figures for I&C and Domestic Sites
 2006**

| | LSP | % | SSP | % | Total |
|-----------------------------------|------------|----------|------------|----------|--------------|
| No. of valid thefts & Kwh claimed | 17 | 1.23% | 1,362 | 98.77% | 1,379 |
| Kwh Claimed | 2,804,453 | 8.57% | 29,916,071 | 91.43% | 32,720,524 |
| Average for 12 months | 164,968 | | 21,965 | | 23,511 |

Unreconciled Energy (Delay Risk)

Table 2a below illustrates a typical read performance (as demonstrated at Distribution Workstream in March) of a shipper to the Industrial and Commercial market across a monthly read portfolio in 2006. This illustrates that actual read performance is consistently around 98-99% each month, leaving an insignificant amount of energy to roll over into the RbD sector each month. In any case, any rollover of energy into the RbD sector is of a temporary nature as the must read timescale for monthly read meters is restricted to four months only.

Table 2a (Source: Gaz de France ESS)

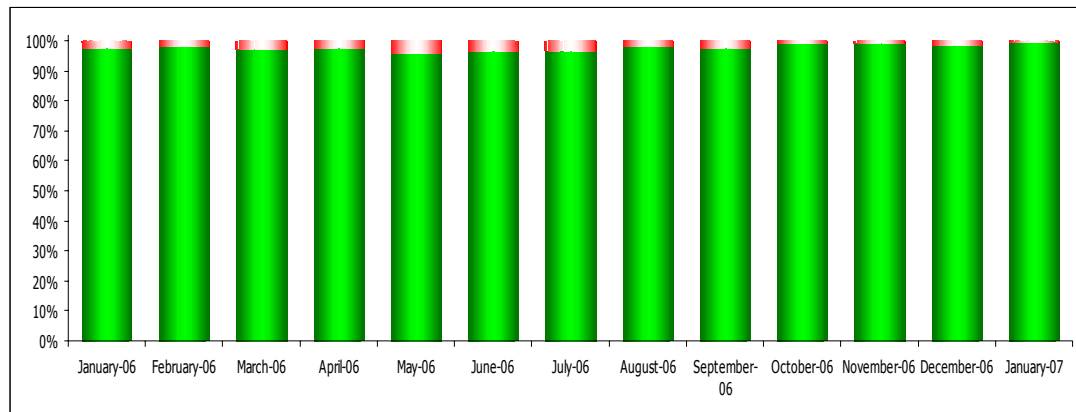
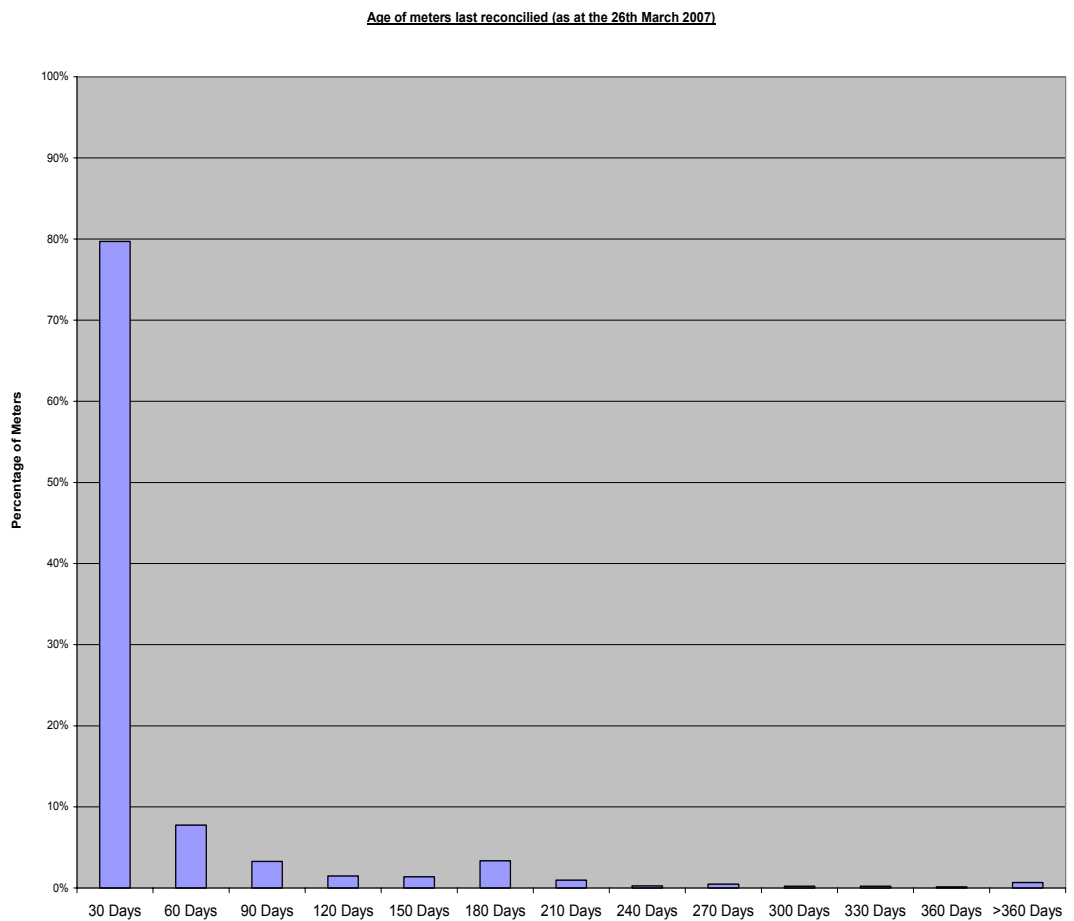


Table 2b below illustrates the read performance of a typical (as demonstrated at Distribution Workstream in March) Industrial and Commercial shipper across its monthly read portfolio and shows the decay in number of days since it's meters were last read. Clearly, the number of meter points where reconciliation is greater than 90 days is minimal and causes little disruption to unreconciled energy in the RbD sector. Again, this demonstrates the insignificant and temporary nature of any contribution to unreconciled energy, and typically by its' very nature this energy tends towards a net zero as negative reconciliation on some sites offsets positive reconciliations on others.

Table 2b (Source: Gaz de France ESS)



Shipperless sites

The issue of shipperless sites is not prevalent in the monthly read LSP sector. Here, supplier pre and post contract processes coupled with customer billing checks clearly identify any missing sites across a portfolio; indeed it is common for there to be specific roles within Industrial and Commercial supply companies to trap and correct such errors in portfolio reconciliation.

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

Standard Special Condition A11.1 (a): *the pipe-line system to which this licence relates;*

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

Standard Special Condition A11.1 (b): *so far as is consistent with sub-paragraph (a), the 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;*

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;*

The alternative modification proposal 0115A proposes a two tier transportation price for LDZ commodity and as such reflects the costs incurred by transporters in their transportation business.

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;*

Some believe implementation of Modification Proposal 0115 would further this relevant objective by introducing a more equitable and accurate allocation of energy and transportation charges across all market sectors and Users, which are currently borne entirely by SSP shippers. Others believe that the allocation would be less equitable and accurate than the existing approach because of the greater control in the I&C sector. Any improvement in the appropriateness of allocation of these charges would, however, improve cost reflectivity and so facilitate the securing of effective competition between relevant shippers and between relevant suppliers.

Implementation of Modification Proposal 0115A would further this relevant objective by introducing a more equitable and accurate allocation of energy and transportation charges to the market segments most likely to cause costs relating to unreconciled energy. Some believe the evidence shows that the main component parts that make up unreconciled energy i.e. theft of gas, delay in LSP reconciliation and meter errors are not present or are insignificant when related to Monthly Read Large Supply Points. Any attempt to smear costs to this segment would therefore artificially inflate costs and hence prices to consumers in this segment and create a cross-subsidy between market segments. This cross subsidy of energy charges would be unduly onerous on those suppliers who are solely active in the Industrial and

Commercial market and this uncertainty will most likely result in suppliers increasing risk premiums and hence costs to consumers.

Proposal 0115A also more closely aligns the calculation of transportation charges to the non-monthly read NDM Large Supply Point segment to normal transportation charges. Allocating charges in this manner avoids creating a cross-subsidy effect which would be detrimental to competition in the Industrial and Commercial market. Any such cross-subsidy of transportation charges would be unduly onerous on those suppliers who are solely active in the Industrial and Commercial market and increases uncertainty and may add costs to consumers.

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.

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

Implementation of either Modification Proposal is not expected to have any effect on security of supply, operation of the Total System, or industry fragmentation.

4 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 development and capital cost and operating cost implications have been quantified, although xoserve believe there would be some.

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

It is proposed that cost recovery should be through the established price control review process.

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

No consequence for price regulation has been identified.

5 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

No such consequence is anticipated.

Some believe Proposal 0115A improves the contractual risk for gas transporters over and above the original proposal as the transportation price mechanism more closely aligns to the transporters' charging methodology principles.

6 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

A system impact assessment would need to be undertaken by xoserve to ascertain the extent of any changes required. However it is believed there will be minimal impact to systems if an offline solution is implemented.

7 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)

It is not expected that there will be any changes to relevant users' operational processes and procedures, as this solution would utilise the current ad-hoc invoicing mechanisms. However, additional invoices would need to be processed and reconciled, increasing costs. Pricing systems would also need to be developed to accommodate this new element.

Development and capital cost and operating cost implications

No such costs have been identified.

Consequence for the level of contractual risk of Users

I&C Shippers would face increased contractual risk since unknown costs would be faced. This would be reflected in operational risk and be built into prices.

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

I&C customers would face higher charges because of the higher costs faced and additional risk factor, but there would be a corresponding reduction in exposure for RBD Shippers which would be expected to lead to reduced prices.

Some believe Proposal 0115A better attributes costs to the relevant market sector where costs are likely to have been created (polluter pays principle). This better protects consumers in the Industrial and Commercial sector against a cross-subsidy effect.

9 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

Some believe Proposal 0115A improves the regulatory obligation of Transporters to comply with Gas Transporters Licence Standard Special Condition in respect to transportation charging over and above that of Modification Proposal 0115.

Standard Special Condition A5 states that Relevant Methodology Objectives should achieve the following:

- a) That compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its' transportation business;
- b) That so far as is consistent with sub-paragraph a), the charging methodology properly takes account of developments in the transportation business;
- c) That so far as is consistent with sub-paragraph a), compliance with the charging methodology facilitates effective competition between gas suppliers and between gas shippers.

A separate charging structure for Small Supply Points and Large Supply Points better meets the above criteria. Under proposal 0115A the costs are apportioned more consistently to normal charges and better reflect the costs incurred by Transporters.

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

Advantages/Disadvantages 0115

- Whether the impacts are advantages or disadvantages depends on the extent of the change implemented, where some believe that the revised proposals allocate too much to the LSP Sector and hence create disadvantages whereas others believe the change is in the right direction and so create advantages.
- Changes the allocation of energy through the reconciliation process.
- Provides arrangements, where costs are not solely borne by SSP Shippers.
- Ensures that going forward all market sectors are treated equally.

- Provides a platform where one market sector does not bear any more risk or reward than another.
- Changes the incentives which may be prevalent in the current arrangements.
- Provides consistent application of smeared reconciliation energy across all market sectors.
- Aligns application of charging methodology to that utilised as part of the Mod640 reconciliation process, although the rate may be inappropriate for the LSP sector.

Advantages/Disadvantages 0115A

- Targets the costs of unreconciled energy to the correct market segments
- Complies with Transporters Charging Methodology Objectives
- Applies fair and equitable transportation charges relating to unreconciled energy to relevant market segments

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

Written Representations are now sought in respect of this Draft Report.

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

No such requirement has been identified.

13 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

No such requirement has been identified.

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

No programme for works has been developed.

15 Proposed implementation timetable (including timetable for any necessary information systems changes)

A reasonable timescale should be allowed to enable suppliers to the I&C market to make changes to their supply contract terms and sufficient lead time to allow a true

reflection of costs and risks when negotiating forward contracts with customers. It is proposed that the UK Link Committee should seek to agree an appropriate implementation timescale following direction by the Authority.

16 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.

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

18. Transporter's Proposal

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

19. Text

Representations are now sought in respect of this Draft Report and prior to the Transporters finalising the Report.

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters