Joint Office of Gas Transporters

UNC Modification	At what stage is this document in the process?

UNC 0622:

Correct allocation of Shrinkage Error as identified by the AUGE

01 Modification
02 Workgroup Report
03 Draft Modification Report
04 Final Modification Report

Purpose of Modification:

It is proposed to remove the cross-subsidy that currently exists where shippers pay for shrinkage error losses via Unidentified Gas (UIG) costs, by continuing the corrective payments process that existed prior to Project Nexus that corrected for UIG costs being recovered solely from the SSP sector.

The Proposer recommends that this modification should be:

- considered a material change and not subject to self-governance
- assessed by a Workgroup

This modification will be presented by the Proposer to the Panel on 15 June 2017 The Panel will consider the Proposer's recommendation and determine the appropriate route.

High Impact:

DNO Users, Shippers

Medium Impact:

Suppliers

Low Impact:

Customers

Joint Office of Gas Transporters

Contents

Timetable

The Proposer recommends the following timetable:	
Initial consideration by Workgroup	22 June 2017
Amended Modification considered by Workgroup	27 July 2017
Workgroup Report presented to Panel	17 August 2017
Draft Modification Report issued for consultation	17 August 2017
Consultation Close-out for representations	07 September 2017
Final Modification Report available for Panel	21 September 2017
Modification Panel decision	21 September 2017

Any questions?

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1 Summary

What

The AUGE has determined a substantial shrinkage error which is currently being allocated to Shippers via Unidentified Gas, resulting in a misallocation of costs between DNO Users and Shippers.

Why

Shrinkage error costs should be allocated directly to DNO Users as they have the ability to tackle the sources of shrinkage error and so reduce costs to the wider industry from midstream losses.

How

In the absence of the shrinkage model being updated to take into account the AUGE's findings, it is proposed to utilise for the 2017/18 Gas Year the table published by the AUGE on 12 May. It is further proposed to continue to use the solution implemented by UNC Modification 0229, where the DNO Users pay a corrective invoice to relevant shippers to cover the costs of the shrinkage error incorrectly allocated to the shipper community.

2 Governance

Justification for Authority Direction

This modification will have a material impact on Shippers and DNO Users and so should be sent to the authority for decision because it seeks to correctly apportion material (500 GWh) shrinkage costs that are being allocated to Shippers, as identified by the AUGE and communicated to the industry on 12 May 2017.

Requested Next Steps

This modification should:

- be considered a material change and not subject to self-governance
- be sent to Workgroup for a short review

Whilst this modification does not justify urgency status, it is important that the mechanism to rectify this error is put in place before the AUGE statement is finalised so that Shippers can accurately price for customer contract beginning October 2017. We also believe that the modification is straightforward and uses an established precedent set out in UNC Modification 0229 and so do not consider that further detailed development is required. However, we believe a short Work Group review may be beneficial. Questions regarding adjustment to the allowed revenue to cover the revised costs are not in scope of this proposal and should be assessed outside of the UNC as part of the price control framework.

3 Why Change?

Since its inception in 2011, one of the potential factors of Unidentified Gas (UIG) that the AUGE has been required to assess has been the impact of errors from the shrinkage calculation undertaken by the DNO Users. After an initial assessment in the 2012/2013, **it was concluded that the current shrinkage estimation model would be relied upon as accurate** (i.e. there was no shrinkage error in UIG as it was captured by the shrinkage model) as there was not a more robust shrinkage assessment available.

During 2016/17, the DNO's carried out their review of Shrinkage via the Shrinkage Forum. As part of this they considered the independent report compiled by Imperial College Consultants Ltd for Energy UK in 2016 and **the DNO's determined that the current shrinkage estimation model would continue to be relied upon.**

At a meeting on 13 April 2017, it was first indicated by the AUGE that this assumption was no longer valid. **The AUGE**, having reviewed the same independent report compiled by Imperial College Consultants Ltd for Energy UK in 2016, has **concluded there is a substantial shrinkage error that is not accounted for in the shrinkage model** and is therefore present in the UIG calculations, with this error being smeared across Shippers. The current estimate (which will be refined by the AUGE up to the deadline for delivery on 30 June 2017) is that this error is in the order of 500GWh or 20% of the total of UIG.

The AUGE is currently proposing that the shrinkage error that exists in UIG is recovered from each Shipper in proportion to its total throughput in each LDZ, achieved by adjusting the scaling factors for each EUC Band and product class appropriately.

Though this results in the shrinkage error costs being evenly spread across Shippers, we believe DNO Users should be directly exposed to the costs of all shrinkage for the following reasons:

- Transporters are currently incentivised via the price control to manage and reduce shrinkage, which the shrinkage error is currently not covered by.
- Transporters are in a better place to procure the gas lost from shrinkage, having in place processes to estimate likely shrinkage amounts and obtain gas to cover these costs. By contrast Shippers will be attempting to manage shrinkage positions with little understanding of its volume and as part of its portfolio management if they are a retail Shipper.
- Shrinkage error being removed from the UIG calculation will reduce the volatility of that calculation and so reduce shipper costs in managing it.
- There is underlying principle in the gas market that organisations are exposed to the costs they can manage. Shippers have no control over the sources and hence the scale of shrinkage and so have no ability to reduce these costs, unlike other the other sources of UIG.

The optimum process for assigning the costs of shrinkage to DNO Users should be through Shrinkage, but there is no prospect for this error being corrected in the shrinkage model as the assessment that the AUGE has based its findings on was effectively dismissed in 2016. It is proposed to use a corrective invoice process to ensure that these costs are appropriately allocated to DNO Users.

4 Code Specific Matters

Reference Documents

Allocation of Unidentified Gas Statement

Energy UK Gas Retail Group Shrinkage Study

Knowledge/Skills

No specific skills or knowledge are necessary.

5 Solution

It is proposed that the UNC be modified to correctly allocate shrinkage.

It is firstly proposed that the AUG table for the Gas Year 2017/18 is that presented by the AUGE on 12 May 2017 where no shrinkage error has been included in the calculations. The values are as follows:

	Product 1	Product 2	Product 3	Product 4
01B	0.000	5.098	5.102	11.240
02B	0.000	5.193	5.185	11.800
03B	0.000	5.422	5.418	11.674
04B	0.000	5.601	5.610	5.455
05B	0.000	5.546	5.570	5.936
06B	0.000	5.072	5.108	5.424
07B	0.000	3.995	4.034	3.932
08B	0.000	2.130	2.157	1.823
09B	0.000	0.000	0.000	0.000

It is also proposed that Shippers are compensated for the additional costs they are incurring for that shrinkage error that the AUGE has identified, by including provisions which provide for the allocation to the Gas Transporters that part of UIG that pertains to "Shrinkage Error " as specified in the AUGS. In this solution, Shrinkage Error is defined as the "Shrinkage Error Value" and the corrective charge as "Shrinkage Error Charge."

The following process will be used:

- The Shrinkage Error value would be determined by the AUGS as part of its wider work on UIG and take effect at the same time as the revised scaling factors for the apportionment of UIG, i.e. finalised by 1 July each year. In the absence of any specified value being set out in the AUGS, a value of 500GWh will be used.
- As soon as the values are finalised, the Shrinkage at M+1, the monthly Shrinkage Error Charge, will be calculated for the relevant calendar month ("M"). For the avoidance of doubt the first monthly charge period will be 1 October -31 October 2017.
- The calculation of the monthly Shrinkage Error Charge shall be 1/12 of the overall Shrinkage Error value multiplied by the previous month's average SAP.

Process (continued)

- At M+1 the LSP Shrinkage Error Charge will be levied on the DNO User in proportion to their total throughput of all LDZs, as derived by Xoserve.
- Xoserve will then raise debit invoices to all DNO Users for their proportion of the Shrinkage Error Charge. It is not envisaged that there will be any specific query process however standard invoice query rules would apply.
- The reallocation of the accrued Shrinkage Error Charge payments to shippers will be made on the basis of their total LDZ throughput that relates to Product 4 sites that are located within EUC Bands01B-03B.

For the avoidance of doubt the ability/methodology for the transporters to recover these costs from the industry is outside of the scope of this modification.

6 Impacts & Other Considerations

Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

No.

Consumer Impacts

No direct impacts.

Cross Code Impacts

None

EU Code Impacts

None

Central Systems Impacts

Central Systems will need to be adjusted to allow the appropriate invoices to be raised and calculated.

7 Relevant Objectives

Impact of the modification on the Relevant Objectives:	
Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	Positive
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.	Positive

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.	Positive
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
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

Transporters have obligations which incentives them to reduce shrinkage and this modification would ensure that all shrinkage costs fall under that regime and thereby further relevant objective c) Efficient discharge of the licensee's obligations.

This modification seeks to correct for the effects of a cross-subsidy between the DNO Users and Shippers by allocating the costs of the shrinkage error to the DNO Users. This will result in more accurate cost targeting and incentivise DNO Users to accurately determine shrinkage costs and to reduce its impact and thereby further relevant objective d) Securing of effective competition.

8 Implementation

This modification will result in a monthly invoice to each DNO User, with corresponding credits paid to Shippers. This process in itself will not result in any new processes to be followed, simply a new invoice to be managed. The costs will therefore be minimal for all parties.

No formal timescales are proposed, but the process will need to be in place prior to 01 October 2017 to prevent cross-subsidy between sectors.

9 Legal Text

Transporters to provide.

10 Recommendations

Proposer's Recommendation to Panel

Panel is asked to:

- Agree that Authority Direction should apply
- Assessed by a Workgroup