

Draft Modification Report
Alternative to Interim Allocation of Unidentified Gas Costs
Modification Reference Number 0327
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

To all intents and purposes this proposal is being raised as an alternative to 0317 and 0317A. Unfortunately, given the complexities of the issues, the analysis provided in this proposal could not be completed within the standard 5 day window during which alternative proposals may be raised. Nevertheless, the proposer believes that the analysis contained herein is helpful to the debate on the allocation of costs, and considers that it would be particularly helpful to interested parties if this proposal could commence its consultation phase at the same time as 0317 and 0317A. This course of action would also avoid unnecessary delays in the (believed likely) event that Ofgem wishes to decide upon all three proposals in parallel.

Background

Within Modification Proposal 0317A British Gas stated that *'we are of the view that the LSP Apportionment of £2.75m proposed by 0317 significantly underestimates the true volume of unidentified gas which should be attributable to the NDM LSP market.'* This Modification Proposal provides an alternative LSP Apportionment value, with supporting rationale.

Modification Proposal 0229, "*Mechanism for Correct Apportionment of Unidentified Gas*", was raised by Shell Gas Direct in order to provide a mechanism through which unidentified gas could be more accurately allocated between the Small Supply Point (SSP) sector and Large Supply Point (LSP) sector.

The process through which the new split of allocation between the SSP and LSP sectors would be arrived at involved both a tendering process to procure an Allocation of Unidentified Gas Expert (AUGE) and subsequent work by that AUGE in order to create an Allocation of Unidentified Gas Statement (AUGS) - the determination on how unidentified gas should be allocated between the SSP and LSP sectors.

The legal text produced in support of Modification Proposal 0229, clearly states that the first AUG year starts from 1 April 2011 and that the reallocation of costs between the SSP and LSP sectors will be attributable back to this date, regardless of when the AUGE delivers its AUG Statement.

Modification Proposal 0317 proposes an interim allocation solution which details a level of contribution to be made by the LSP sector until such time as the AUGE calculates and implements its own statement. The level of this contribution set out in 0317 is derived from an ICOSS commissioned report.

British Gas has undertaken its own analysis based on Reconciliation by Difference (RbD), Reconciliation and AQ data. The method looks at the LSP market share of NDM AQ in consecutive years.

As a worked example, taking the 2009 AQ Review, we can see that prior to the AQ Review the LSP market was 27.06% of NDM AQ.

LSPs would have been deemed based on this share of AQ over the 2008/09 gas year.

Following the AQ Review, the LSP market share changes to 26.33%.

The difference is -0.73%. This percentage when multiplied by the current (post 2009 AQ Review) NDM AQ is representative of the difference between LSP consumption and allocation, this being 3,555GWh. Whilst we acknowledge that actual annual consumption can differ from the sum of NDM AQ, it is an accurate approximation and any variance will be relatively small and subject to later reconciliation.

This 3,555GWh volume is 'Genuine Reconciliation'. This volume only should be passed to the SSP market. The remaining RbD volume should be allocated to the LSP market, representing their proportion of unidentified gas, because on initial allocation both the SSP and LSP sector are allocated their share of unidentified energy, with subsequent LSP reconciliation moving this cost into RbD and onto the SSP sector.

2009 MPRN	Previous AQ	Current AQ	AQ Change	Previous Share	Current Share	Difference	Genuine Reconciliation
SSP 21,118,477	373,845	360,001	-3.70%				
LSP 378,830	138,666	128,657	-7.22%	27.06%	26.33%	-0.73%	-3,555
Total 21,497,307	512,511	488,658	-4.65%				

Applying this methodology to previous years would produce the following results:

Reconciliation (GWh unless stated)	Gas Year		
	2006/2007	2007/2008	2008/2009
Total RbD volumes received in year	11,835	11,888	12,042
Total RbD value (£m)	154	179	210
Genuine reconciliation	5,041	3,393	3,555
RbD minus genuine reconciliation	6,794	8,494	8,486
RbD minus genuine reconciliation value (£m)	88	128	148

In our worked example, for the gas year 2008/2009 the total RbD volume was 12,042GWh. 3,555GWh represents the Genuine Reconciliation element, leaving 8,486GWh to be repatriated to the LSP sector (equivalent to c£148m).

The average value to be reallocated to the LSP sector for the last 3 years equates to £121m.

The analysis clearly demonstrates that there is a significant difference between the LSP Apportionment value of £2.75m proposed by 0317 and the value of £121m,

being the average of the last 3 years that has been calculated as detailed above and is proposed by this Modification Proposal.

It is therefore evident that LSP Shippers should pay for a volume of gas far in excess of £2.75m. We are confident that our recent analysis provides a fair apportionment and we recognise that until such time as the AUGÉ delivers its AUG Statement a definitive figure will be unknown.

British Gas therefore proposes that under this proposal, the volume of gas initially attributable to LSP Shippers be equivalent to £121m (this being the average figure recorded in the last 3 years and gives an expected outcome for future years).

Ultimately the effects of any of 0317, 0317A or this proposal will be temporary in nature, with any values paid under any interim arrangements subsequently being reconciled back to 1 April 2011 following implementation of the AUG Statement.

With this in mind it is essential that the LSP sector ensures that appropriate financial provisions are made to ensure that future liabilities from the introduction of the Modification Proposal 0229 arrangements from 1 April 2011 can be covered. We believe that it would be inappropriate for any financial provision to be formulated based upon the value proposed within Modification Proposal 0317 and that it would be appropriate to make provision for the value as set out in this proposal.

The Proposal

It is proposed that the Transition Document be modified such that, if values have not been established in accordance with the UNC to populate Table E1 in Section E of the Transportation Principal Document, for the AUG Year commencing 1 April 2011, an interim value will be applicable.

It is proposed that the values detailed within the table below will apply from 1 April 2011 until such time as the AUGÉ publishes and implements its AUG Statement. It should be noted that under this proposal all values paid under these interim arrangements will ultimately be reconciled back to 1 April 2011 following delivery of the AUG Statement regardless of the date on which this occurs, resulting in a subsequent debit/credit reconciliation to the LSP sector as appropriate. For the avoidance of doubt the AUG Statement will be applied back to 1 April 2011.

AUG Table beginning AUG Year 2011

LSP Apportionment: £121m	
<u>DM</u>	<u>£0</u>
<u>NDM</u>	<u>£121m</u>

Suggested Text

Legal text should be consistent with that of 0317A, with amendment of the LSP Apportionment figure as detailed within this proposal.

2 User Pays

a) Classification of the Proposal as User Pays or not and justification for classification

Provision of the xoserve elements of this service will be on a User Pays basis as provided for in 0229. No change to this will be introduced by the Proposal which, therefore, is not a User Pays Proposal.

b) Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification

No User Pays charges applicable.

c) Proposed charge(s) for application of Users Pays charges to Shippers

No User Pays charges applicable to Shippers.

d) Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve

No charges applicable for inclusion in ACS.

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

Standard Special Condition A11.1 (a): the efficient and economic operation of 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 subparagraph (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 subparagraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

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

Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs (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;***

Implementation of this proposal would allocate costs more accurately between shippers/suppliers to the relevant LSP and SSP market sectors. As such, this could reasonably be assumed to facilitate effective competition and therefore in the interests of consumers.

Standard Special Condition A11.1 (e): so far as is consistent with subparagraphs (a) to (d), the 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;

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

Standard Special Condition A11.1 (f): so far as is consistent with subparagraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

This proposal seeks an early introduction of a temporary framework that facilitates better-informed decision taking with regard to the allocation between market sectors of unidentified gas. We believe that this Proposal achieves this objective and ensures that the level of contribution by the LSP and SSP sectors respectively is set in a fair, transparent and non-discriminatory manner.

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

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

5 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) Implications for operation of the System:

No implications have been identified.

b) Development and capital cost and operating cost implications:

No costs are anticipated as a result of this Proposal, which utilises the mechanism introduced by 0229.

c) Extent to which it is appropriate to recover the costs, and proposal for the

most appropriate way to recover the costs:

Not applicable.

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

No such consequences identified.

6 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.

7 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

None for this proposal, which utilises the mechanism introduced by 0229.

8 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)

As a result of implementing 0229, some Users are likely to face small administrative and operational costs to manage additional bills from Gas Transporters and the requirement to pass through these costs to consumers. Implementation of this Proposal has the potential to bring forward the time at which such costs are first incurred.

Development and capital cost and operating cost implications

No changes beyond the requirements for 0229 are anticipated.

Consequence for the level of contractual risk of Users

None identified.

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

There will be a fairer interim allocation of charges to consumers in the LSP and SSP sectors with variances from this value subject to reconciliation following the AUG statement.

10 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

No such consequences have been identified.

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

Advantages

This proposal seeks to provide an interim framework for the determination of unidentified gas values that the market must account. The benefits of this proposal are that it will:

- reduce the current cross-subsidy between the LSP and SSP sectors in a clear and simple interim mechanism that allows costs to be allocated at the right level until such time as the AUGE produces a statement in line with 0229.
- introduce interim arrangements which will ultimately result in values being reconciled back to 1 April 2011, providing clarity to all parties.
- allows NDM LSP market participants to ensure that appropriate financial provisions are made in readiness for reconciliation back to 1 April 2011.
- incentivise a timely resolution of the ongoing industry discussions regarding the AUGE appointment process under 0229.

Disadvantages

- Introduces some additional implementation costs to the industry, although it is not envisaged that these will be in addition to those already accounted for in approval and implementation of 0229.

12 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.
Consultation End Date: 10 September 2010.*

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

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

14 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

Implementation is not 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.

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

No programme of works would be required as a consequence of implementing the Modification Proposal.

16 Proposed implementation timetable (including timetable for any necessary information systems changes and detailing any potentially retrospective impacts)

To follow the timescales of 0317 and 0317A.

17 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.

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

19 Transporter's Proposal

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

20 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

Appendix I

Genuine Reconciliation Calculations

There were 3 possible options for threshold crossers, 1. exclude all threshold crossers, 2. include threshold crossers in the sector they finished the AQ Review in, 3. include threshold crossers in the sector they were in before the AQ Review.

Option 3 was chosen. Therefore the AQ change associated with LSP to SSP threshold crossers is included in the LSP AQ change figure.

This is correct because these sites will have reconciled as LSPs throughout the preceding gas year.

This is also the most favourable case for the LSP market. See Mod81 tab for the results of the other scenarios.

	MPRN	Previous AQ	Current AQ	AQ Change	Previous Share	Current Share	Difference	Genuine Rec
2007 SSP	20,927,340	398,952	385,114	-3.47%				
LSP	429,300	154,746	142,382	-7.99%	27.95%	26.99%	-0.96%	5,041
Total	21,356,640	553,698	527,496	-4.73%				
2008 SSP	21,040,909	384,654	372,904	-3.05%				
LSP	409,450	146,306	137,153	-6.26%	27.55%	26.89%	-0.67%	3,393
Total	21,450,359	530,960	510,057	-3.94%				
2009 SSP	21,118,477	373,845	360,001	-3.70%				
LSP	378,830	138,666	128,657	-7.22%	27.06%	26.33%	-0.73%	3,555
Total	21,497,307	512,511	488,658	-4.65%				

Source: Xoserve Mod 81 AQ Review reports.

Reconciliation (GWh unless stated)	Gas Year			
	2006/2007	2007/2008	2008/2009	
Reconciliation received to date relating to year	7,008	6,109	5,327	1
Reconciliation received in year	8,593	11,979	11,497	1
Total RbD volumes received in year	11,835	11,888	12,042	2
Total RbD value (£m)	154	179	210	2
Genuine reconciliation	5,041	3,393	3,555	3
Rec relating to year minus genuine reconciliation	1,967	2,716	1,772	
Rec received in year minus genuine reconciliation	6,627	9,263	9,726	
RbD minus genuine reconciliation	6,794	8,494	8,486	
RbD minus genuine reconciliation value (£m)	88	128	148	4

Sources:

- 1 Xoserve report "NDM Reconciliation By Gas Flow Month". This is purely NDM LSP reconciliation and does not include adjustments. This is used as a sense-check - Genuine Reconciliation must not be more than actual reconciliation for that year.
- 2 From the RbD element of the Reconciliation invoices.
- 3 Mod 81 data (see above)
- 4 A proportion of the RbD value from 2.

Appendix II
MOD81 Data
Threshold Crossers

Including Threshold Crossers: SSP to LSP included in LSP, LSP to SSP in SSP

		MPRN	Previous AQ	Current AQ	AQ Change	Previous Share	Current Share	Difference	GR
2006	SSP	20,852,347	411,150	397,338	-3.36%				
	LSP	428,674	155,152	152,603	-1.64%	27.40%	27.75%	0.35%	1,933
	Total	21,281,021	566,302	549,942	-2.89%				
2007	SSP	20,947,069	404,944	382,657	-5.50%				
	LSP	409,571	148,754	144,839	-2.63%	26.87%	27.46%	0.59%	3,124
	Total	21,356,640	553,698	527,496	-4.73%				
2008	SSP	21,070,931	390,621	372,331	-4.68%				
	LSP	379,428	140,339	137,726	-1.86%	26.43%	27.00%	0.57%	2,912
	Total	21,450,359	530,960	510,057	-3.94%				
2009	SSP	21,146,628	378,701	359,624	-5.04%				
	LSP	350,679	133,810	129,033	-3.57%	26.11%	26.41%	0.30%	1,451
	Total	21,497,307	512,511	488,658	-4.65%				

Excluding Threshold Crossers

		MPRN	Previous AQ	Current AQ	AQ Change	Previous Share	Current Share	Difference	GR
2006	SSP	20,779,713	401,505	394,536	-1.74%				
	LSP	401,454	153,791	149,692	-2.66%	27.70%	27.51%	-0.19%	1,033
	Total	21,181,167	555,296	544,229	-1.99%				
2007	SSP	20,886,744	397,102	380,030	-4.30%				
	LSP	368,975	146,905	139,755	-4.87%	27.00%	26.89%	-0.12%	609
	Total	21,255,719	544,007	519,785	-4.45%				
2008	SSP	21,015,967	383,329	370,005	-3.48%				
	LSP	354,486	139,014	134,827	-3.01%	26.61%	26.71%	0.09%	473
	Total	21,370,453	522,343	504,832	-3.35%				
2009	SSP	21,095,252	372,607	357,303	-4.11%				
	LSP	327,454	132,572	126,336	-4.70%	26.24%	26.12%	-0.12%	584
	Total	21,422,706	505,179	483,639	-4.26%				

Including Threshold Crossers: SSP to LSP included in SSP, LSP to SSP in LSP

		MPRN	Previous AQ	Current AQ	AQ Change	Previous Share	Current Share	Difference	GR
2006	SSP	20,806,933	402,866	397,447	-1.35%				
	LSP	474,088	163,435	152,494	-6.69%	28.86%	27.73%	-1.13%	6,220
	Total	21,281,021	566,302	549,942	-2.89%				
2007	SSP	20,927,340	398,952	385,114	-3.47%				
	LSP	429,300	154,746	142,382	-7.99%	27.95%	26.99%	-0.96%	5,041
	Total	21,356,640	553,698	527,496	-4.73%				
2008	SSP	21,040,909	384,654	372,904	-3.05%				
	LSP	409,450	146,306	137,153	-6.26%	27.55%	26.89%	-0.67%	3,393
	Total	21,450,359	530,960	510,057	-3.94%				
2009	SSP	21,118,477	373,845	360,001	-3.70%				
	LSP	378,830	136,666	128,657	-7.22%	27.06%	26.33%	-0.73%	3,555
	Total	21,497,307	512,511	488,658	-4.65%				