

Draft Modification Report
(Alternative to Mod 0339), Clarification of the AUG Year in respect of UNC Modification
0229

Modification Reference Number 0339 / 0339A

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

Nature and Purpose of this Proposal

Uniform Network Code (UNC) Modification Proposal 0229 ‘Mechanism for correct apportionment of unidentified gas’ was implemented with effect from 10th June 2010.

Included within Proposal 0229 was the business rule: "Changes to the volumes in the Large Supply Point Unidentified Gas allocation table would be announced and could only be implemented for the following year.....". Although no specific date for the first AUG Year was contained within the Proposal, in order to create certainty in terms of the mechanics of the AUG process, the legal text contained a definition of an AUG year as “the twelve month period commencing 1 April 2011.....”

As a consequence of industry development and review of the Allocation of Unidentified Gas Document (currently entitled 'Guidelines for the appointment of an Allocation of Unidentified Gas Expert'), it is clear that the AUG's determination in the form of an approved AUG Methodology (statement) will not be completed by 1st April 2011. This means that the legal text directed upon by Ofgem and implemented in respect of UNC Modification 0229 is not consistent with the intentions of the Proposal.

As a result, there is a mismatch between the intention of the Proposal and the legal text currently contained within the UNC and, as the parties responsible for the implementation of Proposal 0229, the Transporters would like to ensure absolute clarity exists in terms of the AUG Year to which the first energy reconciliation would apply.

This ambiguity has been noted by numerous UNC parties and prompted British Gas (BGT) to raise UNC Modification Proposal 0313 ‘Application Date for MOD0229’ This proposal reinforced the application of 1st April 2011 as being the first AUG Year. Under the circumstances stated above, NGD welcomed this proposal as a measure to create absolute clarity as to the date of the first AUG Year and in a note issued to the Uniform Network Code Committee (UNCC) dated 11th August 2011 provided suggested legal text with respect to the UNC Transition Document. This clearly set out the fact that irrespective of when the AUG Methodology became available, energy charge adjustments would be applied from 1st April 2011. BGT withdrew Proposal 0313 on 14th September and provided a note to the industry explaining its reasons for this action.

While we respect BGT’s right to withdraw the Proposal, we believe that the additional text which would have been included in the UNC by the implementation

of Proposal 0313 would have provided the additional clarity that we now believe to be imperative for implementation. Since this Proposal has been withdrawn it is now necessary for the Transporters to gain further regulatory and contractual assurance to provide all parties with certainty over the date of the first AUG Year.

As the timeline for the appointment of the AUGE has developed, it has become clear that there will be no AUG Methodology available on 1st April 2011. Therefore to have an AUG Year commencing on 1st April 2011 would be inconsistent with the intent of Modification 0229. The June 2010 meeting of the UNCC approved implementation of Version 2 of the Allocation of Unidentified Gas Document. This sets out a timetable of events leading to the appointment of an AUGE and the requirements and responsibilities of the various organisations involved in identifying and agreeing an AUG Methodology. Using a timetable consistent with delivering the relevant 'milestones' set out in the Allocation of Unidentified Gas Document, the Transporters believe that the first AUG Year consistent with the rules specified within Proposal 0229 would be 1st April 2012.

Consequently NGD proposes that the definition of the first AUG Year be defined as this date.

Note: Transporters are financially neutral to the allocation of costs associated with Unidentified Gas between Users operating in the two market sectors. Indeed, it is a condition of our licence that we treat all Users in a non-discriminatory way and this proposal is not intended to confer any advantage on any individual User through its effects on the timing of the reallocation of energy costs. The proposal has been raised to provide Transporters and all Shippers with absolute clarity as to what Transporters are expected to do and by when we are expected to do it.

In addition to the views of the Proposer as set out above, the contents of this Modification Proposal are endorsed by:

Scottish and Southern Gas Networks, Wales & West Utilities and Northern Gas Networks.

Suggested Text

TPD Section E10

10 Allocation of Unidentified Gas ("AUG")

10.1 Interpretation

10.1.1 For the purposes of the Code:

(a) ...

(i) "AUG Year" means the twelve month period commencing 1 April 2012 and the twelve month period commencing on each subsequent 1 April; and in relation to an AUG Year a reference to the preceding year is to the twelve month period ending 31 March before the start of the AUG Year.

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Background

On 26th May 2010 Ofgem directed the implementation of MOD0229, “*Mechanism for Correct Apportionment of Unidentified Gas*”. This modification proposal 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. Currently all unidentified gas is allocated to the SSP 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.

A number of recent Proposals have sought to establish the optimal Application Date for the AUGS (the date from which any reallocation of costs will take place from), so that it strikes the right balance between all Shippers’ need for cost certainty and SSP Shipper’s need for early relief from the inaccurate costs they currently face. In their decision letter on one such Proposal, MOD0317, Ofgem reaffirmed their view that “*the arrangements for the allocation of Unidentified Gas should be reformed such that each market segment makes an appropriate contribution to these costs*”¹, but went on to say that Proposals which provided for the reallocation of costs to be backdated to a point before the scale of reallocation was known may create “*significant uncertainty for small shippers and LSP shippers may have a detrimental impact on competition, in particular in relation to shippers operating only or predominantly in the LSP sector*”².

National Grid has also raised two Proposals which seek to address these points by amending the application date of the AUGS. MOD0339 seeks to set the application date to 1st April 2012 whereas MOD0340 seeks to set it to 1st April 2011. We consider that the former Proposal will leave SSP Shippers facing inaccurate charges for an unreasonable and unnecessary length of time, without regard for the fact that all Shippers will have had certainty about the scale of cost reallocation for some time by that point. Whilst we support the latter Proposal, we recognise the concerns Ofgem have over the level of uncertainty this may create for the LSP sector, and thus believe that an alternative proposal is required to strike the right balance between cost certainty for LSP Shippers and early relief from inaccurate costs for SSP Shippers.

¹ Ofgem Decision Letter for MODs 0317, 0317A and 0327 (18th November 2010), page 5.

² Ofgem Decision Letter for MODs 0317, 0317A and 0327 (18th November 2010), page 6.

Proposal

In determining the most appropriate solution, we have given consideration to both (a) other areas of regulation where Shippers are notified of new costs, such as Gas Network Pricing Changes, (b) Electricity Network Charges and (c) the process for approving the AUGS itself.

Gas Network Pricing Changes

We consider that there is a need for consistency between the way in which volatility in Network charges are treated and the way in which the reallocation of unidentified gas costs is treated in terms of providing industry parties with certainty about the costs they will incur. When Network Owners announce changes to Distribution prices, an initial indication of proposed changes is made not less than five months prior to the implementation with a final notification of the changes not less than two months prior to implementation. The precedent created is that an acceptable level of cost certainty will be afforded to Shippers if they receive at least five months notice of indicative changes to their costs. As the initial draft of the AUGS will be presented on 1st May 2011, an Application Date of 1st October 2011 is reasonable.

Electricity Network Charges

As above, we consider that there is a need for consistency between the way in which volatility in Network charges are treated and the way in which the reallocation of unidentified gas costs is treated in terms of providing industry parties with certainty about the costs they will incur. Following an Ofgem review of the impact of settlement data adjustments on the Network Owners losses incentive schemes, Suppliers in the electricity market have been given four months notice of significant changes to their Electricity Network Charges. We are therefore comfortable that the five months notice that this Proposal affords Shippers of charges they will incur following the publication of the AUGS is more than sufficient, and provides all parties with sufficient certainty of their costs.

The AUGS Creation Process

As above, the process introduced by MOD0229 includes a requirement for the AUGS to publish their draft methodology by 1st May each year³. A “Query Process” will then commence allowing industry Party’s to challenge or clarify the methodology before a final version is published no later than 1st August each year⁴. This methodology will then be approved or rejected by the UNC Committee (UNCC) “on or around the 1st September”⁵. Immediately following this decision of the UNCC, we believe that Shippers will have a reasonable level of certainty of the costs

³ [AUGE Guidelines Document](#), paragraph 6.1.1.

⁴ [AUGE Guidelines Document](#), paragraph 6.1.6.

⁵ [AUGE Guidelines Document](#), paragraph 6.1.8.

which they will incur when the reallocation is completed in the following May. Our view is that again therefore, by 1st October 2011 all Shippers will have sufficient certainty over their costs, and therefore this date is an appropriate Application Date.

Proposed Application Date

As above, both the illustrations above demonstrate that were the Application Date for the AUGS to be 1st October in each year, Shippers would have sufficient certainty about the costs they would incur. This Proposal will therefore amend the UNC so that the AUGE Year is defined as the period starting 1st October in each year, commencing on 1st October 2011.

For clarity, it is the intent of the Proposal that this impacts *all* AUGE years and not just the initial year.

Other Considerations

We also consider that by aligning the Application Date with the start of the Gas Year, this Proposal will complement other processes well; reconciling costs between the SSP and LSP sectors at the same date as the new Annual Quantity (AQ) values take effect.

Finally, we also consider that 1st October each year is a common start date for new LSP contracts, thus mitigating some of the need to either exercise contractual rights to pass on new regulatory charges or to socialise costs received against new customers only.

Treatment of Interim Payment Introduced by MOD0317

We recognise that if implemented this Proposal may leave the LSP NDM sector facing two reallocations; the initial one of £2.75m per annum payable under the process introduced by Modification Proposal 0317 and then a further one payable once the AUGE's methodology is finalised and then applied from 1st October 2011. This may expose the LSP NDM sector to unnecessary charges for the period from 1st October 2011 until the date the AUGE's methodology is published.

This Proposal will therefore ensure that the interim annual payment of £2.75m per annum introduced by Modification Proposal 0317 will only apply from 1st April 2011 until the new start of the AUGE year, i.e. 1st October 2011. For example, if the AUGE delivers a methodology in April 2012, the LSP NDM sector will be liable for a payment of £1.375m for the period 1st April 2011 to 30th September 2011 and an amount to be specified by the AUGE from 1st October 2011 onwards.

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User Pays

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

No changes to User Pays Services are proposed. Consequently this Modification Proposal is not classified as User Pays.

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 coordinated, 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 sub-paragraph (a), the (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;*

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

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 Workgroup members believed that the modification ensures the correct allocation of energy from 01 April 2012, thus being a benefit to competition. However, some members believed that this was the purpose of the 0229 Proposal and this modification was to confirm some technicalities and clarity of the AUG year.

Some Shippers believed that the legal text currently in the UNC meant that cost

allocation would occur from 01 April 2011, the effect of this modification would be to extend the period for which we have incorrect allocation of costs, damaging competition to the extent that the interim payment considered in code (0317) is insufficient.

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British Gas considers implementation of this Proposal would allocate costs more accurately to the relevant LSP and SSP market sectors at a point in time which strikes the right balance between providing cost certainty to the LSP sector and accurate charges for the SSP sector. In doing so, this will in turn achieve the earliest removal of the cross subsidy that is currently present between the sectors. It is generally recognised that cross subsidies are not beneficial to competition and so removing them will have a positive impact.

In addition, this proposal introduces an incentive to appoint an AUGE in a timely manner and ensure that an appropriate methodology is not unduly delayed. In doing so, this ensures that the benefits above are introduced sooner than would otherwise be the case.

Furthermore, as this proposal removes the uncertainty over when the methodology considered under MOD0229 will be effective from, we consider that this modification will improve Shippers ability to plan effectively, thereby improving their ability to compete.

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.

This modification removes ambiguity from the UNC and clarifies the date the AUG statement applies – the first AUG year will be applied from 01 April 2012.

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British Gas considers this proposal will facilitate better-informed decision taking with regard to the allocation between market sectors of unidentified gas, and ensures that the level of contribution by the LSP sector to the SSP sector is set in a fair and transparent manner. As above, this proposal introduces an incentive to appoint an AUGE in a timely manner and ensure that an appropriate methodology is not unduly delayed. In doing so, this ensures that the benefits above are introduced sooner than

would otherwise be the case.

This Proposal incentivises all UNC Parties to ensure the AUGS is developed as per the timeline considered by MOD0229.

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:

There are no implications for operation of the System.

b) development and capital cost and operating cost implications:

Some additional administrative costs could be incurred undertaking an associated reconciliation between the annual charge identified 0317 and the AUG statement.

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 consequences have been 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

There are no development implications for the Transporters' UK-Link system or any other Transporter system. The Proposer is not aware of the implications for Users computer systems.

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)

No implications have been identified.

Development and capital cost and operating cost implications

0339A will provide for an increase in the accuracy of operating costs from 1st October 2011.

Consequence for the level of contractual risk of Users

Some Workgroup members believed that the timing of the application of the first AUG Year could have an impact on a Users contractual risk in terms of the extent of their liability for Unidentified Gas costs so incurred. If the AUG does not produce a statement in time for 01 April 2012, costs would still be reconciled back to the 01 April 2012.

Should the AUG statement be provided and accepted by 01 April 2012 there would be no requirement to prospectively apply the terms of UNC0317, for that AUG Year. However, should the AUGS be delayed beyond 2012 there would be a consequential impact associated with UNC0317 i.e. £2.75m would not be netted off against the AUG Statement.

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

No implications have been identified.

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 consequences have been identified.

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

Advantages

- Ensures that that the date for the first application of the reallocation of Unidentified Gas is clearly set out within the UNC.

British Gas considers 0339A offers the following advantages:

- Provides for relief from inaccurate unidentified gas allocation costs for

SSP Shippers at the earliest possible point in time, without exposing the LSP community to uncertainty.

- Aligns the reallocation of unidentified gas costs from the AUGS with the start of the Gas Year, simplifying industry processes.
- Provides a similar level of cost certainty as Shippers currently receive under the process for managing Gas Network Pricing Changes.

Disadvantages

- Should the AUGS be delayed beyond 2012, some Workgroup members consider this Modification will not deliver the intent of Mod0229 and its interaction with Mod0317 ie the potential duplication of charges resulting from the AUGS and Mod0317.
- British Gas considers 0339A exposes the SSP Shipper community to known inaccurate charges for five months over and above the date considered by MOD0340, allowing a distortion in the competitive markets to be perpetuated and for domestic customers to continue to be exposed to exaggerated prices.

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: **14 February 2011.**

13 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.

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

No such requirement has been identified.

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.

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This Proposal is able to be implemented immediately following a direction to do so

from Ofgem. Given the likely materiality of the scale of any cost reallocation, were this Proposal to be approved, we propose that it be implemented without delay.

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

It is recommended that this Modification Proposal be implemented immediately upon direction.

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.

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For clarity, this Proposal will amend the Code document itself and not the “*AUGE Guidelines Document*”.

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