CODE MODIFICATION PROPOSAL No 0232
Allocation of Unidentified Gas via the Distribution Networks Charges
Version 2.0

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Date: 14/01/2009

Proposed Implementation Date:

Urgency: Non Urgent

1 The Modification Proposal

a) Nature and Purpose of this Proposal

Introduction

This modification seeks to establish a Development Work Group to develop how unidentified gas can be apportioned to the shipping community using a mechanism similar to the one which is in place to recover shrinkage i.e. an agreed volume or value that can be recovered through the Distribution Charging structure from the Shipping Community. Consideration may also be given to developing, as an alternative mechanism, a "Line Loss Factor" to be apportioned to gas transported through Distribution Networks - leading to increased consistency between the gas and electricity distribution models.

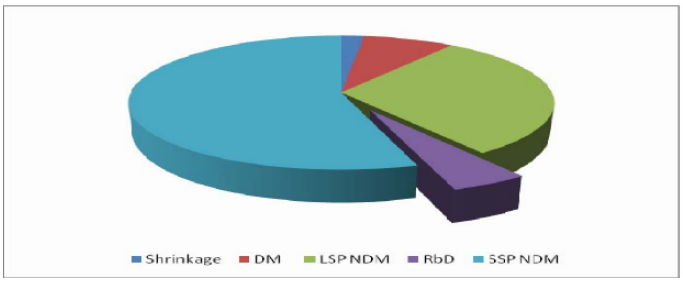
To ensure that appropriate behaviour by shippers is encouraged, the Development Work Group will also examine the potential for developing incentives to discourage the root causes of unidentified gas. For the avoidance of doubt the term unidentified gas refers to gas which is supplied to the GB gas network, but whose use cannot be accounted for.

The energy allocation regime

The current market arrangements for the GB gas market works on the principle of daily balancing. Only the total amount of gas consumed by GB as a whole along with the consumption of Daily Metered (DM) sites is known with any degree of certainty. Gas consumption for the majority of sites is estimated through a combination of algorithms and site categorization, based on historical consumption patterns.

The determination of gas consumption for any given day for Non-daily Metered (NDM) sites works on the principle that once DM and Transporter losses (Shrinkage) are subtracted from total GB consumption, whatever remains is consumed by the Large Supply Point and Small Supply Point NDM customers.

Allocation of UK Gas Consumption (not to scale).



Large Supply Point NDMs consumption is initially estimated via behavior modeling. When a meter reading for that site is obtained, the estimated consumption is corrected with any variation between estimated and actual gas demand being credited/debited to the Small Supply Point market. This correction volume is termed RbD volume.

It is important to note that the current process results in all unallocated energy remaining being assumed to be SSP consumption and allocated by the RbD process, though not by the RbD volume. This assumption does not allow allocation of unidentified gas to the LSP sector.

How significant any allocation errors are, is difficult to ascertain. The Development Work Group for Mod 0194 did not uncover any definitive evidence, though a body of anecdotal evidence does exist, indicating that some unidentified gas for the LSP market is being allocated to the SSP market.

Re-allocation of market error

Modification 0115/01 15a attempted to allocate some measurement errors via RbD. Ofgem gave support to the general principle of spreading the costs of unallocated gas to all market players. In its Modification 0115 decision letter dated 24th October 2007 Ofgem stated that:

"we agree with the basic tenet of the proposals, that it is inappropriate for one sector of the gas market to bear all the costs of unallocated gas through RbD"

The decision letter went onto state that

"there are many issues which are currently contributing to the RbD charge, only some of which have been explored as part of these proposals and not all of these can necessarily be attributed to I&C shippers."

The Modification 0194 Development Work Group considered the use of RbD to allocate such energy to the LSP market, but significant issues were identified in using this approach, in particular the allocation of genuine SSP consumption to the LSP market. One major risk identified is that this could create a cross-subsidy of the SSP sector and the size of the unidentified gas error would vary with total GB throughput.

With RbD not being considered a suitable mechanism, the Mod 0194 Development Work Group considered the way in which transporters take into account theft and leakages as part of their network responsibilities. These losses are currently estimated as discrete values based on analysis of network operations. In moving from a sliding percentage of total throughput to fixed volumes, Ofgem noted as part of its GDPCR consultation

"The evidence available shows that there is little correlation between shrinkage and throughput for the existing networks [1]". A fixed value was considered more appropriate.

We agree with Ofgem's analysis and so we propose to expand the current Shrinkage methodology to include areas of unidentified gas that have been traditionally allocated to the SSP market.

Our proposal

Widening of shrinkage scope

To help develop the analysis of the levels of unidentified gas, we propose that the current Shrinkage methodology be expanded to cover areas where gas is incorrectly allocated. Such areas include:

- **Late confirmation, Unregistered and orphaned sites.** It is our view that late confirmation sites do not add significant levels of unidentified gas, as sites which are confirmed at some stage will have their estimated consumption corrected. We recognize that in rare cases, late confirmation may occur where all of the energy may not be reconciled.

- Late Confirmation IGT. We recognize that the late confirmation of IGT sites is a more significant issue compared to DN sites and hence a separate value is created here.

- Shrinkage Errors. Such shrinkage losses that are not accounted for by the transporters' allowance.

- Theft and Unreported open By-Pass valves

Outside of the late confirmation IGT uplift, we have not made a distinction between IGT and DN sites, as we believe the issues that we have identified apply to all networks and there is no direct evidence that differentiation will enhance efficiency. In some cases, it is our view that this equal treatment is a benefit for the SSP market. For example, we believed that the majority of unregistered sites on IGT sites are SSPs.

Determining size of such factors

[1] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=362&refer=Networks/GasDistr/GDPCR7-1 3

The costs for this shrinkage would be recovered from Shippers, effectively via an uplift to the Distribution Networks Distribution Charges.

This modification itself does not seek to determine the precise levels of unidentified gas that need to be allocated to this new mechanism. It is the proposer's intent that such values would be determined by the transporters.

Business Rules

1. The energy to be purchased will be calculated by a third party in line with the LDZ Shrinkage timescales, so initial proposals will need to be calculated by the 1 March each year in time for the Formula Year.
2. The energy to be purchased by each DN (VA) will be based upon these value of all unidentified energy pushed through their network for the forthcoming formula year.
3. Each transporter will be permitted to collect revenue.

- The price (PM) to be used to determine the level of allowed revenue will be based on will ICE Natural Gas Futures Settle Price for the Month as @ 1st February of the relevant year.

4. Therefore the amount of Allowed Revenue (UG) to be allowed is:

$$UG = VA \times PM$$

5. The recovery of Allowed Revenue (UG) back to the end user is not to be prescribed but should utilise one of the existing rate codes
6. The purchased energy should be deducted from the initial daily allocation in line with DN Shrinkage in accordance with :

$$VD_n = \frac{VA}{365}$$

b) Justification for Urgency and recommendation on the procedure and timetable to be followed (if applicable)

This modification does not require to be treated as urgent.

c) Recommendation on whether this Proposal should proceed to the review procedures, the Development Phase, the Consultation Phase or be referred to a Workstream for discussion.

It is our view that this modification should be considered by a Development Work Group.

2 Extent to which implementation of this Modification Proposal would better facilitate the achievement (for the purposes of each Transporter's Licence) of 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 would not be expected to better facilitate this relevant objective.

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 sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.

Our proposal introduces a framework that enables for better informed decision taking with regard to the allocation of unidentified gas.

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

None identified.

4 The implications for Transporters and each Transporter of implementing this Modification Proposal, including:

a) The implications for operation of the System:

None identified.

b) The development and capital cost and operating cost implications:

None identified, though we feel it appropriate that the Development Work Group seek to identify such costs.

c) Whether it is appropriate to recover all or any of the costs and, if so, a proposal for the most appropriate way for these costs to be recovered:

We would anticipate that any costs incurred operating this process, will be recovered via the newly introduced mechanism**.**

d) The consequence (if any) on the level of contractual risk of each Transporter under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal

None identified.

5 The extent to which the implementation is required to enable each Transporter to facilitate compliance with a safety notice from the Health and Safety Executive pursuant to Standard Condition A11 (14) (Transporters Only)

None identified.

6 The development implications and other implications for the UK Link System of the Transporter, related computer systems of each Transporter and related computer systems of Users

None identified.

7 The implications for Users of implementing the Modification Proposal, including:

a) The administrative and operational implications (including impact upon manual processes and procedures)

Minimal increase in administrative processes handling additional costs.

b) The development and capital cost and operating cost implications

None identified.

c) The consequence (if any) on the level of contractual risk of Users under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal

None identified.

8 The implications of the implementation for other relevant persons (including, but without limitation, Users, Connected System Operators, Consumers, Terminal Operators, Storage Operators, Suppliers and producers and, to the extent not so otherwise addressed, any Non-Code Party)

None identified.

9 Consequences on the legislative and regulatory obligations and contractual relationships of the Transporters

None identified.

10 Analysis of any advantages or disadvantages of implementation of the Modification Proposal not otherwise identified in paragraphs 2 to 9 above

Advantages

- This proposal creates a clear and simple framework to allow consideration of the levels of unallocated gas
- Provides transparency and raises the profiles of the sources of unidentified gas

Disadvantages

None identified.

11 Summary of representations received as a result of consultation by the Proposer (to the extent that the import of those representations are not reflected elsewhere in this Proposal)

12 Detail of all other representations received and considered by the Proposer

13 Any other matter the Proposer considers needs to be addressed

None

14 Recommendations on the time scale for the implementation of the whole or any part of this Modification Proposal

This proposal does require transporters to determine the level of unidentified gas within each LDZ. We anticipate this can be achieved in accordance with the current Shrinkage factor process. To facilitate this, this modification will need to be implemented as soon as practical.

15 Comments on Suggested Text

16 Suggested Text

Code Concerned, sections and paragraphs

Uniform Network Code

Transportation Principal Document

Section(s)

Proposer's Representative

R Dutton (Total Gas and Power Ltd)

Proposer

R Dutton (Total Gas and Power Ltd)