

CODE MODIFICATION PROPOSAL No 0313
Application Date for MOD0229
Version 1.0

Date: 09/06/2010

Proposed Implementation Date: As soon as possible following Ofgem determination.

Urgency: Non Urgent

Proposer's preferred route through modification procedures and if applicable, justification for Urgency

We intend that this proposal is developed for no more than three months at Distribution Workstream, including the drafting of all necessary reports, before requesting that it proceed to consultation.

(see the criteria at http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11700_Urgency_Criteria.pdf)

1 Nature and Purpose of Proposal (including consequence of non implementation)

Introduction

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.

British Gas believe that whilst this two-stage process is necessary to ensure the full value of MOD0229 is delivered, there is significant potential for the AUGS to take a long time to produce and be implemented, thereby allowing the SSP sector to continue to be exposed to unfair allocation costs.

For the sake of clarity, MOD0229 had not been implemented at the time of raising this modification proposal. Implementation had however been directed, and the legal text made clear. This modification proposal therefore seeks to amend the arrangements which will exist at the point this modification is implemented or rejected.

Proposal

This modification proposal will add an application date of 1st April 2011 to the process considered by MOD0229.

The effect of this proposal will mean that if the AUGS is not ready by 1st April 2011, its effect on the allocation of gas between the SSP and LSP sector will be applied from that date. For the sake of clarity, should the AUGS be finalised before 1st April 2011, its effect on allocation between the SSP and LSP sectors should start from the earlier date. Illustrations of how this would work are given below, in the next section.

Finally, this effect of this proposal will be entirely transitory in nature and once the initial re-allocation has been completed, the process reverts back to the timetable considered under MOD0229.

The Application Date

In choosing an appropriate application date, we have given consideration to two competing needs; the needs of those present in the SSP sector to receive some prompt relief from the inaccurate allocation charges they currently face, and the need of those present in the LSP sector to be able to incorporate any increase in costs through their contracts.

In consideration of the latter, we have paid close attention to both the fact that most, if not all, suppliers in the LSP sector provide conditions in their customer contracts which allow changes in the industry charging arrangements to be passed through to the customer either immediately or after a brief notice period if that supplier so wishes, in accordance with the terms of their contract.

We have also recognised the need of both LSP shippers and suppliers to appropriately provision for any costs which may flow to them, and as above, have attempted to balance this with the need of SSP shippers to secure prompt relief from the inaccurate allocation charges they currently face. We note however that under the existing MOD0229 methodology shippers do not know how much to provision for, and furthermore, do not even know when they will be expected to provision for the output from the AUGS. Having considered that this topic has been under discussion since at least March 2007¹), believe that the date of 1st April 2011 strikes the right balance between these competing needs, and improves the overall level of certainty for shippers in the re-allocation process.

We consider that rather than create more uncertainty in the market arrangements the provision of a definite, early, date by when the methodology considered under MOD0229 will be effective from, uncertainty is reduced by decreasing the period of uncertainty shippers currently face under the MOD029 process. This will improve shippers' ability to go about their business and compete with each other.

¹ MOD0115, raised by British Gas in March 2007 considered this issue.

Furthermore, and as mentioned above, we consider that there is there is significant potential for the AUGS to take a long time to be produced and be implemented, thereby allowing the SSP sector to continue to be exposed to unfair allocation costs considerable scope for delays. The implementation of this modification proposal will remove any potential incentive for delays to occur, ensuring that the process of implementing the MOD0229 process occurs as soon as possible.

Finally, we also consider that as 1st April 2011 is some ten months in the future, parties will be aware of the need to provide for a re-allocation under this modification, and thus avoids retrospective application.

Illustration One.

Application date is 1st April 2011, and the methodology is finalised in January 2012. The methodology will be used in May 2012 to reallocate costs between April 2011 and April 2012.

Illustration Two.

Application Date is 1st April 2011, and the methodology is finalised in July 2012. The methodology will be used in May 2013 to reallocate costs between April 2011 and April 2013.

Illustration Three

Application Date is 1st April 2011, and the methodology is finalised in January 2013. The methodology will be used in May 2013 to reallocate costs between 1st April 2011 and April 2013.

Implications of Non-Implementation

In Ofgem's "*Identification and Apportionment of Costs of Unidentified Gas Impact Assessment*" document², evidence was put forward to show that the amount of gas allocated to the SSP sector was over £401m between January 2007 and April 2009³, equivalent to an annualised rate of £172m per annum. The degree to which this amount will be re-allocated between the SSP and LSP sector under MOD0229 is currently unknown. The precise costs of non-implementation of this modification are also therefore not therefore known, however previous modifications and research papers have produced a variety of different estimates which may be used to determine a range of cost impacts which may arise from non-implementation of this MOD.

² *Identification and Apportionment of Costs of Unidentified Gas Impact Assessment*, 30th November 2009.

³ *Identification and Apportionment of Costs of Unidentified Gas Impact Assessment*, page 58. Based on statistics provided by xoserve.

⁴ MOD0229, Appendix 1, section 11.

In order to calculate the potential cost implications of non-implementation, two factors have to be considered: firstly, the total amount currently allocated to the SSP sector and the variety of likely re-allocations of that amount to the LSP sector, and secondly, the amount of time MOD0229 would take to have an applicable AUGS in the absence of this modification.

1. Money will remain incorrectly allocated to the SSP sector.

- Modification Proposal 0228 proposed that 25% of RbD by allocated to the LSP sector. Based on the Ofgem figures above, this would equate to £43m per annum.
- Modification Proposal 0228A proposed that 2978.004 GWh of RbD by allocated to the LSP sector. This equates to ~£30m per annum, based on an average SAP Price.

Whilst it is entirely likely that any AUGS will require a different re-allocation of costs from the SSP to LSP sector, these modifications give an indication of the scale of costs which may result from non-implementation. We accept that were MODs 0228 and 0228A to have over or under estimated the amount of energy to be re-allocated between the SSP and LSP sectors, this suggested impact of non-implementation would itself change in proportion to the extent to which those estimates were inaccurate.

Notwithstanding this, assuming that there was *any* re-allocation from the SSP to LSP sector, there would be a cost associated with the non-implementation of this modification.

2. The time to arrive at, and implement, the AUGS. This modification will ensure that any AUGS produced by the AUGE under MOD0229 will be effective from 1st April 2011. The impacts of non-implementation therefore also depend on the amount of time beyond this date that the AUGS would be produced if the process within MOD0229 was to be left to continue.

Within the proposed guidelines introduced by MOD0229⁴ a start to the process is considered on the 1st October of the first year following implementation. The AUGE is anticipated as have been selected and contracted with by the following March, with an AUGS created and finalised, with published charges, by the February following that.

Assuming that this process would start on 1st October 2010, this means that MOD0229 would provide relief for the SSP sector in May 2012, at the earliest. We also note that there is significant scope for delay in this process, not least throughout the tendering process and acceptance of the AUGS conclusions. Non-implementation of this modification will therefore expose the SSP sector to the costs considered in (1), above, for at least thirteen more months, and possibly twenty-five more months.

Finally, we also believe that there exists significant potential for the AUGS to take a long time to be produced and be implemented, thereby allowing the SSP sector to continue to be exposed to unfair allocation costs. Failure to implement this modification will exacerbate this risk by failing to remove the disincentive that exists on some parties to see the prompt implementation of the process considered by MOD0229.

2

User Pays

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

This change is not User Pays as it has no associated costs of implementation, over and above those already provisioned for within MOD0229.

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

n/a

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

n/a

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

n/a

3

Basis upon which the Proposer considers that it will better facilitate the achievement of the Relevant Objectives, specified in Standard Special Condition A11.1 and 2 of the Gas Transporters Licence

By guaranteeing the implementation of MOD0229 by 1st April 2011, this modification will ensure that the same benefits discussed by MOD0229 are met. We therefore consider that the relevant objectives this modification meets are:

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 to

the relevant LSP and SSP market sectors.

This Proposal should allocate costs more accurately to the SSP and LSP sectors. This in turn should remove a 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 AUGÉ 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 (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;

The 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 AUGÉ 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.

4 **Any further information (Optional), likely impact on systems, processes or procedures, Proposer's view on implementation timescales and suggested text**

5 **Code Concerned, sections and paragraphs**

- a) Uniform Network Code
- b) Transportation Principal Document

Section(s)

Proposer's Representative

David Watson (British Gas)

Proposer

David Watson (British Gas)