

Modification proposal:	<b>Uniform Network Code (UNC) 213v: Introduction of User Pays Governance Arrangements into the UNC (UNC213v)</b>		
Decision:	The Authority <sup>1</sup> directs that this proposal be made <sup>2</sup>		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	07 April 2009	Implementation Date:	To be confirmed by the Joint Office

## Background to the modification proposal

Xoserve is the agent for the gas distribution network owners (GDNs) and National Grid Gas National transmission (NGG NTS). Xoserve delivers, amongst other things, services that facilitate and underpin the booking of capacity by shippers, invoicing for transportation charges and the management of the register of Supply points connected to the gas transporters' network.

Xoserve provides these services via the Agency Service Agreement and is funded primarily by the gas transporters through their allowed revenues set out under the price control reviews.

However, during the development of the last gas distribution price control (GDPCR) the funding arrangements for xoserve were considered. The GDPCR recognised that the current funding arrangements may provide poor incentives on the gas transporters to provide anything more than a minimum level of service. Also, there were few incentives for the users (shippers and suppliers) to consider the costs imposed on xoserve to provide these services. Ofgem proposed a funding regime that would incentivise the gas transporters to be proactive with users in the services they provide.

Ofgem therefore proposed the concept of 'User Pays' which allows the user of the service to pay for them directly. However, core services which are provided to all shippers on a common basis will continue to be funded using price control allowed revenues.

An industry working group including xoserve and the gas transporters considered the services provided by xoserve and identified an initial number of services that could be suitably funded under User Pays. These are:

- Provision of information;
- Reporting;
- User administration;
- Must reads;
- Annual Quantity (AQ) amendments and appeals; and
- Shipper agreed reads.

For the purposes of the price control the cost associated with these services was removed from the revenue allowance of the NGG NTS and GDNs. To avoid the possibility of double funding, standard special condition A15 – *Agency* was modified to provide the legal framework for a common transporter charging methodology covering the User Pays

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup>This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

services and detailing the basis for associated charges. The Agency Charging Statement (ACS) would include the charging methodology along with the associated service charges. Modification UNC188 - *Introduction into the UNC of the Agency Charging Statement*<sup>3</sup> (ACS) which was approved on 7 April 2008 gave full effect to ACS and recognition within the UNC.

UNC213v seeks to enhance the governance arrangements for new and revised User Pays service lines that may be proposed via modifications to the UNC. This does not impact upon any discreet services which individual users may wish to take from xoserve on a bilateral basis.

### **The modification proposal**

UNC213v proposes a number of changes to the UNC Modification Rules along with the introduction of new definitions to facilitate the governance of User Pays proposals under the UNC. UNC213v requires the following:

1. A Modification Proposal shall state whether or not the Proposer believes the Proposal should result in a User Pays Service with supporting arguments;
2. A Modification Proposal would be required to state how the provision of any User Pays Service shall be funded with supporting arguments;
3. The Modification Panel shall be able to send Modification Proposals with a User Pays Service to an appropriate Work stream, Development Work Group or Review Group to attempt to resolve any issues with the funding and charging arrangements;
4. The Transporters shall be required to produce supporting cost estimates and supporting User Pays Charges for all Modification Proposals where incremental agency analysis, development and/or operational costs are funded on a User Pays basis;
5. The Gas Transporters will produce a Guidance document to provide guidance to the industry on the construction of a cost estimate and User Pays Modification Proposals. This Guidance document will be referenced in the Modification Rules and will be amended from time to time subject to approval by Modification Panel majority;
6. The Transporters would be required to ensure cost estimates are appropriately recorded in Modification Reports; and
7. A facility is introduced to seek an Authority View on the proposed funding arrangements.<sup>4</sup>

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<sup>3</sup> UNC188: <http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/UNC188%20D.pdf>

<sup>4</sup> This is consistent with Standard Special Condition A11: Network Code and Uniform Network Code: [http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=14193](http://epr.ofgem.gov.uk/document_fetch.php?documentid=14193)

The proposal also sets out a number of Business Rules that provide additional clarity and interpretation of the new processes.

### **UNC Panel<sup>5</sup> recommendation**

At the Modification Panel meeting held on 19 February 2009, of the 10 Voting Members present, capable of casting 10 votes, 10 votes were cast in favour of implementing this Modification Proposal. Therefore the Panel unanimously recommended implementation of this Proposal.

### **The Authority's decision**

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 3 March 2009. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR<sup>6</sup>. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC<sup>7</sup>; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties<sup>8</sup>.

### **Reasons for the Authority's decision**

Ofgem notes that User Pays is a relatively new concept for the industry and represents a fundamental change to the way that modifications to the UNC and associated systems are funded. We acknowledge the efforts made by the industry to improve upon these arrangements, as represented by this proposal. Eleven responses were received to the Joint Office consultation on this proposal, seven of which were in support, with the remainder offering qualified support. All those in support felt that the proposal presented the most viable means of introducing new User Pays services into the UNC.

Ofgem remains of the view that User Pays is an appropriate mechanism to incentivise gas transporters, via xoserve, to consider the services they provide to users and for users to consider the costs they incur on xoserve's systems. The proposed procedure for the governance of User Pays proposals within the UNC can deliver a number of benefits.

Firstly the costs associated with any User Pays proposal will be set out at the proposal stage. One respondent to the Joint Office consultation noted that the introduction of change costs is a key factor in the decision making process and puts more importance on analysis and cost information. Ofgem welcomes this development and is of the view that increased visibility of costs will provide for a full and detailed debate of the merits of the proposal allowing more robust and informed decisions to be taken by the UNC Panel and ultimately Ofgem.

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<sup>5</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

<sup>6</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.com](http://www.gasgovernance.com)

<sup>7</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: [http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=6547](http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547)

<sup>8</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

*c) so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under its licence*

The proposer believes that this proposal would provide an efficient governance process to support the application of the User Pays approach to the provision of new services and/or changes to existing services. Ofgem agrees with the proposer that implementation of this proposal further underpins the licence requirements as set out in SSC A15 (Agency) by providing the appropriate governance arrangements by which the User Pays services can be delivered within the UNC.

*d) so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition between relevant shippers, suppliers and DNs.*

This proposal further facilitates this relevant objective as it should strengthen the transparency of the governance framework underpinning the User Pays arrangements. This should also help inform users of the potential cost of User Pays services and improve their ability to manage their costs. Ofgem therefore agrees with the respondent that commented that increased visibility of cost information provided by this proposal will enable users to target their resources more effectively on the services they require and therefore underpin a more tailored service to their customers.

*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.*

Whilst generally supportive of the proposal, a number of respondents noted that the administrative arrangements being proposed to introduce User Pays are new and UNC213v should be viewed as an initial step to bedding down the new regime. In addition, the proposer felt that there should be formal review of the underlying rules by the UNC Governance Work stream 12 months following adoption of this proposal. The proposer also notes that issues that may arise around cost apportionment, management of alternative User Pays proposals and the seeking of views from the Authority which may prompt the development of further explicit arrangements.

We note that the principles of User Pays have already been adopted by the industry, notably with regards to modification UNC194 – *Introduction of DNO Obligations to facilitate resolution of unresolved USRVs*<sup>i</sup> which discussed the charges the shipper should pay for the GDN (via xoserve) to resolve USRVs. During the development of that proposal Ofgem noted the concerns that were raised about cost apportionment and which industry parties receive the most benefit from the proposal. Ofgem therefore welcomes the clarity provided by this proposal.

A few respondents suggested that one of the associated Business Rules is inappropriate, as it requires that:

“Any proposal not implemented, where it is established that a portion of the analysis cost should be borne by users, such costs would be recovered in line with the User Pays charge set out in the ACS.”

One respondent is of the view for instance is of the view that where a User Pays modification is aborted prior to Panel decision or rejected by Ofgem it would be more appropriate for assessment and development costs to be levied upon the proposer rather than apportioned across parties that may have not supported the proposal. Another

respondent holds a similar view in that costs should be shared by the proposer and those Parties that supported the modification.

We note these concerns but consider that if the development costs associated with an aborted User Pays proposal were to be allocated solely upon the proposer and/or those who publically supported it, they would be a disincentivised to raise User Pays proposals. Ultimately this could hinder innovation and the incremental improvement of industry arrangements.

It is appropriate that the methodology for recovery of these costs should be set out in the ACS. However, we consider that there is sufficient opportunity to minimise any sunk costs and the need for such a recovery. For instance, the requirement to include an estimate of costs at an early stage in the process will help to clarify its feasibility before substantial resource is spent on its development. It is also likely that any development of a proposal will not simply be written off if it is subsequently rejected by the Authority, but, could form the basis of a new proposal which has the same intent, but also addresses any issues which caused its predecessor to be rejected. In these instances it may be appropriate for the development costs of earlier proposals to be considered as part of a continuum, and recovered only as part of a successful implementation.

Ofgem also notes the concern made a by a number of parties that, notwithstanding their support, the proposal does add further complexity to the governance process of the UNC and may lead to delays to the progression of change proposals. Ofgem sympathises with this view however we believe that the additional complexity is introduced by the options for funding set out in the Guidance Document and not by the proposal. We believe that the process established by UNC213v will increase transparency and promote a fuller discussion on the validity of User Pays proposals which will in turn allow for more robust analysis. Ultimately this procedure will allow for a better informed decision to be made by the UNC Panel and the Authority.

Ofgem agrees with the proposer that this modification fully facilitates this relevant objective.

### **Decision notice**

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 213v: *'Introduction of User Pays Governance Arrangements into the UNC'* be made.

**Mark Feather,**  
**Director, Industry Codes and Licensing**

Signed on behalf of the Authority and authorised for that purpose.

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<sup>i</sup> USRVs – User Suppressed Reconciliation Values