

Modification proposal:	Uniform Network Code (UNC) 339, 339A: Clarification of the AUG Year in respect of UNC Modification 0229; UNC 340: Clarification of the AUG Year in respect of UNC Modification 0229 (alternative); and UNC 366: Clarification of legal text for UNC Modification 0229		
Decision:	The Authority ¹ directs that proposal UNC 339 be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	19 April 2011	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

This group of UNC modifications have been raised with the aim of clarifying the introduction of arrangements to allocate unidentified volumes of gas between market sectors.

Reconciliation by Difference (RbD) was introduced in the Small Supply Point (SSP) sector in 1998 to facilitate the introduction of competition in the domestic gas market. RbD is the method of reconciling the difference between actual (metered) and deemed (estimated) measurements of gas. At the time RbD was introduced, it was not considered practical to individually reconcile all supply points in this sector (which currently number around 22.3 million) based on actual meter readings. The introduction of RbD was designed to offer an efficient mechanism for reconciling consumption in the SSP sector, as a cost-efficient alternative to individual meter point reconciliation (as used for the Large Supply Point (LSP) sector). The introduction of RbD avoided the development of a more complex system that would have delayed the roll-out of domestic competition.

Gas that is not directly attributed to a shipper is known as Unidentified Gas. RbD manages the allocation of Unidentified Gas to shippers in the SSP market and it is treated as a smeared cost for all SSP shippers. No volumes of Unidentified Gas are currently attributed to the LSP sector. Unidentified Gas may be caused by a number of factors including theft, gas offtaken at late registered or unregistered sites, or measurement errors.

UNC Modification Proposal 229

UNC 229³ (Mechanism for correct apportionment of unidentified gas) introduced a mechanism for apportioning Unidentified Gas between the SSP and LSP sectors. This modification proposal introduced a table to the UNC which would apportion a fixed volume of Unidentified Gas to the NDM LSP and DM LSP sectors and introduced a requirement for an independent expert (Allocation of Unidentified Gas Expert, or AUGEX) to apportion values within this table on an enduring basis. The Modification Report said that "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 starting on 1 April, and in the same timescale as the DNO changes to transportation charges for that year."

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

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

³ The decision letter for UNC229 can be found on the Joint Office website at: <http://www.gasgovernance.co.uk/0229>. At the time we considered modification proposals UNC194, UNC194A, UNC228, UNC228A and UNC229.

This proposal was accepted by Ofgem on 26 May 2010. In our decision letter we commented that UNC 229 offers a route to allocate Unidentified Gas based on a widely researched and transparent analysis of the underlying causes of Unidentified Gas, and for that methodology to be replicated on an enduring basis.

We considered that UNC 229 would improve transparency and accuracy in the allocation of Unidentified Gas to the appropriate sector. We also considered that the aims and objectives of UNC 229 promote effective and efficient competition between the parties.

We published an Impact Assessment (IA) in November 2009⁴ that discussed a number of related modifications. The November 2009 IA set out our minded-to view to accept UNC 229 and reject the other remaining proposals. Some respondents to the IA noted the potential long lead-time in the AUGE appointment process that could have potentially delayed the effective start of the reallocation process.

In our decision letter directing the proposed modification UNC 229 be made, we encouraged industry parties to complete the appointment process and appoint the AUGE as soon as possible so as to achieve the start date of April 2011 set out in the legal text for the modification.

xoserve announced the appointment of the AUGE in March 2011.

Modification proposal implementation process

In the decision letter for UNC 229, we welcomed commitments provided to Ofgem from Transporters to provide monthly reports to Ofgem and the industry to increase transparency on progress in implementing UNC 229 including the appointment of the AUGE, and to provide parties with the information that they need to consider the merits of potential interim solutions.

We note that the current timelines set out in these reports will not achieve an AUGE appointment date which would allow the AUGE to produce a statement (the AUGS) to populate the AUGE table for the April 2011 proposed date.

UNC 317, UNC 317A and UNC 327 were raised to address any delay in the appointment of the AUGE, production of an AUGS and population of the AUGE table in time for an April 2011 start date.

UNC Modification Proposal 317

In November 2010 we approved UNC317. It was raised by Shell Gas Direct on 8 July 2010. Its intention was to set values in the AUGE Table if the AUGE was not appointed and an AUGE table was not agreed by 1 April 2011. For each AUGE year commencing 1 April 2011 until the AUGE has defined its charging methodology and an AUGS is produced, the LSP NDM sector would contribute £2.75m towards the total cost of Unidentified Gas and the LSP DM sector would make no contribution.

The implementation of UNC 229 aimed to produce transparent charges for Unidentified Gas based on a consistent methodology, which could in theory be reconciled back to April

⁴Identification and Apportionment of Costs of Unidentified Gas (reference 143/09) may be found on the Ofgem website: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Unidentified%20Gas%20-%20RIA%20final%20version.pdf&refer=Licensing/GasCodes/UNC/Ias>

2011. However, in our view this approach carried a high degree of uncertainty and risk to the LSP sector. UNC 317 provided a fixed allocation of charges to the LSP market, until the AUGS has been established, and removed the uncertainty brought about by the AUGS not having an agreed AUGS in place by April 2011.

Under the transitional arrangements put in place by UNC 317 and the enduring arrangements implemented by UNC 229, the legal text in the Transitional Document and Transportation Principal Document has the following effects:

- The transitional text will no longer apply once the first AUG Table is established and adopted by the Committee⁵;
- The process and methodology used to establish an AUG Table will involve reconciliation back to April 2011, but will not be subject to any express requirement to take into account the £2.75m paid annually under the transitional arrangements.

The modification proposals

UNC Modification Proposals 339, 339A, 340, 366

This decision letter sets out the Authority's decisions for UNC Modification Proposals 339, 339A, 340 and 366. Collectively, these proposals seek to clarify the legal text to implement UNC 229, and in particular, the definition of the AUGS year.

- UNC 339 was raised by National Grid on 12 October 2010. It seeks to introduce an application date for the first AUGS year of 1 April 2012. This is the date from which the AUGS Table adopted by the UNC Committee (UNCC) will have effect. From 1 April 2011 until the first AUGS Year, LSP NDM sites will be charged £2.75m per annum for Unidentified Gas in accordance with UNC 317. Under this proposal, if the AUGS Table is not implemented by 1 April 2012, interim payments under UNC 317 will continue to be paid. Once implemented, charges will be reconciled back to the 1 April 2012 date of the first AUGS Year. Note that there is no express requirement for any interim payments made by LSP shippers to be taken into account in this reconciliation.
- UNC 339A is an alternative proposal to UNC 339, raised by British Gas Trading on 27 January 2011. UNC 339A seeks to introduce an application date for the first AUGS Year of 1 October 2011. Under this proposal the interim annual payment of £2.75m per annum will be prorated and will only apply from 1 April 2011 until 1 October 2011. Once the AUGS Table is implemented, charges will be reconciled back to 1 October 2011 date of the first AUGS Year. However, unlike UNC 339, there will be no possibility of overlap between the periods covered by the transitional arrangements and the first AUGS Table being established and adopted by the UNCC – therefore there is no question of dual payments being made under both the transitional and enduring arrangements.
- UNC 340 was raised by National Grid on 12 October 2010. It seeks to introduce an application date for the first AUGS Year of 1 April 2011. From 1 April 2011 until the AUGS Year where the AUGS Table is implemented by the UNCC, LSP NDM sites will contribute £2.75m per annum for Unidentified Gas. Under this proposal, any interim payment under UNC317 will continue to be paid until the first year for

⁵ The committee, or UNCC, has the function to review such matters concerned with the implementation of the Code and to do such other things as are provided for by the Code. The UNCC may by panel majority decide upon the procedures to be adopted by it.

which the AUGE Table is implemented. Once the AUGE Table is in place, charges based on that table will be reconciled back to April 2011. Note that, as with UNC339, there is no express requirement for any interim payments made by LSP shippers to be taken into account in this reconciliation.

- UNC 366 was raised by Total Gas and Power on 4 February 2011. It seeks to ensure that the effect of the AUGE Table, once adopted, is to allocate Unallocated Gas prospectively commencing from the next 1 April occurrence. Accordingly, there would be no reallocation of charges for any period prior this date.

UNC Panel⁶ recommendation

UNC 339 and UNC 339A

At the Modification Panel meeting held on 17 March 2011, of the nine Voting Members present, capable of casting eleven votes, eight votes were cast in favour of implementing UNC 339. Therefore the Panel recommended implementation of this Proposal.

At the same meeting, six votes were cast in favour of implementing UNC 339A. Therefore the Panel recommended implementation of UNC 339A.

The Panel then proceeded to vote on which of the two Proposals (the original or its alternative) would be expected to better facilitate achievement of the Relevant Objectives⁷. Of the nine Voting Members present, capable of casting eleven votes, four votes were cast in favour of implementing UNC 339 in preference to UNC 339A, and four votes were cast in favour of implementing UNC 339A in preference to UNC 339. Therefore, the Panel determined that UNC 339 and UNC339A would equally facilitate the achievement of the Relevant Objectives.

UNC 340

At the Modification Panel meeting held on 17 March 2011, of the nine Voting Members present, capable of casting eleven votes, three votes were cast in favour of implementing UNC 340. Therefore the Panel did not recommend implementation of this Proposal.

UNC 366

At the Modification Panel meeting held on 17 March 2011, of the nine Voting Members present, capable of casting eleven votes, five votes were cast in favour of implementing UNC 366. Therefore the Panel recommended implementation of this Proposal.

Overall Recommendation

At the Modification Panel meeting held on 17 March 2011, the Panel then proceeded to vote on which of the four Proposals (UNC 339: its original and alternative, UNC 340, and UNC 366) would be expected to better facilitate achievement of the Relevant Objectives. Of the nine Voting Members present, capable of casting eleven votes, three votes were cast in favour of implementing UNC 339 in preference to the others, two votes were cast in favour of implementing UNC 339A in preference to the others, two votes were cast in favour of implementing UNC 340 in preference to the others, and three votes were cast in

⁶ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁷ The UNC Relevant Objectives can be found at: <http://www.gasgovernance.co.uk/UNC>.

favour of implementing UNC 366 in preference to the others. Therefore, the Panel determined that, of the four Proposals, UNC 339 and UNC 366 would better and equally facilitate the achievement of the Relevant Objectives.

Relevant Issues

Reconciliation of Charges

There continues to be debate as to the cost of Unidentified Gas that should be attributed to the LSP sector. We consider that determining the appropriate allocation of Unidentified Gas to each sector is a role best fulfilled by the AUGE. We approved UNC 229 to allow an AUGE to determine the allocation of Unidentified Gas between sectors, and we approved UNC 317 as an interim arrangement given that the AUGE will not be in a position to determine an AUGS for implementation before 2012 at the earliest⁸.

In our decision letter for UNC 317, 317A and 327, we noted that, in this specific circumstance, an advance payment followed by reconciliation was potentially onerous given the uncertainty that this approach would introduce. We noted that shippers that operate in both sectors of the market may not be subject to the same degree of uncertainty and may not need to price a value for an unknown volume of Unidentified Gas into their customer contracts. For these shippers, any increase in payments from the LSP sector may, to some extent, be compensated by a reduction in payments in relation to their SSP portfolio. We concluded that uncertainty may therefore have a disproportionate effect on those shippers that operate only or predominantly in the LSP sector.

We note that the AUGE arrangements are on schedule to deliver an AUGE Table for April 2012. If however, the April 2012 date is missed, we note the effect of UNC 317 is that it will continue to require a contribution of £2.75m/year from LSP NDM shippers until the AUGE arrangements are in place. In the UNC 317, 317A and 327 decision letter we expressed concerns that an advance payment followed by reconciliation would be potentially onerous given the uncertainty that this approach would introduce. However, we noted that, should the 2012 date be threatened by circumstances within the control of market participants, we may reconsider this view and note that parties may raise further modification proposals that sought to encourage an April 2012 effective start date.

We note that the effect of UNC 317 described above was an unintended consequence of placing the legal text in the Transitional Document for the UNC and not making any express provision for the treatment of payments made under those transitional arrangements. As noted above, if the AUGE Table is adopted after the first AUGE year, this would lead to reconciliatory charges for the LSP sector (which would not take into account any interim payments). We consider that this outcome was not an intended result of UNC317 and these unintended consequences are not desirable for the reason set out in our UNC 317, 317A and 327 decision letter.

The Authority's decision

The Authority has considered the issues raised by the modification proposals and the FMRs dated 17 March 2011. The Authority has considered and taken into account the

⁸ The AUGE was appointed in March 2011, and to date all milestones have been achieved on schedule.

responses to the Joint Office's consultation on the modification proposal which are attached to the FMR⁹. The Authority has concluded that:

1. Implementation of modification proposal UNC 339 and rejection of modification proposals UNC 339A, UNC 340 and UNC 366 will better facilitate the achievement of the relevant objectives of the UNC¹⁰; and
2. Directing that the modification be made is consistent with the Authority's principal objective and statutory duties¹¹.

Reasons for the Authority's decision, and assessment against UNC Relevant Objectives

As stated in Ofgem's decision letter for UNC 229, we consider that the arrangements for the allocation of Unidentified Gas should be reformed such that each market segment makes an appropriate contribution to these costs.

We have assessed each of the Proposed Modifications against the UNC Relevant Objectives. We consider that the Proposed Modifications impact on Relevant Objective (d)¹² only. The proposals are neutral with regards to the other Relevant Objectives. A summary of our views against Relevant Objective (d) is set out below.

UNC 339

This modification proposal seeks to amend the fixed date for the application of Unidentified Gas charges to LSPs. We consider that the aim of the modification is to fulfil the aim of UNC 229 to provide prior notification of the charges related to Unidentified Gas to the LSP sector.

We welcome the intent to provide clarity on the start date for the AUGÉ Table adopted by the UNCC. We recognise that this date provides a reasonable opportunity, based on current expected timescales, to ensure that the AUGÉ Table will be in place to meet the proposed 1 April 2012 application date. In this case, we note that there will be no requirement for reconciliation and that parties should have a clear idea of their prospective charges.

We further note that, were the AUGÉ Table implementation date to slip, this would lead to reconciliation of charges. Under these arrangements, the LSP sector would have paid for Unidentified Gas under both the charges identified in UNC 317 and those identified at a later date by the AUGÉ for the same period. Whilst this is not ideal, we consider that this may be appropriate given the length of time that this misallocation has occurred between the SSP and LSP markets.

We therefore consider this modification proposal better facilitates the achievement of Relevant Objective (d). It strikes an appropriate balance between cost certainty for NDM

⁹ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com.

¹⁰ 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.

¹¹ 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.

¹² 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.

LSP shippers, and, given the realistic timescale for the AUGE in its first year, minimising the cost burden on SSP shippers.

UNC 339A

UNC 339A recognises the concerns noted above on the potential for double recovery of charges from the LSP sector. It therefore ensures that the interim and enduring arrangements do not cover the same period of time. We note the benefits of this approach. However, we consider that the proposed application date for the AUGE Table of 1 Oct 2011 has disadvantages on balance, when compared to UNC 339. In addition, we note that the prospects of double recovery will not occur under UNC 339 if the AUGE Table is implemented for 1 April 2012.

We have concerns with the earlier Application Date of 1 October 2011, compared with the UNC 339 Application Date of 1 April 2012. As set out in the AUGE guidelines, code parties may submit queries from 1 September to the last day in February. The AUGE will investigate the change and if required amend the AUGS. The UNCC will then endorse or reject the proposed change, and if approved, final Unidentified Gas volumes will be calculated. If not endorsed, the AUGE will have 28 days to review the proposed change and submit an updated proposal. Given that this is a new, untried process, there is potential that LSP shippers will not have a fully accurate view of their likely charges. In this first year, it would be prudent to allow the process of developing the charges run its full course prior to implementation.

We consider that not allowing the AUGE guidelines and methodology to run the full agreed course may have a detrimental impact on competition. Therefore we do not consider that UNC 339A facilitates Relevant Objective (d).

UNC 340

The Panel members had less confidence that this modification proposal would deliver a more accurate allocation than under modification proposals UNC 339 and UNC 339A. We note that this modification proposal would lead to reconciliation of charges. Under these arrangements, the LSP sector would have paid for Unidentified Gas under both the charges identified in UNC 317 and those identified at a later date by the AUGE for the same period. This would result in a difference in cost allocation for LSP only shippers compared to others, which may increase comparative costs to LSP only parties. As such, we do not consider that this modification proposal offers an improvement to the competitive environment when compared to the UNC 229 arrangements and therefore does not facilitate the achievement of effective competition and Relevant Objective (d).

UNC366

We note the intended benefits of UNC 366 that it would allow a flexible application date for the AUGE Table, and that these charges would only apply on a prospective basis. However, we are concerned that it could reduce incentives to agree and finalise the AUGE methodology in an expedient manner. At this stage in the AUGE appointment process, we consider UNC 339 provides a clearer expectation for the application of the AUGE Table and the allocation of charges between the NDM LSP and SSP sectors. Therefore we do not consider UNC 366 to better facilitate Relevant Objective (d) when compared to UNC 339.

Conclusion and other considerations

For the above reasons, we are accepting modification proposal UNC 339. Industry participants have indicated that the timeframe for the implementation of the arrangements for allocating charges based on the adopted AUGE Table will be April 2012.

If this is delayed then parties could raise further modifications to amend the application date of the AUGE Table. However, as stated above, in the absence of unforeseen material impacts upon consumers, we are unlikely to consider such proposals favourably, particularly if the reasons for delay were within the control of parties and could have been avoided.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 339 be made.

Ian Marlee
Partner, GB Markets

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