Joint Office of Gas Transporters

Stage 02: Workgroup Report

What stage is this document in the process?

01 Proposal

02 Workgroup Report

03 Draft Modification Report

04 Final Modification Report

0379 / 0379A:

Provision for an AQ Review Audit

0379: aims to obligate the Network Owners to audit Shipper's use of the AQ Review window under certain circumstances.

0379A: aims to introduce the requirement for an audit of Shippers, whose update performance in the AQ Review process is less than 85% of their portfolio (including amendments phase) and introduce incentives to improve AQ accuracy.

The Workgroup recommends that these modifications should now proceed to Consultation

High Impact:
Shippers

Low Impact:
Network owners

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About this document:

The purpose of this report is make a recommendation to the Panel, to be held on 19 January 2012, on whether Modification 0379/0379A are sufficiently developed to proceed to the Consultation Phase and to submit any further recommendations in respect of the definition and assessment of this modification.

Any questions?

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1 Summary

Is this a Self-Governance Modification

The Panel have determined that both proposals do not meet the self-governance criteria.

Why Change?

The AQ Review process helps assign £billions of cost in the gas market and any issues or misuse of it can therefore have a material impact on the accuracy of cost allocation and therefore consumer's bills. Both proposers believed that the current controls on Shipper's use of the AQ Review process are not proportionate to the potential damage that would be done to competition were the process to be misused.

The Workgroup [Scottish Power] agree that there should be more robust controls around the AQ Review process, not just the amendment phase, but the process overall.

Over the past four years average performance by SSP and LSP Shippers has constantly fluctuated around 83% and 65%[1] respectively. This means that over the past four years there has been 17% of the SSP market not updating AQ and more significantly 35% of the LSP market.

Although Scottish Power appreciate the intent of the British Gas modification, they do not consider that it represents the best solution for ensuring robust and up to date AQs are derived through the AQ review process, and it limits accuracy of AQ which are ultimately used to allocate Shipper costs. In addition Scottish Power felt that the British Gas' proposals could lead the industry to track the lowest performing Shippers in the review, as Shippers are incentivised to track the mean.

Solution

0379

This proposal will obligate the Network Owners to direct an audit of any Shipper's use of the AQ Review process in the event that the aggregate kWh reduction in AQ values resulting from the AQ Review process is more than 1% over the median in any one AQ Review year, and / or the difference between the total number of AQ reductions compared to AQ increases is more than 7.5% over the median.

British Gas propose that in the event that the audit identifies any misuse of the AQ Review process, financial liabilities will apply on Shippers such that they do not profit from any misuse of the process.

0379A

This proposal will introduce a requirement for Shippers to have meter reading performance levels to result in at least 85% (subject to periodic review) of their AQs updating during the Review process. This would include those sites, which update by the T04 stage and those sites where the Shipper proposes an amendment. For the

Where can I find more information about how the AQ appeals process works?

The rules which govern the AQ appeals processes can be found in UNC section G, from paragraph 1.6 onwards. Link here.

[1] As per Xoserve Operational Forum presentations November 2010.

avoidance of doubt the performance would take into account all sites in the Shipper portfolio including vacants, dead and capped etc.

If a Shipper does not achieve an 85% or more performance level, then Ofgem, via the Transporters Agent (xoserve) would instruct an audit of the Shipper and the Shipper would be required to meet the cost of that audit. The auditor would work with the Shipper/Supplier to understand their meter reading strategy, meter reading submission process and AQ Review approach, including their approach to amendments, and in the case of LSP site, their appeals. The auditor would then recommend an improvement plan for the Shipper, to aid them achieving the 85% performance level.

If at the following year's AQ Review the Shippers performance was still below the 85% level, then the auditor would apply "Supplier Charges" and another audit would be instructed by Ofgem, again with the Shipper paying for this. The level of "Supplier Charges" would have to be worked out, but at this stage we would propose that this follows the rationale for those which apply in the electricity Balancing and Settlement Code (BSC). The rationale being that those Suppliers who have met the 85% performance level should receive the re-distribution of the Supplier Charges, based on their market share and performance (net of the cost of Xoserve for carrying out the audit).

Impacts & Costs

Modification 0379 will place an obligation on Network Owners to make arrangements for an audit of Shipper activity during the AQ Review process and will therefore impact their resources. All NDM Shippers will be required to fund this audit provision, regardless of whether they themselves are audited, with those facing audits facing specific resource impacts required to support the audit.

Modification 0379A will place a requirement on [Ofgem] to request Xoserve to appoint and instruct auditors to carry out the proposed audit, so would have an impact for Xoserve in respect of resources and costs. The only other costs would be placed on those Shippers, whose performance is below 85% in each AQ Review. This would therefore provide an incentive for Shippers to invest in data quality measures and therefore drive more accurate allocation of gas and transportation costs. It would also bring parallels between gas and electricity, where performance is driven through incentives in meter reading and settlement.

Implementation

The Workgroup consider it is important that the implementation date should be [before 1st November 2011 so that audits can be carried out on the 2011 AQ Review.]

The Case for Change

British Gas believe that by improving the control and assurance framework around the AQ appeal process the industry will have more confidence that the process is working effectively, Shippers will be dissuaded from any potential misuse of the process and the industry will be better able to identify and resolve any misuse. They consider that this in turn will ensure that cost allocation in the gas market will be as accurate as possible thus facilitating effective competition between Shippers. In addition, they consider this Modification 0379 will provide greater transparency over the degree to which Shippers are compliant with the existing Code obligations not to misuse the AQ appeal process, thus facilitating efficiency in the implementation and administration of the Code. This Proposal will therefore facilitate Relevant Objectives (d) and (f).

Scottish Power believe that the rules currently contained within the UNC around the AQ Review process do nothing to promote the update of AQ values on an annual basis. The poor overall industry performance is evidence of this situation, with the LSP market typically updating 65% and the SSP market typically updating 82%. They therefore believe that an incentive is needed to assure the allocation of gas and transportation costs. Given the 65% performance in the LSP market it is unclear whether LSP sites are using readings to reallocate costs in time before the close out period of. Scottish Power have asked Xoserve for information on this and expect this to be discussed as part of the assessment process.

Recommendations

[The Workgroup considers that the Modification is sufficiently developed and should now proceed to the Consultation Phase.]

2 Why Change?

Context

In the Non-Daily Metered (NDM) market the allocation of gas costs are allocated based on an estimate of how much gas a site has used. These estimated costs are then aggregated up for all the sites on a Shipper's portfolio to calculate the charges that Shipper is liable for.

The estimate referred to above is known as the Annual Quantity (AQ) value, and it is derived from historic consumption at a site. As with any other estimate bases on historic information, the AQ is not absolutely accurate and therefore the AQ Review process exists to allow Shippers to correct any material variations between the AQ and the consumption they see at the site. Scottish Power also highlight that the AQ will never reflect future usage.

Under the AQ Review rules, as set out in section G of the UNC (G1.6.3), the Transporter will notify the Shipper of the proposed AQ values for each site, based on the meter reading information sent to Xoserve throughout the year. The Shipper then has the right to amend the AQ, where in the case of a Smaller Supply Point it considers that the Provisional Annual Quantity should be greater or lesser than the Provisional AQ notified by the Transporter by not less than 20%. In respect of any Large Supply Point there is no such tolerance. (ref UNC 1.6.4 (a))

There are conditions as to when a Shipper is permitted to submit an amendment. These are outlined in UNC 1.6.4 (b), which states that the Shipper must reasonably consider that the Transporter's calculation of the Provision AQ is derived from either Meter Readings that are incorrect or were taken prior to Meter Readings available to the Shipper or where there are materially incorrect details used for the relevant Supply Meter Point.

Importantly, Shippers have an obligation to ensure that in the AQ Review they have applied a methodology which is consistent across their Supply Points, they have been even handed in their submission of AQ amendments – whether they be increases or decreases – and that it has not been selective over the AQs which it has finally appealed.

The resultant AQs, which are established during the AQ Review process are used to allocate gas and transportation costs across the industry for the next twelve months from October each year. It is therefore imperative that the AQs are accurate and that there are adequate controls in place to ensure that there is no "gaming" of the process for commercial advantage.

The risk arising from misuse of this process is material: £billions of cost is allocated through the AQ process each year and we calculate that were a Shipper with a 10% NDM market share to avoid just 1% of their costs through misuse of the AQ Review process, the misallocation of costs would be worth ~£6.5m[2].

[2] Assuming approximate SSP aggregate AQ of 328 TWh at an average cost of approximately £20m p/TWh, or £6.5bn total value. 10% share of this cost is therefore approximately £650m, with 1% of that cost valued at approximately £6.5m.

Despite the significant impact of the AQ Review process, and the impact that would arise from any misuse of it, the controls around it are inappropriately weak. British Gas consider it a major flaw in industry governance that, given the amount of cost, which the process allocates, in the NDM market, there is no provision for an audit of Shipper behaviour.

3 Solution

Modification 0379 will obligate the Network Owners to provide for an audit of a Shipper's use of the AQ Review process in the event that Shipper's aggregate kWh reduction in AQ values resulting from the AQ Review process is more than 1% over the median in any one AQ Review year, and / or the difference between the total number of AQ reductions compared to AQ increases is more than 7.5% over the median.

Immediately following an implementation of this Modification, the Network Owners will assess Shipper's performance in the last AQ Review period to have occurred and arrange for an audit of any Shipper's use of the AQ Review process in the event that Shipper's aggregate kWh reduction in AQ values resulting from the AQ Review process is more than 1% over the median in that AQ Review year, and / or the difference between the total number of AQ reductions compared to AQ increases is more than 7.5% over the median in that AQ Review year.

These levels have been chosen as they signify what we consider to be material variations in those two metrics, which are worthy of further scrutiny.

The audit will be tasked with assessing compliance with all rules relevant to the operation of the AQ Review Process and include an assessment of the degree to which any AQ movement was inappropriate.

Furthermore, this Proposal will also introduce a new obligation on the Network Owners to ensure that, in the event that a Shipper has been found to have breached the provisions of the UNC relating to use of the AQ Review process and financially benefited as a result of erroneous cost reallocation, to the detriment of other Shippers, they will arrange for the auditor to quantify the extent of that benefit and then raise an ad-hoc correction to correct the misallocation of costs. The audit and any subsequent corrections must be made before the end of the subsequent Gas Year in which an offence took place in.

Modification 0379A will allow Ofgem to direct Xoserve, as the Transporters' Agent, to instruct an audit of Shippers, whose update performance in the AQ Review overall (Proposed AQ values and amendments) is less than 85%. This audit would be paid for by the Shipper who has below 85% performance, with auditor working with the Shipper/Supplier to create an action plan to improve the Shipper's performance by the next AQ Review.

If at the stage of the next AQ Review the Shipper still has an update performance of less than 85% and therefore has not made substantial improvement, then "Supplier Charges" would be applied.

It is proposed that these "Supplier Charges" would be similar in scale to charges under the electricity Balancing and Settlement Code, of the same name.

4 Relevant Objectives

Implementation will better facilitate the achievement of **Relevant Objectives a, d and f.**

Proposer's view of the benefits against the Code Relevant Objectives	
Description of Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	0379A
b) 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.	None.
c) Efficient discharge of the licensee's obligations.	None.
d) 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.	0379 & 0379A
e) 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.	None.
f) Promotion of efficiency in the implementation and administration of the Code	0379 & 0379A
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators	No

The Workgroup consider that:

a) Efficient and economic operation of the pipe-line system.

Implementation of Modification 0379A may drive more accurate AQs through incentivising update performance Transporters will have a more accurate picture of customer demand. This in turn will be able to be factored into decisions on system capacity and investment.

d) 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.

The provision of an audit mechanism around the AQ review process will give the industry more confidence that the process is working effectively, that Shippers are adhering to both the rules and spirit of the UNC in relation to the Review Process. In addition it will dissuade Shippers from any potential misuse of the process, during the amendment window and prior to the AQ Review commencing (pre-T04 stage) and better enable the industry to identify and resolve any misuse.

It is considered that this in turn will ensure that cost allocation in the gas market will be as accurate as possible thus facilitating effective competition between Shippers.

Under Modification 0379A the requirement for any Shipper who has less than 85% performance to undertake an audit and work with the auditor to come up with a plan to improve performance it will ensure that more AQs update on an annual basis and that costs applied through allocation are more accurate. This will ensure more accurate allocation and apportionment of cost.

f) Promotion of efficiency in the implementation and administration of the Code

Both modifications will provide greater transparency over the degree to which Shippers are compliant with the existing Code obligations not to misuse the AQ amendment process, thus facilitating efficiency in the implementation and administration of the Code.

5 Impacts and Costs

Consideration of Wider Industry Impacts

The modification is unlikely to have wider industry impacts.

Impacts

This Proposal will impact both Shippers and Network Owners. Network Owners will need to procure or provide the audit service and Shippers will bear the costs associated with that.

Costs

Indicative industry costs – User Pays
Classification of the proposal as User Pays or not and justification for classification
User Pays
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification
Shippers will pay 100% of the costs associated with this. This is justified, as the anticipated benefit will be entirely in the Shipper market. Shippers and Transporters will share the cost of the set up the requirements for the MOD e.g. establishing reporting capability, establishing a Panel of Gas Industry Experts/Auditors. The costs of which will be split between the Transporters and Shippers on a 50:50 basis. This is because it is equally in the Transporters' interests to have accurate AQs for systems planning and efficient network investment, as it is for the Shippers to ensure fair apportionment of costs. The operational cost of the modification will however be met by those Shippers who fail to achieve the performance level of 85% on an equal share basis, for example if there are 5 Shippers who fail to meet the performance level, then they will each pay 1/5 of the costs of running the arrangement. The costs here will be those that Xoserve see for dealing with producing actual reports and administering the collection and re-distribution of payments associated with performance.
Proposed charge(s) for application of Users Pays charges to Shippers
TBC
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve
TBC

Impacts

Impact on Transporters' Systems and Process

Transporters' System/Process	Potential impact
UK Link	• TBC
Operational Processes	• TBC
User Pays implications	• TBC

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	• Shippers facing an audit will need to provide operational support and other resource, as necessary, for the duration of the audit.
Development, capital and operating costs	• Those Shippers who failed to meet the performance level may have increased operating costs, but these would be line with the costs of those Shippers who are currently meeting the performance level and therefore will only serve to put the Shippers on an equal footing. There may be a capital investment required, but again this will be to address the Shipper's shortcomings.
Contractual risks	• None.
Legislative, regulatory and contractual obligations and relationships	• None.

Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	• This modification will be beneficial to system operation, as it will drive more accurate and up to date AQs and will therefore ensure that the system is being balanced to an appropriate level. In addition it will ensure efficient network investment is made, as the AQs will be more reflective of actual usage.

Impact on Transporters	
Development, capital and operating costs	• This modification should ensure that the network is only sized to meet the consumer demand and therefore should be beneficial in the efficient use of capital
Recovery of costs	• This modification will ensure that recovery of costs are made at the correct level from each party, as the AQs will be more accurate and costs targeted at those Users who have greater throughput on the networks
Price regulation	• TBC
Contractual risks	• None
Legislative, regulatory and contractual obligations and relationships	• None
Standards of service	• None

Impact on Code Administration	
Area of Code Administration	Potential impact
Modification Rules	• None.
UNC Committees	• The UNCC will have an additional role of "approving" Gas industry Experts/Auditors to place on a Panel for use by the Shippers
General administration	• None.

Impact on Code	
Code section	Potential impact

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact
The modification proposes a new UNC Related Document	

Impact on UNC Related Documents and Other Referenced Documents	
Network Entry Agreement (TPD I1.3)	None.
Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4)	None.
Storage Connection Agreement (TPD R1.3.1)	None.
UK Link Manual (TPD U1.4)	None.
Network Code Operations Reporting Manual (TPD V12)	None.
Network Code Validation Rules (TPD V12)	None.
ECQ Methodology (TPD V12)	None.
Measurement Error Notification Guidelines (TPD V12)	None.
Energy Balancing Credit Rules (TPD X2.1)	None.
Uniform Network Code Standards of Service (Various)	None.

Impact on Core Industry Documents and other documents	
Document	Potential impact
Safety Case or other document under Gas Safety (Management) Regulations	None.
Gas Transporter Licence	None.

Other Impacts	
Item impacted	Potential impact
Security of Supply	This modification will have a positive impact on security of supply, as it will ensure that a greater percentage of AQs are updated and therefore lead to more accurate view of User requirements.
Operation of the Total System	None.
Industry fragmentation	None.
Terminal operators, consumers, connected system operators, suppliers, producers and other non code parties	None.

6 Implementation

[It is proposed that implementation of either modification should be 1st November 2011 if an Ofgem direction to implement is received by 28th October 2011,

Immediately following any later Ofgem direction, so that it can be applied to the AQ Review this year and drive immediate improvements in data quality and allocation. Although the instruction of an auditor would apply following this year's AQ Review process, the application of Supplier Charges would not kick in until following the AQ Review in 2012. This approach will ensure that Shipper has the ability to prepare and also work with the auditor to identify improvements in their process that will not only benefit the Shippers own business and customers, in terms of data quality and up to date AQs, but also the industry more generally, through accurate allocation.

The Shipper will have the ability to influence their performance ahead of the 2012 AQ Review process, such that it is entirely in their gift to avoid Supplier Charges. For the avoidance of doubt, the requirement to continue with a consistent approach to upward and downward movements in relation to AQ amendments will continue to apply.]

0379A - This proposal should be implemented as soon as possible after Ofgem direction. It is important that the implementation date should be before 1st November 2011 if an Ofgem direction to implement is received by 28th October 2011, 2nd November 2011 if an Ofgem direction to implement is received by 1st November 2011, and immediately following any later Ofgem direction, so that audits can be carried out on the 2011 AQ Review and performance improvement plans can be agreed between the auditor and Shipper/Supplier.

If the plans are developed early, then the Shipper/Supplier will have the opportunity to improve performance ahead of the 2012 AQ Review and therefore avoid Supplier Charges.

[dates are too late and no minimum lead time for backstop date?]

7 The Case for Change

Advantages

1. Provides greater transparency over Shipper behaviour during the AQ Review process, deterring any non-compliance and ensuring that any non-compliance can be identified and addressed.
2. Liabilities provision ensures that any misuse of the AQ Review process does not ultimately lead to a misallocation of costs.
3. Ensures that AQ update performance improves and therefore gas and transportation cost allocation is more accurate.
4. Places incentives on all Shippers to update more AQs on an annual basis.
5. Ensures that LSP Shippers submit meter readings ahead of the T04 stage and that these are used to reconcile LSP sites and credits/debits are factored through RbD in a timely manner.
6. Brings consistency between the electricity and gas markets in relation to performance assurance.
7. Improves network investment decisions by the Transporter, as AQ information will be more accurate.
8. Has corresponding benefits to security of supply by ensuring that there is a more accurate and up to view of User requirements.

Disadvantages

None identified.

8 Legal Text

To be provided by the Transporters.

9 Recommendation

The Workgroup invites the Panel to:

- AGREE that Modification 0379 and 0379A be submitted for consultation;