

Modification proposal(s):	UNC721 'Shipper submitted AQ Corrections during COVID-19'		
Decision:	The Authority ¹ has decided to reject this modification proposal ²		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	2 June 2020	Implementation date:	N/A

Background

COVID-19 presents a serious challenge for the energy industry to tackle on behalf of the homes and businesses that depend on the sector for gas and electricity. The lock-down of non-essential sectors of the economy, the re-purposing of some sites and changes in consumer behaviour means that energy consumption is varying from season normal patterns to an unprecedented extent. This is having a consequential impact throughout the energy supply chain.

Against this backdrop a specially convened session of the Uniform Network Code (UNC) Distribution workgroup was held on 14 April 2020 to consider the likely impacts of COVID-19 on the UNC arrangements and potential mitigating actions. To date, five UNC modification proposals³ have emerged from those discussions. We acknowledge and appreciate the efforts of all who have contributed to the expedited development of these proposals.

On 7 May 2020 we issued our decision to accept UNC722, UNC723 and UNC724, but were not at that time in a position to make a decision upon UNC721. We subsequently issued our decision to reject UNC725 on 29 May 2020.

The Annual Quantity (AQ) is an estimate of the projected consumption of a Supply Point over a year under average weather conditions. The AQ forms a key billing variable for Non-Daily Metered (NDM) Supply Points, forming the basis of several energy and Gas Distribution Network (GDN) charges to the relevant Gas Shipper.

Whereas the actual daily consumption at a Daily Metered (DM) Supply Point should be known, the AQ of an NDM Supply Point will be profiled across 365 days in order to provide an estimated daily consumption for that site. Any residual balance between the initial gas allocations and the total amount used within a given Local Distribution Zone (LDZ) will be attributed to Unidentified Gas (UIG). UIG, which can be a positive or negative value, is socialised across all Supply Points on a weighted basis. Whilst these values will be adjusted within the Gas Day and subject to reconciliation as further meter readings are submitted to the CDSP, Gas Shippers are required to settle on the basis of the gas confirmed to have been allocated to them at D+5. To the extent that there is a significant deviation between the volume of gas which is allocated to Gas Shipper on the basis of the AQ, and the volume of gas that the consumer will be billed based on actual

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

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

³ Those are UNC721, UNC722 'Allow Users to submit Estimated Meter Reading during COVID-19', UNC723 'Use of Isolation Flag to identify sites with abnormal load reduction during COVID-19 period', UNC724 'Amendment to Ratchet charges during COVID-19 period', and UNC725 'Ability to Reflect the Correct Customer Network Use and System Offtake Quantity (SOQ) During COVID-19'

metered consumption, UIG impacts upon the accuracy of cost allocation and can contribute to liquidity issues for Gas Shippers and Suppliers.

The AQ is also a key variable for capacity and commodity charges levied upon Gas Shippers. The capacity charge makes up around 95% of applicable gas distribution charges, with the remaining 5% being a commodity-based charge, linked to actual consumption. Whereas for DM Supply Points, the capacity charge is calculated using the Supply Point Offtake Quantity (SOQ) nominated by the Gas Shipper/Supplier, as being the maximum daily demand, for NDM Supply Points the SOQ cannot be measured using metered data and must therefore be estimated. The NDM SOQ, and therefore the applicable capacity charge, is calculated using a combination of the AQ and relevant peak Load Factor⁴ for that End User Category (EUC) that the Supply Point falls within. A Gas Shipper would therefore receive lower capacity and commodity charges for an NDM Supply Point if the AQ is reduced, and vice versa.

The modification proposal

UNC721 seeks to extend the circumstances under which a shipper may 'correct' the AQ applicable to a registered supply point, rather than gradually revise the AQ value through the submission of valid meter reads. Those circumstances are currently limited under the prevailing UNC rules⁵ to the following circumstances:

- a) a confirmed case of theft of gas;
- b) the installation, replacement or removal of Consumer's Plant⁶ which results in a material change in the basis on which gas is consumed;
- c) the commencement of a new business activity or discontinuance of an existing business activity at the consumer's premises.

While the eligible causes under a) and b) are not time bound, a Gas Shipper may only give notice of an AQ Correction under cause c) within the first three months of acquiring the Supply Point.⁷

A step change in the AQ may also be permitted where the meter readings are failing validation owing to being outside the range of tolerance⁸ for reads expected of the prevailing AQ value.

The modification proposal would extend the circumstances in which AQ may be revised to include circumstances where a site's consumption has varied unexpectedly due to the impact of COVID-19. This aims to allow the AQ to more quickly reflect actual consumption as result of restrictions imposed to control the spread of COVID-19.

UNC Panel⁹ recommendation

⁴ For each Gas Year, the EUC peak load factor, and (for the purposes of calculating it) 1- in-20 peak day demand and average daily load, for each EUC is determined by the Demand Estimation Sub-Committee.

⁵ UNC Section G1.6.21

⁶ Defined under the UNC as being: "the plant and/or equipment in which gas off taken from the Total System at that point is to be used (including any plant or equipment in which gas is compressed or otherwise treated before being consumed)"

⁷ UNC Section G1.6.24

⁸ In order to fail validation a meter read would need signify consumption that differs by several orders of magnitude beyond what is expected at a supply point of that AQ since the last valid meter reading.

⁹ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

At its meeting of 30 April 2020, the UNC Panel voted by a majority to recommend the implementation of UNC721.

Our decision

We have considered the issues raised by the Final Modification Reports (FMR) dated 30 April 2020. We have considered and taken into account the responses to the industry consultation which are attached to the FMR¹⁰ and concluded that implementation UNC721 would not better facilitate the achievement of the relevant objectives of the UNC.¹¹

Reasons for our decision

As noted above, while a significant proportion of the UK's economic activity has been reduced or suspended in order to contain the spread of COVID-19, gas continues to be allocated to many Supply Points on the basis of their typical seasonal consumption, for which the Gas Shipper will then be liable. Whilst the allocated energy will be reconciled over time with the submission of meter readings, we recognise that in the meantime there may be strains on the liquidity of relevant Gas Shippers, as well as end consumers. It is therefore welcome that the UNC parties have considered how to mitigate the impacts of COVID-19 and we have considered this and other related modifications in that context.

Given that the AQ is integral to the calculation of applicable transportation charges as well as to the accuracy of gas allocation, we agree with respondents and the UNC Panel who considered that UNC721 should be considered against relevant objectives (b) and (c) as well as relevant objective (d).

(b) so far as is consistent with sub-paragraph (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

We are sympathetic to the intention of the proposal and recognise that a short term reduction in AQ values through the correction process could offer some relief to the Gas Shippers upon whom those charges are levied, and to the extent that those charge reductions are passed through, to the end consumers. Whilst the proposer focused on energy allocation, we recognise that a widespread revision to AQs values could, even if temporary, also have a significant impact upon the GDN charging arrangements, as the AQ also forms the basis for commodity and capacity charges.

Although UNC721 is predicated on being a response to COVID-19, there is nothing to restrict the use of this process to only the worse affected Supply Points, rather than those which have seen a reduced consumption for some unrelated reason. Even with the proposed restriction of UNC721 to EUC bands 2 to 9, this could still apply to around 250k Supply Points. Whilst we note the ability of the Central Data Services Provider (CDSP) to exercise discretion and cancel AQ corrections submitted to it if the applicable criteria have not been met, we share the concern of those respondents who suggested that there would in practice be little to assure the appropriate use of this process. UNC721 could therefore result in the GDNs under recovering against their allowed revenue for the current formula year, which may redistribute liquidity problems upstream to those GDNs.

¹⁰ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

¹¹ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, available at: <https://epr.ofgem.gov.uk/Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

There would be a greater and more enduring impact if the temporarily adjusted AQ values feed into GDNs calculations for charges to apply in the subsequent formula year. For instance, if aggregate Aqs for the EUC2-9 (typically non-domestic) Supply Points are adjusted through the UNC721 process and remain suppressed when the AQ snap shot is taken 1 December 2020, this could result in a greater proportion of the GDNs allowed revenue being allocated to EUC1 (typically domestic) Supply Points. This redistribution of cost could be compounded if EUC1 Supply Points were to also see a temporary increase in consumption as a result of the lock-down, leading to an atypically high AQ at the time of the snapshot. We are therefore concerned that the cumulative effect of UNC721 would be to undermine the predictable and cost-reflective basis on which the GDNs recover charges.

In cases where the consumption ceases entirely, the relevant Gas Shipper may seek to avoid the commodity element of the charges by effecting an isolation of the Supply Point. Our recent acceptance of UNC723¹² will, for a limited period linked to the COVID-19 lock-down, allow such isolations without the usual requirement of an on-site inspection. UNC723 also extends the arrangement to circumstances where there may be a small residual amount of consumption rather than needing to have ceased entirely. However, capacity charges would continue to apply unless the Gas Shipper also 'Withdraws'¹³ from the Supply Point, meaning that they would be removed from the Supply Point Register as being the responsible Party.

As noted in our decision on UNC725, we consider that there may also be exceptional circumstances where relief could also be provided for the capacity element of GDN charges. Whereas UNC725 was focused on DM Supply Points, for which there is readily available evidence of daily consumption, or the lack thereof, an alternative process could be developed for NDM sites, whilst ensuring that the circumstances could be verified by the CDSP and/or relevant GDN in a proportionate manner. The isolations process may be a potential means of doing this.

We understand that the current isolation process was last subject to a substantive change in 2004 as part of the unbundling of metering provisions from the then network code. At that time the split in transportation charging between capacity and commodity was 50:50. It may be appropriate for UNC Parties to review whether the isolated status of a supply point should also offer any full or partial relief from capacity charges, without requiring a full Supply Point Withdrawal. Alternatively, UNC Parties could consider whether to extend or waive the current three-month post-acquisition deadline for an AQ Correction owing to a discontinuance of existing business activity. Whilst these and other options would require further assessment, we consider that either could offer a degree of flexibility to users who are precluded from utilising the network due to the imposition of COVID-19 related regulations, and mitigate the risk that such users might otherwise leave parts of the network under-utilised.

We consider that on balance and without rigorous control over the use of the AQ correction process, the implementation of UNC721 could have a negative impact upon relevant objective (b).

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

¹² UNC723: ['Use of Isolation Flag to identify sites with abnormal load reduction during COVID-19 period'](#).

¹³ UNC Section G3.2.1

Several GDN respondents referred directly or indirectly to their obligations under licence and in particular the requirement not to over or under recover allowed revenue by more than 6% in one formula year.¹⁴ Whilst we agree that this is a relevant concern, if such an under (or over) recovery had been effected by a change that the Authority has directed to the UNC and/or change methodology, we would reasonably have to take that into account when considering any enforcement action.

Licensees are also required to ensure that their charging methodologies are cost reflective.¹⁵ As noted in our decision on UNC725, capacity charges are intended to recover the costs of making the gas network available, and to do so in a stable and predictable manner. A temporary reduction in the AQ may be reflective of the consumers' demands in the short term, but the consequential reduction in the SOQ and applicable capacity charge would not be reflective of the cost the GDNs incur in providing that capacity, or of the consumers' longer terms capacity needs.

Whilst any shortfall in revenue arising from UNC721 would, in due course, be recovered through future transportation charges, these would fall upon all consumers, rather than only those who benefit from the short-term charge reduction. As we also noted in our UNC725 decision, there may be exceptional circumstances in which this may be justified. However, we are concerned that in the absence of robust, enforceable and verifiable conditions, the AQ correction process could be used in circumstances that are not directly related to COVID-19. Whilst we appreciate that UNC721 was developed at pace and that it was the proposer's intention that further safeguards be considered and applied post-implementation, we consider that the implementation of this modification in its current form would be inconsistent with charging principles and would therefore have a negative impact on relevant objective (c).

(d) so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition between relevant shippers;

The AQ value is itself derived from historic meter readings and therefore its accuracy will be dependent upon how frequently and recently the relevant Gas Shipper has submitted valid meter reads to the CDSP. It would ordinarily require the submission of several meter readings over a significant period of time before a material change in consumption is reflected in the prevailing AQ, and hence has an impact on the initial allocation of energy, and applicable commodity and capacity charges.

Any variance between allocated volumes of energy and actual consumption will impact upon Unidentified Gas (UIG). As UIG is socialised on a weighted basis across all Gas Shippers, it negatively impacts upon the accuracy of cost allocation. There have been several UNC modifications in recent years aimed at reducing UIG. The current lock-down associated with the COVID-19 could exacerbate the UIG problem both in terms of their being a greater variance between estimated and actual demand, and in making it harder to obtain the valid meter reads that allow for that variance to be reconciled. Gas Shippers are therefore exposed to the cost of energy which their own customers may not be consuming, and will remain so until reconciliation occurs. We are therefore sympathetic to intent of the proposal insofar as it seeks to expedite a revision to the prevailing AQ and bring costs more closely into line with current demand and network usage.

¹⁴ Gas Transporters Licence - Standard Special Condition 1B

¹⁵ Gas Transporters Licence - Standard Special Condition A5

However, revisions to the AQ are made on a rolling basis, intended to reflect long term trends in consumption rather than potentially being skewed towards atypical short term consumption. These arrangements, introduced as part of Project Nexus, replaced the Annual AQ review process. That process was heavily dependent upon a pairing of meter reads selected at the discretion of the Gas Shipper. The Competition and Markets Authority investigation into the energy market¹⁶ found that this process provided opportunity for gaming which had an adverse effect upon competition. We are concerned that a widespread use of the AQ Correction process would re-introduce some of the detrimental features of the previous regime.

Whilst the current reference period of at least nine months for the calculation of AQs means that the AQ is slow to react to changes in demand, this will be as true of consumption increases as it has been of demand reductions. We are concerned that the implementation on UNC721 would allow for an immediate step-change reduction in AQ where there is reduced demand, whether linked directly to COVID-19 or not, but there is no requirement to similarly expedite an upward revision to AQ when demand returns. Whilst we acknowledge that the demand may not wholly return immediately upon the lifting of lock-down restrictions, to the extent that the 'corrected' AQ would now be below actual demand the Gas Shipper would have a perverse incentive to make a further correction, and the gradual adjustment through meter readings may take many months. In the meantime, the Supply Point would be contributing to positive UIG, with the costs being allocated across the whole market.

We recognise that the proposer and several respondents suggested that the Performance Assurance Committee should have a role in further developing the AQ correction arrangements post-implementation to address these concerns. However, without the necessary reports and assurance techniques being in place, the likely lead time before they could be developed and the absence of a clear and time-bound exit from the ad-hoc arrangements, we are concerned that UNC721 would have a detrimental impact on the accuracy of cost allocation. Accurate cost allocation promotes effective competition by ensuring a level playing field for Gas Shippers and Suppliers, whose own efficiencies relative to their competitors allow them to compete on the basis of price. We are concerned that the redistributive effects of UNC721 would have an adverse effect on competition that outweighs any short term benefits it may provide.

We also note the concerns raised by some respondents that UNC721 is limited to Supply Points in EUC Bands 2-9 only. Although some of those respondents recognised that Supply Points in EUC1 (AQ below 73,200 kWh) had been excluded from the proposal in order to limit the impact upon the CDSP, they considered that this could have adverse impacts upon competition. Some suggested that and that proposed AQ correction process should therefore be extended to include EUC1 Supply Points, though this remains outside of the scope of UNC721.

We note that the AQ correction is an exception process with typical volumes of around 3000 requests per month. We therefore recognise that there are limitations on the extent to which this processed could be scaled up without the development of a systemised solution, which would be impracticable given the urgent nature of this proposal. Whilst the majority of the circa 22 million supply points which fall within EUC1 are domestic premises, we also recognise that there are several hundred thousand non-domestic Supply Points in that band. Based on the information available, which have

¹⁶ Final report of CMA energy market investigation 2016 can be found here: <https://www.gov.uk/cma-cases/energy-market-investigation>

been unable to reach a conclusion on whether the limited application of UNC721 could be unduly discriminatory against such EUC1 consumers.

We consider that on balance, the implementation of UNC721 would not further facilitate relevant objective (d).

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority hereby directs that UNC721: '*Shipper submitted AQ Corrections during COVID-19*' should not be made.

Frances Warburton
Director, Energy Systems Transition

Signed on behalf of the Authority and authorised for that purpose