

Modification proposal:	Uniform Network Code (UNC) 450/450A/450B: Monthly revision of erroneous SSP AQs outside the User AQ Review Period (UNC 450/450A/450B)		
Decision:	The Authority ¹ directs that UNC450B be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	20 February 2014	Implementation Date:	1 October 2014

Background to the modification proposal

The Annual Quantity (AQ) represents an estimate of the amount of gas to be off-taken at a supply point during a given Gas Year, which runs from 1 October to 30 September. AQs are used in a number of Uniform Network Code (UNC) processes, including the billing of energy and calculation of transportation charges.

Section G of the UNC requires Gas Transporters (GTs) and Shippers to engage in an annual review of the AQ at each supply point, referred to as the AQ Review process.

Under this process, each year by 31 May for Smaller Supply Points (SSPs) and 30 June for Larger Supply Points (LSPs), GTs provide Shippers with a Provisional AQ for the supply points in their respective portfolios. The Shipper then has until 13 August to review the Provisional AQ values and if appropriate seek to revise them by submitting a more recent pair of valid meter reads than the GT may have had available when calculating the Provisional AQ. The AQs are then confirmed by the GT on 14 September and effective from the start of the next Gas Year.

In addition to this AQ Review period, Shippers also have the ability to appeal an AQ for LSPs³. This may be at any time between the GT confirmation of the new AQ and 31 July the following year.

The modification proposals

UNC450 and the alternative proposals UNC450A and UNC450B each seek to extend the AQ appeal process to SSPs; the differences between them stem primarily from the allocation of Xoserve's available system capacity.

UNC450 seeks to allow the AQ at SSPs to be appealed between 1 October and 31 May, after which the annual AQ Review process will be available. An appeal would not be allowed if the revised value is within 20% of the current AQ. This is also subject to a minimum movement of 4,000kWh. For instance, a supply point with an AQ of 25,000kWh may be revised down to 20,000kWh as this meets both criteria, whereas a 5,000kWh revision at a supply point with a current AQ of 50,000kWh would not be permitted.

Xoserve has indicated that it would be able to handle 20,000 SSP appeals per month. In order to achieve an equitable distribution of Xoserve's available capacity, UNC450 proposes that each Shipper would initially be allocated 50 appeal opportunities. The appeal opportunities that remain after this initial allocation will then be divided amongst

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 This includes sites which, if amended, would go above the 73,200kWh threshold and therefore be re-classified from being an SSP to an LSP.

Shippers in proportion to the share they hold of the SSP market. An exception to this is that any Shipper with less than 50 SSPs would receive an initial allocation equal to the number of SSPs held, rather than 50.

UNC450A would follow the same allocation method as UNC450 but allows an appeal only for supply points that have been subject to a customer switch and therefore acquired from another Shipper, between the dates 1 September and 31 May. The proposer, British Gas, considers that this should achieve the desired outcome of allowing Shippers to appeal erroneous AQs for sites which have recently come into their ownership, but exclude those supply points which they have held longer and could have utilised existing AQ Review procedures.

UNC450B is identical to UNC450 other than increasing the initial allocation of capacity from 50 per Shipper per month, to 200. Gazprom, the proposer of UNC450B, considered that its alternative would deliver greater benefits for smaller shippers by increasing their guaranteed allocation of monthly appeals.

In all three proposals the 4,000kWh and +/-20% threshold would not apply to sites which are being revised from an existing AQ of 1kWh⁴.

Each of the proposals would also add SSP appeals to the existing scope of the 'UNC378 report'⁵ in order to provide transparency of whether Shippers are taking a balanced approach to upward and downward AQ corrections.

UNC Panel⁶ recommendation

At the UNC Panel meeting of 16 January 2014, despite six of the eleven voting members being in favour of at least one of the UNC450 options, votes were divided and none of the proposals managed to secure a majority. The five GT Panel members did not vote for any of the proposals. Therefore, the UNC Panel did not recommend the implementation of UNC450, UNC450A or UNC450B.

The UNC Panel then went on to express its preference between the proposals. While most of the GT members again chose not to cast a vote, the majority of votes that were cast were in favour of UNC450B.

The Authority's decision

The Authority has considered its statutory duties and functions in reaching its decision. The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 16 January 2014. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposals which are attached to the FMR⁷. The Authority has concluded that:

⁴ A supply point may legitimately be assigned an AQ of 1kWh if it is known to have ceased consuming gas. However, sites have in the past also had their AQ set to 1 as a default where Xoserve has considered the calculated AQ to be manifestly incorrect. Several parties have raised concerns that this creates a perverse incentive for the relevant Shippers to revise the AQ.

⁵ UNC378: '[Greater transparency over AQ Appeal performance](#)' required the publication of additional information on shipper performance, both during the AQ Review and separately through the AQ Appeal process.

⁶ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules. The minutes and voting record are available at: www.gasgovernance.co.uk/panel

⁷ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

1. implementation of any of UNC450, UNC450A or UNC450B would better facilitate the achievement of the relevant objectives of the UNC⁸;
2. of the three options, implementation of UNC450B would provide the greatest benefits; and
3. directing that the UNC450B be made is consistent with the Authority's principal objective and statutory duties⁹.

Reasons for the Authority's decision

Whilst views on the proposals were divided, the majority of respondents, including the proposer of the original UNC450, stated a preference for UNC450B to be implemented. Only three of the thirteen respondents failed to support any of the three proposals.

We agree with the proposers, the UNC Panel and those respondents who referred to the relevant objectives, that UNC450 and the two alternative proposals should be assessed against relevant objective d). We consider that the proposals would have a neutral or no impact against the other objectives.

Relevant objective (d): the securing of effective competition

Allocation of costs

The majority of respondents agreed that the implementation of one of the options would allow for the correction of AQs outside of, and therefore in a more timely manner than, the existing annual AQ Review process. It was noted that more accurate AQs would lead to the more accurate and efficient allocation of costs across the market. We agree that accurate AQs are fundamental to the accurate allocation of charges, which is a key pillar to effective competition between Shippers and Suppliers.

Distributional effects

One respondent, opposed to any of the options, suggested that the costs to their own systems of adopting one of these proposals would be in the order of £500,000 though they did not clarify how this figure had been arrived at. As Shipper participation in this process would be entirely elective and follow the existing procedure used for LSP appeals, we do not consider that the implementation of these proposals would of itself impose any costs upon Shippers. Although economies of scale generally benefit larger Shippers, we recognise that in this case smaller Shippers may be at a relative advantage in terms of being able to more readily adopt these procedures and/or to greater effect than larger Shippers. Each Shipper will be able to make informed decisions on whether their own costs of progressing SSP appeals would be outweighed by the benefits of correcting AQs within their own portfolios.

It was also suggested that Shippers may be compelled to participate in this process in order that they are not disadvantaged relative to other Shippers who may be able to reduce their costs. We acknowledge that the current process of Reconciliation by Difference (RbD) in the SSP market may mean that any reduction in costs allocated to an individual Shipper following an AQ reduction would be balanced by a socialisation of that

⁸ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: <https://epr.ofgem.gov.uk//Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

⁹ 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, as amended.

cost across the rest of the SSP community. However, the reverse is also true, as any increase in AQ will reduce the costs allocated through RbD.

We recognise there may be a concern that Shippers will only appeal AQs where it would be to their advantage. These risks apply equally to the LSP sector and led to the implementation of the UNC378 report. We consider that extending the scope of this report to cover SSP appeals will provide necessary transparency, and demonstrate whether Shippers are taking a balanced approach to upward as well as downward corrections.

A further respondent recognised that there are inherent problems with the existing AQ Review process, but suggested that placing a cap on the number of SSP appeals could create a cross-subsidy between larger and smaller Shippers. If the 20,000 appeals per month capacity is fully utilised we would expect Xoserve to explore means of making more available in subsequent months, if this could be done efficiently. However, while such a constraint exists we consider that the proposed mechanisms offer a pragmatic and equitable basis for allocating the limited capacity currently available.

We recognise that the initial 50 or 200 appeal allocation per Shipper could result in some smaller Shippers being able to appeal a relatively larger proportion of their portfolio than larger Shippers, though the differences are marginal and such concerns do not of themselves warrant the rejection of these proposals.

Implementation costs

The implementation costs for any of the proposed modifications is estimated by Xoserve to be in the range of £160,000 and £230,000. Some respondents questioned whether this would be economically efficient, given that this functionality is expected to be superseded by Project Nexus in 2015. One suggested that this SSP appeal functionality would not be required if Shippers met their existing UNC obligations with respect to the timely and accurate submission of meter reading. We have some sympathy with this view, but note that some issues with the provision of timely and accurate reads currently sit outside of the Shippers control and that while concerns over the accuracy of AQs exist, it is appropriate to consider means of improving it.

We acknowledge the concern about the potential shelf life of these proposals, which will become an increasingly relevant consideration for systems dependent modification decisions as we draw nearer to Project Nexus implementation. With respect to UNC450 and its two alternatives, we note that the minimum correction is 4000kWh. Assuming full use of the suggested 20,000 capacity over each of the 8 months, at least 640MWh of annual energy consumption could be notionally re-allocated as a result of this proposal.

The financial impact of this reallocation will be greater for those appeals made earlier in the year. I.e. a supply point which has its AQ reduced in October 2014 would receive a near 12 month adjustment of costs. An appeal made in May 2015 may influence only 4 months of costs, as the AQ may in any case have been revised with effect 1 October 2015 following the annual AQ Review.

Based on a System Average Price (SAP) for gas of 2.3p/kWh¹⁰, even with diminishing returns over the course of the year this would more accurately allocate over £10million¹¹

¹⁰ 2012/13 SAP 2.3p/kWh - source: National Grid website - <http://marketinformation.natgrid.co.uk>

¹¹ Based on those supply points appealed in October reallocating charges for at least 80Mwh (£1.84m) of energy, those during November being limited to 11/12 (£1.687m) of charges, and so on.

of energy imbalance costs alone. The final figure could prove to be much greater as the scale of each individual appeal is likely to exceed the 4000kWh minimum threshold, especially as shippers will have an incentive to use their allocation where it will have greatest effect. The revised AOs will also impact upon the allocation of transportation commodity and capacity charges for each supply point.

Whilst there is no obvious benchmark for how much should be spent ensuring the accuracy of other costs, as the suggested implementation costs are likely to be less than 2% of the reallocated costs, we do not consider them to be disproportionately high. We also note that UNC450 was first raised in March 2013 and progress has been disappointingly slow. It appears that the delay was largely due to a failure to reach consensus on how the available capacity should be allocated amongst Shippers. We consider that it should have been possible to have completed the modification process in time for the 2013/14 Gas Year, which would have enabled an additional 12 months of any benefits arising from these proposals.

Conclusion

We consider that the implementation of any of these proposals would increase the accuracy of cost allocation and therefore further effective competition between Shippers and Suppliers. The costs of implementing the proposals are comparable, though a distinction can be made in their potential benefits.

We consider that the idea of limiting appeals to those sites which have been recently acquired has some merit. However, we share the concerns of those respondents who noted that it may be some time before historic inaccuracies come to light and/or two valid meter reads become available to the incoming supplier. We further consider that AOs should be made as accurate as possible as soon as possible, irrespective of the initial reasons or who may be at fault for any prevailing erroneous values. We therefore consider that the additional stipulations of UNC450A may inhibit the benefits of the SSP appeal mechanism and has potential to further complicate the customer transfer process.

UNC450 and UNC450B are identical in all aspects others than the allocation of available capacity. The majority preference, particularly from smaller new entrants to the market including the proposer of UNC450, is for UNC450B to be implemented. We note the concern of some shippers that the higher initial allocation of UNC450B could lead to some capacity not being used, though this should be balanced against ensuring that all Shippers have a reasonable initial allocation. We agree with the majority of respondents who considered that the minimum 200 appeals offered by UNC450B provides a more appropriate starting position than the 50 appeals offered through UNC450.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority hereby directs that modification proposal UNC450B: *'Monthly revision of erroneous SSP AOs outside the User AO Review Period'* be made.

Rob Church

Associate Partner, Smart Metering and Smarter Markets

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