

The Joint Office, relevant Gas
Transporters and other interested
parties

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Dear Colleague

**UNC642: 'Changes to settlement regime to address Unidentified Gas issues' and
UNC643: 'Changes to settlement regime to address Unidentified Gas issues
including retrospective correction'.**

We have received requests from Corona Energy and Orsted that their modification proposals UNC642 and UNC643 respectively are given urgent status and follow urgent modification procedures.¹ This letter confirms that we have agreed to those requests.

Background

Prior to the implementation of UNC432² on 1 June 2017 as part of the Project Nexus, any gas used within a Local Distribution Zone (LDZ) that was left over once allocations had been made for Daily Metered (DM) usage and shrinkage would be allocated to the Non-Daily Metered (NDM) sector. The amount of gas allocated to the NDM sector would be adjusted over time as meter readings came in, allowing for a reconciliation between the amount of gas initially allocated to individual sites and actual metered consumption. However, such reconciliation only took place for larger supply points. Smaller supply points, which typically include domestic premises, continued to be allocated an Annual Quantity (AQ) based proportion of whatever gas was left over once all other reconciliation had taken place. UNC432 removed this Reconciliation by Difference (RbD) process and required smaller supply points to be individually reconciled in the same way as larger supply points.

UNC432 also means that NDM consumption is no longer used as the *balancing factor* in each LDZ. Instead, a new NDM demand algorithm uses actual weather data to derive a *bottom up* estimate. This estimate is subtracted from total LDZ throughput, along with DM measurements and an allowance for shrinkage, with any residual Unidentified Gas (UIG) usage being the new balancing factor. This daily UIG is apportioned across all supply points, in accordance with a weighted scaling factor determined by an independent expert, the AUGE³.

The industry has become accustomed to *permanent* Unidentified Gas estimates of around 1% of throughput. This figure represents the residual amount of gas still unaccounted for at the UNC cut-off date, i.e. after 3-4 years of reconciliation. However, the daily UIG

¹ Modification Proposal UNC642 and UNC643 can be found on the Joint Office website at: www.gasgovernance.co.uk/0642 and www.gasgovernance.co.uk/0643

² UNC432: "Project Nexus – Gas Demand Estimation, Allocation, Settlement and Reconciliation reform"

³ The Allocation of Unidentified Gas Expert, see: www.gasgovernance.co.uk/augenex

figures since 1 June 2017 have generally been in excess of this and have shown considerable volatility (UIG can be a positive or negative value), as shown in the weekly reports provided by Xoserve. This unpredictability makes it difficult for gas shippers to determine how much gas they should purchase in order to balance their daily positions. The issue is compounded by uncertainty over how much of the variance between allocated gas and actual consumption will be resolved through subsequent reconciliation, and when this will occur. In the meantime payment for energy including the shipper's allocation of UIG will become due, which may have significant cash flow implications for some shippers.

The modification proposals

Both UNC642 and UNC643 seek to provide greater certainty, particularly to the DM sector. In summary, both proposals seek to:

- change UIG to a fixed percentage of LDZ throughput. That percentage would be determined for each Gas Year by the AUGER. For instance, for 2017/18 it would be 1.1%. The UIG volume would continue to be shared across all supply points as per the AUGER weighting factors;
- reintroduce a variable scaling factor into the NDM allocation algorithm, in order to balance total gas allocation with LDZ throughput; and,
- modify the reconciliation process such that any reconciled gas volumes (now to be termed 'Settlement Error') are smeared across sites that have not been reconciled. The reconciled volumes would be apportioned according to new weighting factors to be developed by the AUGER. Until such reconciliation weighting factors are developed, the same weighting factors as UIG would be used.

UNC643 is in effect an alternative to UNC642 in that it proposes to make the same changes to the gas settlement regime, but for those change to have retrospective effect from 1 June 2017, unwinding some of the effects of UNC432. Also, whereas UNC642 would smear the reconciled volumes across only NDM unreconciled sites,⁴ UNC643 would apply to both NDM and DM sites.

UNC Modification Panel View

Before making our decision on whether these proposals should follow an urgent modification procedure, we requested the UNC Modification Panel's view, in accordance with paragraph 10.1.1(b) of the Modification Rules.⁵ At its meeting of 21 December 2017 the Panel members voted that both UNC642 and UNC643 should follow urgent procedures.⁶

Authority decision

In reaching our decision, we have considered the details contained within the modification proposal, the Proposers' justifications for urgency and the views of the Panel. We have also assessed the requests against the criteria set in Ofgem's published guidance⁷. In particular, we have considered whether it is linked to "*an imminent issue or a current issue that if not urgently addressed may cause a significant commercial impact on parties, consumers or other stakeholder(s)*".

We note the proposer's concern that the current levels and volatility of UIG are placing a significant burden on gas shippers to manage. As set out in our guidance, we do consider that urgency could be warranted by a current and ongoing issue rather than necessarily an upcoming event.

⁴ Unless a yet to be defined 'Reconciliation Target' is reached, whereupon it would be smeared across all supply points.

⁵ UNC Modification Rules: www.gasgovernance.co.uk/sites/default/files/Modification%20Rules_13.pdf

⁶ Panel minutes and voting record are published on the Joint Office website: www.gasgovernance.co.uk

⁷ Ofgem's Guidance is published on our website:

www.ofgem.gov.uk/system/files/docs/2016/02/160217_urgency_letter_and_amended_criteria_2.pdf

We also note that shippers had over three years to prepare for the changes to the gas settlement regime, with UNC432 having been directed to be implemented in February 2014. The use of UIG as a balancing factor, combining daily settlement error with the more systemic and stable causes or permanent unidentified gas was reasonably expected to increase the volumes and volatility of that value. The primary impact of UNC432 is that all shippers now have greater transparency of and exposure to UIG on a daily basis, rather than it being smeared through the RbD mechanism. However, we acknowledge that the current volumes and volatility of UIG are currently making it difficult for some shippers to make efficient purchasing decisions, and forecast when UIG volumes may be 'returned' to them through reconciliation. We are therefore satisfied that there is an issue that if not urgently addressed may cause a significant commercial impact to shippers, and more importantly to consumers if shippers seek to pass through this risk to their customers as a tariff premium.

In this letter we do not comment on the proposed retrospective effect of UNC643, other than in relation to our decision to grant it urgent status. As noted in our published guidance on urgency, the retrospective application of a modification may negate the need for its development to follow an urgent or otherwise contracted timetable, and vice versa. However, given that UNC642 and UNC643 are, as noted above, in effect mutually exclusive alternative proposals, it would not be good regulatory practice and could lead to market uncertainty if the two proposals were to follow different timetables. Therefore, whilst it may not have been necessary for UNC643 to follow urgent procedures, we consider it appropriate that the two proposals be considered alongside each other and accordingly that the timetable to be followed apply to both. We would expect this to also apply to any further alternative proposals that may be raised.

We note that proposers' suggested timetable would have allowed for a single workgroup discussion, to be held 4 January 2018, prior to consultation and submission to the January meeting of the UNC Panel. Given the relative complexity of the proposals, we do not consider that this would have been adequate, particularly for full consideration of legal text. We consider that the timetable set out below strikes the appropriate balance between expedience and ensuring the proposals are fully developed and assessed with an appropriate degree of rigour, though we reserve the right to deviate from this timetable if any evidence or analysis that is reasonably expected or requested is not forthcoming.⁸

Process	Date
First workgroup discussion (further ad hoc workgroups may be held as and when required – to be confirmed by the Joint Office)	4 January 2017
Consultation issued	1 February 2018
Consultation closes	8 February 2018
Modification reports issued to the UNC Panel	12 February 2018
UNC Panel makes its recommendation on the proposal	15 February 2018
Authority decision expected by	End of February 2018

For the avoidance of doubt, our decision on urgency should not be treated as any indication of our view on the merits of modification proposals UNC642 and UNC643. It remains to be established whether the appropriate means of addressing the issues highlighted in these proposals is via a further UNC modification rather than, for instance, through the individual actions of shippers. We will make a decision on the proposals themselves in due course, in

⁸ We also note that the granting of urgency to these proposals does not of itself exempt them from being 'sent back' to the UNC Panel if appropriate, in accordance with Standard Special Condition A11(15)(b)(ii) of the Gas Transporters Licence.

accordance with the appropriate process and after having taken account of all relevant considerations.

Yours sincerely

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