



Nigel Nash  
Ofgem  
9 Millbank  
London  
SW1P 3GE

29 January 2010

Dear Nigel,

**Re: Ofgem Impact Assessment on Identification and Apportionment of Costs of Unidentified Gas (Mods 0194/0194A, 0228/0228A, 0229)**

Thank you for the opportunity to comment on the above proposals relating to the financial apportionment of the costs of I&C related unidentified gas to the LSP sector. Corona Energy (CE) believes it is vital that all gas suppliers are able to compete efficiently and effectively on a fair and transparent basis. As requested CE has provided a detailed response to each of the questions in Ofgem's Impact Assessment (Appendix I)

CE agrees with Ofgem's proposal to implement UNC 0229 as it believes the dual principle of appointing an independent expert to determine the level of any charge and having those charges levied on a predictable basis is a fair one.

CE has previously argued that proposals 0194, 0228 and 0228A could seriously impact the competitiveness of the I&C market (see Appendix II) and notes that the independent report produced by TPA on behalf of the ICoSS group (Appendix III) supports this position. This upholds Ofgem's stated position that the methodology proposed by British Gas and Scottish Power under UNC modification proposals 0194, 0228 and 0228A were flawed.

The ICoSS Group asked TPA to undertake analysis on the unidentified gas issue, including analysis considering of the merits of the underlying principles of the proposed solutions. The brief provided to TPA was based on that proposed under UNC 0229 for the independent expert. It was noted that this report would act as 'proof of concept' for the implementation of UNC 0229 if Ofgem were to direct implementation.



CE would also like to highlight that TPA also identified 'a number of areas where greater clarity and understanding of the factors influencing the allocation and reconciliation process' should be pursued. TPA recognise that one such improvement could be achieved in understanding the true level and nature of theft from the GB gas networks via the introduction of a National Revenue Protection Service.

CE trusts these comments are helpful. If you have any queries regarding this response please contact Richard Street on 07920 803271.

Yours,

Richard Street\*  
Regulatory Affairs Manager  
Corona Energy

\*please note as this letter has been delivered electronically a signature will not be attached



## Appendix I

In addition to the analysis undertaken by TPA solutions, Corona Energy has provided the following comments in response to the questions contained within the Impact Assessment.

### CHAPTER: Three

#### ***Question 1: Do you agree with Ofgem's assessment that the likely impact of the Modification Proposals on charges made to consumers?***

The industry is looking to implement a mechanism whereby costs for Unidentified Gas that are currently wholly allocated to the SSP sector are smeared across both the LSP and SSP sectors. Any methodology that undertakes this, will alter the cost of supplying those customers and hence impact customer charges.

The only modifications that suggest a value are Modifications 0228 & 0228A. It is clear that the costs for LSP customers (I&C and Domestic) that are proposed are significant, but as is shown by the TPA analysis, with no clear rationale. Any reallocation of Unidentified Gas should be undertaken only after extensive analysis of the scale of the problem has been undertaken.

#### ***Question 2: Do you consider that the proposed governance arrangements under UNC229 offer adequate protection to the interests of consumers in their present form?***

Modification 0229 proposes a transparent process for determining the values that will be allocated to each market segment. This will give consumers scrutiny of the AUGE's activities and they will be able to put pressure on their Shippers if they feel the mechanism is unfair. We have seen recently with the Modification 0275 process that Code Parties are prepared to raise modifications in response to these concerns from customers. The UNC framework therefore seems adequate for protecting consumer interests. In any event, we do note that Modification 0267 is aiming to examine the UNC governance regime and so this should highlight any deficiencies.

In the unlikely event that the AUGE process highlights issues which cannot be solved within the UNC, Ofgem is able to either implement new licence conditions, or undertake a major policy review.



***Question 3: Do you anticipate any further impact upon consumers in addition to those considered in this chapter?***

As highlighted by Ofgem, Modification 0229 (through the appointed AUGÉ) will create a body of information on the scale and causes of Unidentified Gas. This will allow the industry and consumers gain greater understanding of the problem and so ultimately allow solutions to be taken forward. None of the other Modifications will realise this benefit.

**CHAPTER: Four**

***Question 1: Do you agree with our assessment that any of these Modification Proposals will have an effect upon incentives for shippers to reduce the quantity of Unidentified Gas offtaken at LDZs?***

The issue of creating incentives or mechanisms to reduce Unidentified Gas is a separate issue to the intent of these modifications which is the correct apportionment of Unidentified Gas. At present there is a perverse incentive placed upon LSP Shippers to not identify Unidentified Gas as they will bear the full costs of any gas identified; also SSP Shippers stand to gain from any Unidentified Gas they can ascribe to a customer as RbD is not adjusted retrospectively. In order to allow the most appropriate treatment of Unidentified Gas by Shippers, any regime must aim to be as revenue neutral as possible for all Shippers. None of these modifications seek to create this situation and so should not be judged against these criteria.

It should be noted that the industry is currently examining the incentive mechanisms for identifying Unidentified Gas through Modification 0274. Whilst this modification is outside the scope of this impact assessment, any regime to reduce Unidentified Gas will benefit from additional information. Only Modification 0229, through the work of the AUGÉ, will help provide greater understanding of the issues surrounding Unidentified Gas. Only this modification therefore should be seen to be creating an environment that will reduce Unidentified Gas volumes.

***Question 2: Do you agree with our assessment of the likely distributional impact of the Modification Proposals?***

Please see the work undertaken by TPA solutions



***Question 3: Do you believe that the potential benefits of the Modification Proposals justify the additional costs which may be imposed on customers?***

Any modification that is proposed should bring greater benefits than its costs. There is currently little benefit to customers from Modifications 0194, 0228 and 0228A as they do not attempt to reduce the scale of Unidentified Gas; they merely benefit one set of customer costs at the expense of another. Only Modification 0229 attempts to determine the size of the problem through analysis. This will ensure that costs are appropriately targeted. It is also the only modification that allows those values to be adjusted in light of market developments. Finally, Modification 0229 will also result in significant information on Unidentified Gas being compiled; so helping the industry form measures to tackle the causes. Compared to the other modifications, there is therefore much greater benefit to customers and the industry from Modification 0229.

***Question 4: Do you agree that applying a variable RbD charge upon LSP shippers would potentially entail a negative impact upon competition? Do you feel that this potential impact justifies the imposition of a fixed rather than variable charge on LSP shippers?***

Modifications 0194 and 0228 propose to use a percentage of RbD to the LSP market sector. RbD varies daily, so this link will create the counterintuitive effect of the Unidentified Gas error varying with RbD. There is no evidence that Unidentified Gas varies with reconciliation of LSP sites, and certainly does not become negative.

RbD is also a correction mechanism triggered by periodic reconciliation of LSP meter points, and so is unpredictable. This means that Shippers will be unable to accurately include this additional volume in either their contracts, or their wholesale gas procurement. This will lead to greater inefficiency (increasing costs to consumer as a whole), in particular those Shippers that concentrate on LSP consumers. Both Modifications 0194 and 0228 will damage competition and result in cross-subsidies between market sectors.

These issues are avoided by using a fixed charge, which is the solution proposed by Modifications 0228A and 0229. This allows efficient procurement of gas resulting in lower costs for customers. Modification 0228A does suggest a fixed value but the lack of any supporting analysis of the values proposed, make it impossible to say that they do not result in a cross-subsidy.

Modification 0229 creates greater certainty that the volumes derived are accurate as they are not varying according to market reconciliation, but as a result of analysis by a third party. We do note that during the last Price Control review, the Shrinkage volumes moved to a fixed volume basis as Ofgem believed that this gave a more accurate reflection of losses.



***Question 5: Should any third party authority created under the terms of UNC229 be tasked to review incentives for investigating theft upon individual shippers?***

As stated above, we do share Ofgem's concerns that the costs of reallocating Unidentified Gas to the LSP Sector should be proportionate. The work that would be undertaken by the AUGE will highlight the scale and nature of the causes of Unidentified Gas to the industry. The industry is likely to then raise modifications that would address these causes. Modification 0229 is therefore likely to stimulate development of incentives by Shippers, avoiding the need of separate investigations.

**CHAPTER: Five**

***Question 1: Do you agree with Ofgem's assessment that any impact on sustainable development as a result of these Modification Proposals is likely to be marginal?***

These modifications will have a marginal impact on sustainable development as their primary focus is the correct allocation of Unidentified Gas.

***Question 2: Do you agree with Ofgem's assessment of the relative impact on sustainable development of each of the Modification Proposals?***

Modification 0229 is likely to have the greatest impact on sustainable development, through the additional work that will be done by the AUGE (although we note it will only be marginal as stated in Question 1).

***Question 3: Do you consider that there are any further impacts on sustainable development that are likely to result from the Modification Proposals?***

We do not anticipate any further impacts.

**CHAPTER: Six**

***Question 1: Do you anticipate any impact on health and safety as a result of these Modification Proposals? If so, what?***

The modifications will have limited health and safety implications. Only Modification 0229 is likely to have any noticeable impact on customer behaviour through its work in investigating the underlying causes of Unidentified Gas.



## CHAPTER: Seven

### ***Question 1: Do you agree that implementation of UNC229 would leave parties with adequate recourse to query decisions made by the AUGE?***

The AUGE appointment process will be subject to the oversight of the UNCC directly, or via an appointed sub-committee. Shippers also have the option to raise modifications to challenge the process. The Major Policy Review process that is currently proposed gives Ofgem the ability to suggest corrections if major issues are identified. These measures provide sufficient recourse to challenge AUGE activities if it is felt that the UNCC was not undertaking its duties under Modification 0229. Consumer representatives do not currently have a vote within the UNCC, but the self-governance discussions occurring under the auspices of Modification 0276 may result in greater consumer representation.

### ***Question 2: If not, how should any additional governance be implemented?***

As stated above we would do not feel that any additional governance is needed, but feel that the AUGE process should be included in the discussion currently being undertaken in Modification 0276.

### ***Question 3: Are there any additional risks which may be placed upon industry parties by implementation of the Modification Proposals within scope of this Impact Assessment which we have not identified in this document?***

We believe that all have been identified.

### ***Question 4: How could the Governance Arrangements for appointment of an AUGE be structured to minimise impact upon shipper parties? Should GTs be indemnified from any risks from holding this contract, and if so how might this be implemented in practice?***

The Transporters' concerns in this area are ill-founded. The terms of reference for appointing the AUGE clearly state that Shippers will be able to commence legal proceedings for the activities undertaken by the AUGE in compiling the AUGS only if the AUGE activities are found to be fraudulent or clearly erroneous. In addition the AUGE must limit its legal proceedings to the recovery of any fees from the Transporter.

Therefore the Transporters are insulated from any liability from this process. Accordingly they only have to create a standard contract, drawing on previous



contracts for appointing such third parties as the RbD auditor and the Meter Error Expert, of which historically there has been no issue. It should be noted that the GT have complete control over the contract terms and conditions and are in a strong position to ensure an appropriate contract.

There is therefore no need to create additional securities to indemnify the GTs. To do so would damage the AUGÉ appointment process as the GTs would not be incentivised to draw up the contract with the due care and diligence expected of a commercial entity.

It should be noted that Modification 0229 (unlike the other Modifications) has not had the benefit of legal text being produced. If this had been done, then a form of legal wording will have been developed to cover these issues.

## **CHAPTER: Eight**

***Question 1: Do you agree with Ofgem's assessment that the benefits of appointing an independent third party to assess Unidentified Gas would accrue to the industry?***

Any third party that is appointed as the AUGÉ will be required to undertake significant analysis of the sources of Unidentified Gas to derive appropriate values. Through a rolling yearly contract they are incentivised to make a robust case for the values derived. As they are not impacted by the values derived they will be objective in their judgement. They will also be able to adjust the Unidentified Gas values over time in light of industry developments. None of the other modifications generate these benefits.

## **CHAPTER: Nine**

***Question 1: Do you believe that a post-implementation review will be necessary for the Modification Proposals which Ofgem is minded to implement?***

Modification 0229 have a number of mechanisms to allow improvements to be suggested. If this modification is implemented then no post-implementation review is needed. The other modifications, owing to their arbitrary values will need review





## Appendix II

Tim Davis  
Joint Office of Gas Transporters  
31 Homer Road  
Solihull  
West Midlands  
B91 3LT

30 October 2008

Dear Tim,

**Re: Modification Proposal 0194 - Framework for correct apportionment of NDM error and 0194A - Framework for correct apportionment of LSP unidentified gas**

Thank you for the opportunity to comment on the above proposals relating to the financial apportionment of unidentified gas from the LSP sector. Corona Energy (CE) supports modification 194A but does not support the British Gas Trading (BGT) raised modification 194.

CE believes it is vital that all gas suppliers are able to compete efficiently and effectively on a fair and transparent basis. It is also part of a shippers' duty of care to its customers to avoid passing costs through that are unfair and arbitrary. CE are therefore extremely concerned by the changes proposed under modification 194 which we believe will not only lead to substantially increased bills to Industrial and Commercial (I&C) customers but will also substantially impact on competition in the SME sector.

Based on a twenty five percent share of the RbD smear, these changes are estimated to add around £75m to the annual bill of the I&C shippers. Due to the nature of these charges, I&C shippers would find it difficult to pass-through these charges to consumers which would leave the majority of I&C shippers unprofitable. CE therefore believes it is essential that if Ofgem are minded to implement the 194 proposal, that they first conduct a Regulatory Impact Assessment. This will ensure that the full impacts of any decision including the destructive affect it will have on competition are completely understood prior to a decision being made by the authority.

The purpose of these charges is to compensate the domestic gas companies for theft or other such missing gas contributed by I&C businesses. CE believes however the



mechanism proposed by BGT is designed to reduce the entire exposure faced by domestic shippers to the RbD mechanism and not just their exposure to unidentified gas. By contrast, the mechanism proposed in proposal 194a is clear, transparent, predictable and ensures that only appropriate charges are targeted at the correct parties.

CE believes the changes proposed in modification 194 will substantially impact on the business model operated by most specialist I&C suppliers active in the market today. Ultimately, this will provide the 'big six' domestic businesses with an unfair advantage which may lead to the demise of many of the I&C specialist gas suppliers. This would leave the majority of the I&C market dominated by the same 'big six' gas suppliers that currently dominate the domestic market.

The 194a proposal provides a more appropriate way to solve the issues in question. It recognises that the I&C market should make a contribution in recognition of the level of unidentified gas the LSP market generates. Proposal 194a achieves this in a clear, transparent and predictable way and avoids the market distortions that proposal 194 creates.

I trust these comments are helpful. If you have any queries regarding this response please contact myself or Richard Street on 0208 632 8169.

Yours,

Matthew Gray\*  
Managing Director  
Corona Energy

\*please note as this letter has been delivered electronically a signature will not be attached