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Identification and Apportionment of Costs of Unidentified Gas Impact Assessment

Dear Nigel

Thank you for the opportunity to respond to your impact assessment of the five UNC modification proposals aimed at the Identification and Apportionment of Costs of Unidentified Gas.

The existing arrangements which allocate all unidentified gas to the Small Supply Point market has long been identified as being inequitable..

We agree with Ofgem that there is insufficient analysis of the data to make the case for an appropriate apportionment of unidentified gas to any particular grouping on an enduring basis. This is the case for any re-allocation or indeed for the continuance of the current position which allocates all to the Small Supply Point market. Given this we believe that 'doing nothing' is not an option and the status quo cannot continue.

We also agree with Ofgem that UNC 229 would provide an enduring solution. A proper methodology and analytical approach to the investigation of the sources and causes of unidentified gas is paramount. What is equally important is that this process is transparent and that it can be appropriately challenged. The results however should be binding which is why we support the role of an independent third party. The industry has introduced a precedent for this in the area of Offtake Metering where as part of the Measurement Error Guidelines an

independent expert produces a methodology which itself is challengeable but the outcome in terms of the results produced by the methodology is not.

As the roll out of smart metering develops, the transition will see a diminishing RbD pot. In order for the industry to evaluate the integrity of the RbD process during this period it will be important to separate out those elements which are associated with proper Small Supply reconciliation and those which are associated with unidentified gas.

Our concerns lie in two areas:

1. Timing

The time that it is taking to resolve this issue is unacceptable. Effectively domestic customers have been subsidising I&C customers for nearly 14 years. We note that in other areas where similar inequalities existed, namely the interruptible market, steps have been taken by the DN's to bring about reforms. UNC 229 may well be the solution but its protracted development and apparent lack of positive support by the transporters means further delays.

Whilst we welcome and support the long term solution provided by UNC 229 we feel that Ofgem has a duty to domestic customers to right the inequalities referenced above by implementing an interim solution.

We believe that UNC 228a is the best option for the interim. Its premise is based on the best available analysis to date and it removes the risk of fluctuating RbD exposure to suppliers in the Large Supply Point market by using allocations based on fixed volumes.

As a significant supplier in the LSP market we refute the argument that the costs cannot be passed on. We would expect most supply contracts in the sector, particularly at that larger end would include the right of the supplier to pass on variations in third party costs. The majority of supply contracts in this sector are for twelve months and are negotiated throughout the year, therefore in the majority of cases costs could be incorporated into new contracts. In any event the costs are relatively small, at around £183.27 per NDM LSP and only £3.35 per DM LSP.

Implementation of UNC 229 would involve a degree of preparatory work including the employment of the AUGER and it would be some considerable time before the gas allocations could be arrived at and invoiced.

The cost of implementing UNC 228a has been put at £110,000 - £360,000 or somewhere between 52p - £1.71 per customer on average. This can be compared with a reduction in subsidy paid by a domestic customer of £ 2.75 (Table 2). It would therefore seem that interim implementation of 228a for any duration longer than 2-7 months would be worthwhile.

2. Governance

The existing UNC Committee is weighted towards transporter representation and is not proportionally representative of the shipping community. Under UNC 229 the AUGÉ's decisions can be overruled by the UNCC, if transporters take a neutral position this seems to create a situation where certain shipper groupings have the power to take decisions on commercial grounds in support of their own market sector. This is not to say that transporters will not take an objective view and address issues of methodology regardless of the outcome in terms of gas allocation. Ofgem's review of governance arrangements may resolve this problem.

In response to the consultation questions:

CHAPTER: Three

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

We agree.

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

We have concerns as explained above. A key could be customer representation but this would of course very much depend upon the representative and the necessary equal treatment of the various market sectors. Alternatively a UNCC sub-committee with proportional representation between transporters and shippers based on relative Small and Large Supply Point market share could carry out AUGÉ methodology evaluation.

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

We have not identified any other impacts.

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?

In general we agree although we believe that better identification will help inform other groups. For example other UNC groups looking at theft would be better able to focus on those areas identified as delivering most benefit. Another example would be supply point metering. If it was shown that certain categories of meter were less accurate than others then this could influence design and selection.

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

We agree and particularly take note of the effect of UNC 228a. The increased charge to LSP NDM customers would be less than 1% of their bill. For DM customers £3.35 represents an increase to the smallest mandatory DM firm supply point of only 0.000006 p/kWh in unit rate terms.

We do not believe that in the main LSP shippers will be unable to pass on increases to customers either because supply contracts in this sector would normally include such provision or the natural re-contracting process will allow these costs to be included in new contract rates.

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

We believe that the costs are insignificant when compared to the benefits. As we have demonstrated above, the implementation of 228a even as a short term interim is cost effective for any period greater than 2-7 months depending on eventual xoserve costs.

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?

We do not believe that the greatest affect on competition is the absolute increase in cost that would be borne by the LSP sector but the risk associated with RbD fluctuations. For that reason we support a fixed methodology.

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

No, we believe that the role of the third party expert should be specific and should focus on identification of unidentified energy rather than incentives to tackle theft. Others groups looking at theft can then take the results as inputs to their own targeted initiatives.

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?

We agree that the direct impact of the Modification Proposals is likely to be marginal, however we believe that UNC 229 by quantifying the elements of unidentified gas is likely to play a vital role in the development of incentives albeit indirectly.

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

We agree.

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

We have not identified 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?

None other than initiatives to reduce theft facilitated by UNC 229

CHAPTER: Seven

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

We have concerns that parties may query decisions made by the AUGE purely for their own commercial interests and, dependent upon the prevailing make up of the UNCC could gain support from shippers operating in their market sector. We would however expect the DN's in their neutral role to challenge any such queries.

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

We believe that problems in this area may be overcome by creating a UNCC sub-group to oversee the AUGE appointment. The AUGE would then develop a methodology which the sub-group would have the opportunity to challenge, this would form the scope of the contract however the resultant outcome in terms of actual energy allocation would be binding on all parties.

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 have not identified any additional risks.

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?

See answer to Q:2.

We do not believe that the GT's would be subject to any material risks from holding this contract. They have extensive experience in procurement and contract management. A parallel can be drawn with Offtake Measurement Error Guidelines process whereby they contract with an independent expert. We understand that as a result they have not sought additional allowed revenue to indemnify themselves against any additional risk.

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?

We agree.

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?

As we have outlined above, our concerns are that UNC 229 will not deliver changes to the allocation of unidentified energy for some considerable time, at this stage we cannot identify the need for any post implementation review but that need may arise at some point in the future.

Should you have any questions or queries regarding our comments please contact Brian Durber.

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Yours sincerely

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Retail Regulation