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Dear Nigel,

Response to Identification and Apportionment of Costs of Unidentified Gas – Impact Assessment

Introduction

GDF SUEZ Energy UK is a major supplier to the Industrial and Commercial Gas and Electricity sectors, having a market share of around 5% in electricity and 12% in gas, in this sector. We supply both Half-Hourly and Non-Half Hourly electricity customers and Daily Metered and Non-Daily Metered gas customers.

Summary Points

Thank you for the opportunity to respond to the above consultation. GDF SUEZ Energy UK is broadly in agreement with Ofgem's "minded to" decision to implement UNC 0229, given the options available. The principle of appointing an independent expert to determine the methodology by which unaccounted for gas costs are allocated is a fair one.

We are however very concerned that the methodology proposed by British Gas and Scottish Power under UNC modification proposals 0228 and 0228A is seriously flawed and introduces an unjustified cost bias towards the Large Supply Point (LSP) sector. As a result of this concern GDF SUEZ Energy UK, along with other Industrial and Commercial Gas suppliers, have asked TPA solutions to produce a report on this issue.

We would hope that the key conclusions and detailed analysis contained in the TPA report are of use to Ofgem when considering the issue of unidentified gas generally, and specifically with regard to taking forward a robust and fair cost allocation methodology.

The TPA report and conclusions should be read in conjunction with our response and is attached together with this document. It is intended that this report should help to take forward industry thinking on the unallocated gas issue and to this extent we have no problem with making this report accessible to interested parties.

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Consultation Questions and Response

CHAPTER: Three – Impacts on Consumers

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

The Ofgem estimate of £9.33 per domestic customer attributed to RbD charges looks to be a reasonable on the basis of the information provided. However, it is important to note the following in relation to this estimate:

- Given the reasons listed below, implementation of any such cost redistribution measure, whether it is better targeted or not, may result in an overall **increase** in the cost to consumers across all market sectors.

- There is a much higher degree of cost visibility to the customer in the Industrial and Commercial (I&C) sector. Flexible gas purchasing arrangements and highly visible cost pass through items such as transportation and metering costs are commonplace. It is likely therefore that given the degree of transparency in this sector that additional charges arising from regulatory change arising from any of the proposals listed will be passed through in a similarly transparent manner.

- This degree of cost visibility is not present in the domestic tariff market and it is unlikely that any cost decreases as a result of such changes will be passed through to consumers. It is unlikely that tariff reductions will be made solely as a result of any regulatory change of this order. At best it will be taken in the round with other factors at some point in time, at worst it will be supplier shareholders, not domestic consumers who are likely to benefit.

- It is important to give confidence to the market that regulatory change can bring forward real benefits for consumers. In regard to its statutory duties, how do Ofgem intend to prove, and audit, on an ongoing basis that the potential benefit to domestic consumers from this cost allocation has materialized?

Additionally:

- The RbD charge should not be viewed as an additional cost which only Small Supply Points (SSPs) bear. Much of this cost estimate will comprise genuine reconciliation which is present in all market sectors due to deeming error. Large Supply Points (LSPs) carry this reconciliation risk to a larger extent as volumes are higher and hence costs in the LSP sector are very sensitive to the contract price v's System Average Price (SAP) differential.

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

UNC 0229 proposes that governance is undertaken by the Uniform Network Code Committee, which comprises in effect the UNC modification panel. The panel has previously coped well with providing good governance; in the case of UNC 0229 shipper representatives and consumers share a common interest to minimize costs, so in this respect the interests of consumers are well catered for. The transporter element of the UNCC or panel whilst they do not have the same incentives as shippers or customers, are likely to be neutral on the issue.

On a wider note we are supportive of a consumer representative (as long as they represent the interests of all consumers), having a voting seat on the UNC Panel and UNCC.

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

Yes, it is likely that costs to consumers overall will **increase**. See response to Question 1.

CHAPTER: Four – Impacts on Competition

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?

We no not agree that any of the suite of proposals are likely to provide a meaningful incentive to reduce the scale “unidentified gas”. These proposals relate solely to the redistribution of costs arising from “unidentified gas”, not to incentives.

Where any party pays the same cost as any other similar party in the relevant market there is no incentive to change the magnitude of costs one way or the other. Hence, a proposal such as UNC 232 (withdrawn) (Total Gas and Power), where such costs are factored into a transporter shrinkage regime, is a better model for delivering this type of cost allocation.

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

Ofgem’s assessment seems fair given the limited information available.

In addition we have further points to make:

- Re-allocating costs from the SSP to LSP sector may inhibit competition in the Industrial and Commercial sector as there is an opportunity for cross subsidies to occur between markets. Those companies who operate in both the Domestic and I&C sectors have the opportunity to use this to the disadvantage of single sector players.

- The costs arising from measurement errors which are outside of the control of a shipper should be paid by the Distribution Network Companies and a targeted incentive regime should be put in place to reduce such costs, for example LDZ metering error.

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

We are not convinced that benefits to customers will arise at all should any of the proposals be implemented. See our response to section 3, question 1.

The additional cost associated with the appointment of the independent expert (AUGE) associated with UNC 0229 may not materialize. The work done by TPA (attached report) can help to establish a robust cost allocation mechanism in the first instance. This cost has already been funded by shippers directly.

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?

Yes, this argument has been well expressed in consultation responses and at the modification panel assessment of both UNC 0194/0194A and UNC 0228/0228A/0229.

The risk of variable RbD charges is a risk which was a risk of choice, not an imposed risk on SSP shippers. From 1998 through the role out of competition in the domestic gas market, the variable cost RbD mechanism was chosen to take precedent over a the individual reconciliation model. This choice was largely based on simplicity and a way to avoid costly system changes for the incumbent supplier at the time. The decision to absorb the risk of variable RbD charges was a conscious one by market participants and judged as a worthy trade-off compared to the cost and complexity of system changes.

The case of an RbD type charge being levied on LSP shippers would not be a conscious one; and would be an unwelcome imposition on the market.

In our view, any costs arising from RbD under these proposals should not be attributed to the LSP sector until such a time when there is individual reconciliation in the SSP sector. The imposition of any costs before this time will always be arbitrary and unproven as the true value of genuine reconciliation will be unsubstantiated prior to this. Once the real value of genuine reconciliation is known for the SSP sector, this is the time to allocate costs of the mismatch of energy.

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, this is outside of what we understand to be the scope of the AUGE under UNC 0229. It is the role of the AUGE to determine a sustainable methodology for cost allocation only, not incentives on shippers. The incentive issue is already being addressed by industry workgroups such as “The creation of a National Revenue Protection Agency”.

CHAPTER: Five – Impacts on Sustainable development

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?

Yes, there are no tangible benefits on sustainable energy as a result of any of these proposals.

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

See above.

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

No.

CHAPTER: Six – Impacts on Health & Safety

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

No impacts are anticipated.

CHAPTER: Seven – Risks and Unintended consequences

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

Yes. See response to section 3, question 2.

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

N/A.

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 already identified additional risks for consumers in section 3 of our response and for I&C only participants in section 4 of our response.

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?

No comment.

CHAPTER: Eight – Other Impacts

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?

The appointment of an independent party to assess and attribute the costs of "unidentified gas" is a fair one. However, any cost allocation can only ever be arbitrary until such time that the genuine reconciliation value is identified for the SSP sector (see section 4, question 4).

CHAPTER: Nine – Post Implementation Review

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

No comment.

End of response to questions.

I trust this information is helpful and if you have any questions or would like to discuss further, please do not hesitate to contact me on 0113 306 2104 or mobile 07733 322460.

Yours Sincerely,

P. Broom

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