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Dear Nigel

## **Regulatory Impact Assessment Ref 143/09: Identification and Apportionment of Unidentified Gas**

National Grid Gas Plc (NGG) welcomes the opportunity to comment on Ofgem's Impact Assessment on the above issue. NGG owns and operates the Gas Transmission System and also owns and operates four of the eight Gas Distribution Networks in Great Britain.

In order to provide a comprehensive response, this has been structured in two sections: Section 1 contains an overview commentary on the underlying issue and the principles of and issues surrounding Modification Proposal 0229 ('0229'), whilst Section 2 addresses the consultation questions in turn. We have focussed our response around 0229, given Ofgem's expressed view that they are minded to accept 0229 and reject the other related proposals covered by the Regulatory Impact Assessment (RIA).

### **Section 1 – Overview Commentary**

The central issue which underlies UNC Modification Proposals 0194, 0194A, 0228, 0228A and 0229 is the question as to whether it is reasonable to assume that unidentified gas is attributable both to Smaller Supply Points (SSPs) and to Larger Supply Points (LSPs). It is NGG's view that such an assumption is valid, and that there is a clear need for the industry to work together to address the limitations of the existing methodology by which unidentified energy is apportioned purely to SSPs via the Reconciliation by Difference (RbD) process.

It is also NGG's view that the benefits of seeking a resolution to this issue lie principally in the supply sector of the market, as Gas Transporters (GTs) will be neutral to the outcome of any changes in apportionment of unidentified gas. However the segmented nature of the supply sector makes it naturally very difficult for Domestic and I&C shippers to gain alignment of views both on an appropriate methodology for and the required extent of any reapportionment of unidentified gas between those market segments.

For the above reasons, NGG therefore supports the aims of 0229 to introduce an Allocation of Unallocated Gas Expert (AUGE) to produce an Allocation of Unallocated Gas Statement (AUGS). However, we also note that the UNC Modification Panel did not recommend implementation of this proposal as it did not appear to meet the GT Licence relevant objectives. The fact that the proposal was not supported by the Panel (5 for and 5 against)

or the industry (of the 13 representations received, 6 offered support, 1 offered qualified support and 6 did not support implementation of the Modification Proposal) highlights that there are clear issues which should be addressed prior to any proposal being implemented. Ofgem's RIA has therefore provided a valuable opportunity to explore these issues further, particularly as it continues to be NGG's view that 0229 itself does not present an optimal solution and further work is still required.

Specifically, NGG believes that 0229 is drafted in such a way that would make it extremely difficult to deliver a timely solution for the following reasons:

- The proposal specifies that the tender for selection of the required AUGE would be controlled by the UNC Committee, thus effectively forcing GTs to contract with a party which they had not selected.
- The concomitant matter of funding is not properly addressed in that, whilst the proposal refers to the User Pays mechanism in respect of expenses incurred by xoserve, it provides no clear mechanism for funding the procurement and services of the AUGE, the costs of which are likely to be considerable, given the level of difficulty of the role. More specifically, were GTs to be collectively responsible for contracting with an AUGE – particularly if that was to be achieved other than via xoserve – the funding would necessitate an enabling modification to the GDN Licences in order to pass the costs on to system users.
- In terms of the process for delivery of the outputs, NGG believes that 0229 provides too many “stop point” opportunities for parties to challenge the output of the appointed AUGE which, in our opinion, undermines the purpose of having an independent agent.
- The ‘guidelines’ process identified in this proposal is inconsistent, incomplete and overly protracted. As a result, any output in terms of a reallocation of energy – if at all – may not be forthcoming for up to two years from the point of implementation.
- In NGG's opinion, the production of legal text for 0229 would be fraught with difficulty and would raise numerous issues requiring clarification and hence many possible changes to the Proposal as drafted.

Therefore, NGG's view of UNC 0229 is that, notwithstanding the fundamental shortcomings of the proposed selection and contracting arrangements, the complexity of the proposal and inconsistencies contained within the associated ‘guidelines’ document threatens to undermine its own delivery timescales and substantially increase the likelihood of a default population of the AUGS with “zero volumes”. This would be a particularly undesirable outcome, since much cost would have been incurred by the industry – and hence by customers – to no avail.

NGG has therefore taken the opportunity to encourage the industry to consider preparing an alternative UNC Modification Proposal, based on the principles of 0229, including the appointment of an independent AUGE and the production of an AUGS. Our view is that, in order to make the proposal workable from a GT perspective, the independent authority of the AUGE, as a body free from commercial drivers and influence is vital. An alternative proposal should therefore feature a simplified process for the tendering and appointment of an

independent AUGE, but taken largely as a GT responsibility. Any such proposal should also aim to address the “default” scenario in which the selection of an AUGE cannot be agreed upon. Any alternative proposal should also allow for challenge and review, but be created in such a way that it ensures that the final outputs are not compromised and are delivered to an acceptable timescale.

NGG (Gas Distribution) provided a presentation setting out its views at the January 2010 meeting of the UNC Distribution Workstream. As an action from the meeting, we have agreed to meet with the Proposer to discuss further our concerns. It is NGG’s intention to seek that a further Modification Proposal which addresses the issues identified within this letter is forthcoming at the earliest opportunity. Noting that Ofgem has stated that it is “minded to accept” 0229, NGG would encourage that such a decision be temporarily delayed pending development of a revised 0229 regime in the UNC Distribution Workstream. We are hopeful that any alternative proposal would be acceptable to all UNC parties, and anticipate that this could be achieved relatively quickly with such a Proposal being raised and discussed at the February 2010 UNC Modification Panel. We would strongly advocate such action on the basis that we believe that, in its current form, 0229 cannot be implemented, and presents a significant risk of generating additional industry costs and liability with little or no benefit.

## Section 2 – Response to Consultation Questions

Given Ofgem’s “minded to” position to implement 0229 and reject the other related proposals made to date, NGG’s comments are focussed on 0229 itself.

### CHAPTER: Three

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

Our views are that the concerns which 0229 seeks to address would appear to be valid and given the segmented nature of the gas supply market and the associated difficulty in gaining alignment among shippers on an appropriate basis for and the required extent of any reapportionment of unidentified gas between those market segments, we support the basic aims of 0229 to introduce an Allocation of Unallocated Gas Expert (AUGE) to produce an Allocation of Unallocated Gas Statement (AUGS). This view is provided on the basis that the segmented nature of the gas supply market make it difficult in gaining alignment among Domestic and I&C shippers both on an appropriate methodology for and the required extent of any reapportionment of unidentified gas between market segments.

NGG believes that 0229 could impose a higher level of additional costs on the industry than for the other related proposals cited. We are also of the view that the industry should be encouraged to consider preparing an alternative UNC Modification Proposal, based on the principles of 0229, including the appointment of an independent AUGE and the production of an AUGS, but that this must take account of the total perceived cost-benefit to customers.

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

NGG agrees with Ofgem’s view on the importance of total independence in the role of the AUGE; however, the fact that the process for delivery of the outputs in 0229 allows numerous opportunities for parties to challenge the output of the appointed AUGE actually undermines the purpose of having an independent agent and presents a significant threat to the delivery of a meaningful outcome.

Our view is also that, since the independent authority of the AUGE is vital, the industry should be encouraged to develop an alternative proposal featuring a simplified process for the tendering for and appointment of an independent AUGE, but taken largely as a GT responsibility. Any such proposal should also aim to avoid the “default” scenario occurring, in which the selection of an AUGE can not be agreed upon. This proposal should also allow for adequate challenge and review, but in such a manner that will ensure that the final outputs are not compromised and are delivered to an acceptable timescale.

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

Ofgem states that the system implementation costs of implementing 0229 would be higher than those for 0194 (£110k - £360k) as they do not include the costs of xoserve providing

data to the AUGÉ, or the costs of appointing and resourcing and independent expert. Ofgem also state that the “exact extent of costs could be determined by Users and would vary with the complexity of the solution implemented”.

Although these costs are unknown, the fact that the process and guidelines, as drafted in 0229, are both complex and unclear leads NGG to expect that the costs of implementing 0229 would be likely to be higher than those shown in Ofgem’s RIA.

## **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?**

NGG agrees with the central principle expressed by Ofgem that, where possible, the costs of supplying customers should be correctly targeted at the sector that gave rise to those costs. To that end, we support the central principle underlying 0229, as we believe that it is valid to assume that unidentified gas is attributable both to Smaller Supply Points (SSPs) and to Larger Supply Points (LSPs). We also recognise that this approach could accommodate the seasonality issue highlighted within the consultation whereby overall volumes of Unidentified Gas are likely to be higher within the winter period. We are therefore urging the industry to consider preparing an alternative proposal, based on the principles of 0229, including the appointment of an independent AUGÉ and the production of an AUGS, as we believe this will establish official recognition of the issue, as a vital first step. We believe that this then provides a framework upon which the industry may begin to develop appropriate incentives to address the causal factors via consultation by the established independent AUGÉ.

NGG is also of the view that some factors which contribute to unidentified gas cannot be attributed solely to the actions of shippers within a particular market sector, and that the alternative proposal referred to above would provide a more equitable basis for the operation of the gas transportation market; but also that this emphatically not intended to dilute the requirement or urgency for any such market-wide errors to be addressed, wherever that is possible.

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

NGG agrees with the central principle expressed by Ofgem that, where possible, the costs of supplying customers should be correctly targeted at the sector that gave rise to those costs. We would also agree with Ofgem’s assessment of the general distributional effects between SSP and LSP customers, as expressed in paragraph 4.5 of the RIA. However, as a GT we are necessarily neutral to the actual apportionment of unidentified gas between market sectors and not therefore in a position to comment in any detail about the underlying distributional factors, the potential impacts upon competition or the means by which those might be resolved.

We also agree with Ofgem’s view that any 0229 methodology will not reflect seasonal load patterns or necessarily consider the seasonality of some the issues affecting RbD such as theft and unregistered gas.

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

NGG is of the view that the industry should be encouraged to consider preparing an alternative UNC Modification Proposal, based on the principles of 0229, including the appointment of an independent AUGE and the production of an AUGS, but that this should aim to take account of the total perceived cost-benefit to customers.

**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?**

Please refer to NGG's comments against Chapter Four, Question 2, above.

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

It is NGG's view that 0229 does not specifically task the AUGE to incentivise shippers to address theft. It is not clear to what extent such a task could be effectively imposed on an AUGE.

**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?**

NGG's view is that it is difficult to see any clear link between the Modification Proposals and sustainable development of the gas network or market.

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

NGG has no view on this question.

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

NGG has no view on this question.

**CHAPTER: Six**

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

NGG does not envisage that any of the Modification Proposals, if implemented, would give rise to any health and safety issue.

**CHAPTER: Seven**

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

NGG believes that the process of appointing an AUGE and approving a methodology, as drafted within 0229, is complex and provides an opportunity for both to be unduly challenged or appealed. This could readily lead to no AUGE being appointed or no methodology being identified and implemented. Although Ofgem “consider it important that shippers recognise the need for the third party to be genuinely independent of interference from individual shippers” and “that shippers respect the AUGE’s decision”, we do not believe that 0229, as drafted, would allow the fulfilment of these aspirations. The fact that Ofgem cannot directly intervene in the process is therefore likely to be of limited relevance.

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

We believe a simpler governance process is required. Ofgem highlights (7.14) that “one potential weakness of 0229 is that it is unclear from the Final Modification Report as to how any process would be implemented should no bid for tender come forward in the first instance” and suggest that if this was to arise that the “industry would have to search for an alternative solution”.

Ofgem also highlights that “the process of appointing an AUGE and identify a suitable methodology will take some time” and that “a clear timetable needs to be drawn up prior to implementation of UNC0229, detailing target dates for implementation, appointment of an AUGE, and production of a methodology for apportioning unidentified gas, to avoid any further delays to this process”. Given that three such timelines are presented in the proposal, it is unclear who would lead on this work and what would be produced which, yet again, emphasises that further work is required to simplify and clarify the governance arrangements.

In view of the above concerns NGG is therefore of the view that the industry should be encouraged to develop an alternative proposal now.

## **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?**

NGG believes that, as 0229 specifies that the tender for selection of the required AUGE would be controlled by the UNC Committee, this would effectively force GTs to contract with a party over which they had no decisive control of procurement or selection. We believe that such an arrangement could both compromise the GTs’ independence and that of the AUGE and may be unworkable in law.

It is NGG’s view that whilst it may be appropriate for the UNC Committee to contribute to the terms of reference for the AUGE, the process of tendering and selection of a truly independent AUGE body should rightly rest with the GTs and be free from third party influence or interference, and that any alternative proposals which may be developed by the industry should reflect this as a central principle.

Overall, we believe that the current structure of the AUGE appointment process and the opportunities for industry parties to challenge the AUGS determined by the AUGE may discourage potential providers from submitting a tender. To this extent, we believe that there is a significant risk that due to either the absence of an appointed AUGE, or the absence of an agreed AUGS there may be no volume determined as attributable to Larger Supply

Points. In such circumstances we note that the prevailing arrangements (pre 0229) would be applied.

**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?**

Our concerns with regards to the contractual liabilities, etc. were highlighted in our 0229 representations. We believe these continue to be valid and still need to be addressed.

Liabilities may arise as a consequence of GTs being obliged by the UNC to enter into a contract for services with a third party, without having full control of the arrangements, since the UNC Committee<sup>1</sup> has the ability to influence the tender process and the contractual arrangements between the gas transporters and the third party.

We recognise that it may be difficult for the tendering process to be undertaken by Shippers, as we appreciate the administrative difficulties this may entail, given the segmentation of the supply market. However, we note that Development Workgroup 0274 is currently considering the procurement of a provider of a National Revenue Protection Service on behalf of all Suppliers (and potentially Transporters) which would indicate that this problem is not seen as frustrating such a process. If GTs do assist as an administrator of this process, it is only reasonable that they should both be appropriately funded and avoid incurring any liability in doing so. NGG believes that the governance process in any alternative proposal must ensure that GTs are not exposed to the risk of any legal action that may result from the appointment of the AUGE or production of the AUGS.

## **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?**

NGG is in agreement with Ofgem's assessment, as we have stated elsewhere in this response.

## **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?**

NGG believes that 0229 should not be implemented for the reasons given above. However, we would agree with the principle of a post-implementation review (PIR) in respect of any acceptable UNC Modification Proposal implemented as a result of the further development work, which NGG is encouraging the industry to undertake. However in NGG's view, the timing of any PIR should allow a reasonable period of operation to have elapsed first, and that the terms of the PIR must clearly avoid the impugment of any action taken by the AUGE or GTs that is within their terms of reference, as defined in the implemented modification.

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<sup>1</sup> "The Committee" – The UNC or an authorised technical workstream or sub committee appointed by the UNCC to administer the AUGS process



I trust the information provided in this response is helpful. Should you have any questions or require clarification on any of our comments, please contact me.

Yours Sincerely

Paul Whittaker  
UK Director of Regulation  
By email.