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Our Ref: LM / NN

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Dear Nigel

Identification and Apportionment of Costs of Unidentified Gas – Impact Assessment (143/09)

Thank you for the opportunity to respond to the Impact Assessment (IA) published on 30th November 2009, considering the merits of five Modification Proposals to the UNC which aim to improve the equity of the allocation of Unidentified Gas between sectors in the gas market.

ScottishPower is strongly opposed to the implementation of Modification 0229, as proposed by Ofgem, in particular if this is at the expense of the other Modifications. We believe that there are fundamental issues within the IA and it's consideration of the implications on the different market sectors. In addition we do not believe that it is a sustainable proposition that the SSP market, being mainly domestic customers, should be picking up the cost of unidentified gas and think that it is essential that this issue is addressed with immediate effect.

We have previously raised our concerns regarding the level and volume of reconciliation quantities that continue to flow through Reconciliation by Difference (RbD). As you are aware, when RbD was introduced in 1998 it was anticipated that the volumes of energy requiring reconciliation would decrease over time with improvements to data quality. However, the reality is that large volumes of energy (RbD error) not directly associated with genuine reconciliation continue to be allocated to RbD, with the costs related to these volumes being borne solely by the SSP market sector. In the period January 2007 to April 2009 this has equated to a £401 million debit. We have therefore welcomed the work that has been carried out by the industry in an attempt to identify the contributing factors and volume of unidentified gas and the possible solutions to address the issues surrounding the current RbD process, with the output of this work being a number of UNC Modifications, namely, Modifications 0194, 0194A, 0228, 0228A and 0229.

From as long ago as October 2007 Ofgem has publicly acknowledged that the current RbD arrangements are not acceptable, where in considering Modification 0115 Ofgem stated, "it is inappropriate for one sector of the gas market to bear all costs of unallocated gas"¹. This view is shared by industry, as it is inequitable for one sector of the gas market, and the customers in that market, to bear all the costs of unallocated gas.

The SSP market is picking up the cost for all unidentified gas, although it has been identified that the LSP market contribute to this and should rightly pay an allocation of it. As it stands the RbD mechanism does not promote competition or stimulate new

¹ Ofgem Decision Letter, UNC 115/115A 'Correct Apportionment of NDM Error, 24th October 2007

entrants to the domestic supply market, in particular since there is no transparency or auditability of cost and due to the continued risk of retrospective adjustments. We believe that it is inappropriate to persist in the discrimination of this one market sector, in order to continue the stability of another. This would remain a key concern, should Ofgem approve Modification 0229 in isolation.

In reality the SSP market is cross-subsidising customers in the LSP market (domestic consumers supporting industrial and commercial customers), at a time where fuel poverty is a real concern and when Government and industry is working to otherwise support these customers. The SSP market has been subject to this arrangement for over a decade and we believe that now is the time to address the issue. Modifications 0194, 0194A, 0228 and 0228A would allow this to happen and therefore we would question Ofgem's minded to position to implement Modification 0229, which is in conflict to the MOD Panel recommendation, and delaying the opportunity to address these concerns. We are also concerned that the IA is currently unclear on the scope of the arrangements for the AUGÉ and this will be left to the industry to develop. Without such clarity at present this will further extend the timescales involved in the AUGÉ being introduced.

We have a number of serious concerns with the IA and Ofgem's minded to position. We have provided our further specific comments on the questions asked within the IA in Annex 1, attached, but in summary our main concerns are:

- **Impact to Domestic Customers:** Ofgem has readily noted that that the current RbD arrangements result in increased costs for domestic customers by as much as nearly £10 per customer per annum. Although the addition of 1% may appear small, it should not be underestimated what this costs means for fuel poor customers and, particularly the impact on the number of customers in fuel poverty. We believe that such an imposition could result in a significant number of customers being put in to fuel poverty, with each £10 increase to annual bills meaning up to 40,000 domestic customers falling into fuel poverty each year based on previous analysis from Age Concern, National Energy Action and Ofgem.² This comes at a time when the issue of fuel poverty is at the forefront of the social agenda, with a number of measures being taken to support such customers. The IA fails to take on board this consequence and also a domestic customer's ability to pay. Although the statement that any 'transfer of monies which are presently smeared exclusively amongst SSP customers to LSP customers will present a benefit to SSP customers and additional cost to LSP customers'³ is substantially true, the reality is the fact that SSP customers have essentially been cross subsidising the LSP market for over a decade, with additional costs in the SSP markets having a much more significant impact due to the nature of the end users, such as vulnerable/fuel poor. The re-apportionment of this cost is simply redressing the balance, not delivering a 'benefit' going forward and reflecting the sectors responsible for the unallocated gas.
- **Impact on Competition:** We do not agree with the statements regarding the impact of competition on the LSP market. The concerns regarding the

² This is Money - http://www.thisismoney.co.uk/bargains-and-rip-offs/household-bills/article.html?in_article_id=441169&in_page_id=510

Age Concern - <http://www.ageconcern.org.uk/AgeConcern/NewsArchive-May08-energywatch-comments-on-energy-prices.asp>

Business and Enterprise Select Committee - 11th report of the 2007/08 session (Energy Prices, Fuel Poverty and Ofgem)

³ Ofgem Impact Assessment, Identification and Apportionment of Costs of Unidentified Gas (Ref: 143/09) Page 19, paragraph 4.5

inequitable basis of RbD are not new and have been discussed for a number of years now. Ofgem noted the inequitable nature of RbD back in 2007. Hence, the LSP market has been aware of this issue and has had sufficient time to make any necessary changes to contract provisions. In fact, as far as we are aware many of contracts in the LSP market have existing 'pass through' provisions. We are also surprised that Ofgem does not see that there is an impact to the SSP market in respect of competition.

- **Governance:** The proposed governance route under the 0229 Proposal is unacceptable, as it is proposed that the Uniform Network Code Committee (UNCC) would agree the methodology proposed by the AUGE and parties could then raise a modification to amend/object. However the current constituency of the UNCC is skewed toward the LSP only Shippers, with there being 3 members, to 2 members for the mainly SSP Shippers. The same individuals of the UNCC make up the MOD Panel, it would therefore appear that it would be impossible for the 'domestic' Shipper to successfully object to a proposal. The result of this would be to remove the statutory right provided for through the Energy Act 2004 to appeal to the Competition Commission.
- **Implementation of 0229:** We have serious concerns over the cost and the time it will take to implement 0229. Realistically the earliest implementation would be at least 2011/12, and we do not believe the SSP market should continue to pick up all unallocated costs until then. Also, the implementation of 0229 in isolation will have little incentive for LSP market players to develop the AUGE, especially in the short to medium term since they cause part of the problem with no financial responsibility. Moreover this seems to be the wrong approach when other modifications could be implemented almost immediately.

In summary, we cannot support the introduction of Modification 0229 at this time, due to the continued and profound effect on domestic customers and do not believe we are serving the interests of any customers, but particularly vulnerable and fuel poor customers, if we do. If Ofgem does decide to approve Modification 0229 we believe this cannot be in isolation given the governance issues that will have to be dealt with prior to the commencement of an AUGE. We believe that Ofgem should approve either 0228 or 0228A with immediate effect, with 0229 being a potential long-term solution. ScottishPower do not believe it is acceptable to leave the existing RbD mechanism in place while the Allocation of Unidentified Gas Expert (AUGE) is fully developed, although we will commit to working with other industry participants to deliver a robust means of introducing a AUGE and corresponding methodology.

We would be grateful for the opportunity to discuss these issues with Ofgem and intend to arrange a meeting in February to do so, but in the meantime please do not hesitate to contact Lorraine McGregor (lorraine.mcgregor@scottishpower.com or 0141 568 3284) or I if you have any questions.

Yours sincerely,

Colin Gilchrist
Director of Customer Services
ScottishPower Energy Retail