

## Response to Ofgem IA – Identification and Apportionment of Costs of Unidentified Gas

### **CHAPTER: Three**

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

As Ofgem has used industry data provided by xoserve, we are not in a position to agree or disagree with Ofgem's figures.

However, a point that we would like to make is that the SSP market already has an over allocation of gas for all unidentified gas including theft built into it because it is not reconciled. If gas use at all SSP meters was reconciled against meter readings, then the RbD allocation would increase significantly to take account of all the total misallocations and would not just include that amount which is allocated to the LSP sector. The use of the scaling factor allocates these misallocations to the SSP sector and so at the moment they are not visible. The RbD allocation only includes that gas which is unidentified and unallocated due to LSP reconciliations, whereas in the SSP sector there is a huge amount of gas which is unidentified, but is not unallocated. We therefore believe that it would be more equitable for unidentified gas to be allocated to both SSP and LSP sectors to reflect that costs can be attributed to both.

We still consider that there is yet to be complete understanding regarding the true amount of unidentified gas. As the total amount of NDM gas that is reconciled for LSPs is approximately 40% of the throughput, it is very likely that the total amount of unidentified gas is actually approximately 2.5 times the size of the RbD allocation, but currently this component of, unidentified gas is being allocated solely to the SSP market and there is no transparency. This is not something that we feel has been accounted for correctly in previous industry discussions, including any suggested percentage allocations to the LSP sector, which may well have been understated because of this oversight.

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

The governance arrangements as drafted appear overly complex, for example, the appeals mechanism, which could lead to 'zero' values being entered into the table. This would have a detrimental impact to consumers, as the SSP sector would continue to bear the costs of the unidentified gas.

Under UNC229 it is proposed that the GTs should contract with the expert, albeit that the intention is that the GTs will be fully reimbursed by shippers for the costs incurred. We agree that because there is currently not a mechanism under the UNC framework which provides for the appointment of the expert by shippers it is logical for this appointment to be undertaken by the GTs on behalf of shippers. However, it is important to bear in mind that the costs associated with contracting with the AUGE, once appointed, are likely to be significant and would certainly fall under the usual industry procurement rules. In this regard therefore, it would clearly be inappropriate for the GTs to be placed in a position where shippers would be seeking to choose who the AUGE is, which could potentially be in conflict with procurement guidance.

Notwithstanding this, however, we do believe that where possible there should be transparency around how the expert is chosen and that shippers should be invited to provide input to the terms of reference for the appointee, particularly when they will ultimately be bearing the associated costs.

We note that Ofgem has recognised this issue in its comments in 7.21 of the IA document, however we understand that UNC 229 cannot be varied now it has reached the Ofgem decision stage. We believe that an alternative governance mechanism, and therefore a new modification proposal would need to be adopted in order to address the concerns we have identified above.

We understand that Consumer Focus is likely to become a voting member of the UNCC following Ofgem's Governance Review. Should this happen, this will ensure that consumer interests are represented at this forum.

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

Implementation of any of the proposed Modifications will impact on consumers. In the short-term, any reallocation of costs to the LSP sector will lead to an increase in costs directed to parties in that sector and a reduction in costs incurred by the SSP sector.

However, in the medium to long term there should be an overall decrease in costs as there will be an incentive on both LSP and SSP shippers to reduce the costs of unallocated gas and there should also be greater transparency about where these costs lie, which should help in the overall aim of reducing them.

A further benefit to consumers is in removing cross-subsidy between SSP and LSP Shippers.

#### **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?*

Apportioning costs onto LSPs will act as an incentive for these Shippers to reduce the quantity of unidentified gas. At the moment, as all costs are absorbed by the SSP market, there are no financial incentives for LSPs to do so. The introduction of greater transparency regarding the costs that have been incurred and where they lie should also have a positive effect on the incentives on shippers.

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

We agree that it is more equitable to spread the cost of unallocated gas across LSP and SSP.

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

We do not see there being any detriment to customers through these proposals. The modifications seek to apportion the costs of unallocated gas more equitably and remove the cross subsidy between SSP and LSP that currently exists.

Additional costs may be passed through to the LSP sector however this is justified on the basis that they should pick some up if they are contributing to them.

As stated earlier, the implementation of any of these Modification Proposals will benefit customers in the long term.

**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 applying a variable RbD charge on LSP Shippers will negatively impact on competition. Non-domestic contracts are, in the main, structured to allow variable costs to be passed on. Therefore, there is no reason why a variable charge could not be employed and it will be up to the individual shipper/supplier to decide how it passes those costs through to customers.

If a fixed amount was applied to the LSP sector then the SSP sector would bear an increased risk, as any increase in RbD costs over and above those expected would be allocated in total to the SSP sector. We therefore do not believe that this justifies imposing a fixed charge on LSP shippers as that would have a negative impact upon competition in the SSP sector.

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

We do not believe that this is an appropriate duty for the AUGE. The incentives for investigating theft are already being reviewed through the UNC process and therefore we see no need to duplicate that work, although we would expect the AUGE to take account of any changes when setting or reviewing the allocation methodology.

#### **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 with Ofgem's assessment that the impact will be marginal.

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

We agree that all of the proposals have an equal impact on sustainable development, though Mod 229 will not deliver the benefits as quickly as the others for the reasons already given. It is for this reason that we believe that 0228 should be adopted as an interim solution.

**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 believe that there are any further significant impacts on sustainable development.

#### **CHAPTER: Six**

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

We do not believe that any of these proposals will have a significant impact on health and safety. Having said that, because there will be an incentive on LSP shippers to reduce their unallocated gas costs there may be additional benefits realised such as greater incentives to identify and detect energy theft, which will have a consequential positive impact on overall safety.

#### **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 believe that the current governance proposals are overly complex and allow parties to query and dispute too broad a range of subjects and at too many intervals during the process. This potentially could lead to the AUGE's decision either being delayed or postponed;

resulting in a 'zero' value being entered into the table. As stated before, this would be detrimental to consumers.

Should a clear set of Terms of Reference be agreed by the UNCC with Shippers and Transporters, then the AUGE would then be free to do their job, perhaps with parties having the ability to suggest new information that the AUGE could take into consideration when making a decision, but which would not delay or halt the process.

We therefore believe that there is a risk that the current governance process provides too much recourse to query the AUGE's decisions, which could lead to sub-optimal outcomes.

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

We have hopefully covered this in our answer to the previous question and to Question 2 of Chapter Three.

**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 consider that there will be an increase in contractual risk to the Transporters due to the current proposed structure of who contracts with whom. In addition, there are further complexities associated with the fact that the Transporters will be contracting with a non-UNC party, i.e. the AUGE, who will not be bound by the liability limitations which are placed on UNC parties. In this regard, any attempt under UNC proposal 0229 to limit the Transporters' liability, may not, in our view be possible. Furthermore, as Ofgem has identified in paragraph 7.20, whilst Transporters will be seeking to pass through the costs associated with employing the AUGE, understandably shippers would not wish to pick up unlimited liabilities over which they have no control.

This legal issue requires further consideration before the Governance Arrangements regarding the appointment of the AUGE are finalised.

**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?*

As we have stated above in our response to Question 3, there are contractual risks associated with appointing the AUGE which have not been fully developed or addressed.

Specifically regarding the impact on shipper parties, we believe that provided shippers have sufficient ability to input to the methodology and the terms of reference for the AUGE, this should ensure that there is as much transparency as possible regarding the allocation of the costs. In this regard shippers can anticipate the costs associated with unallocated gas and take a view on their impact.

#### **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 that appointing an independent third party would benefit the industry, but with the necessary changes to address the governance and contractual issues that we have identified 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?*

A post implementation review would seem sensible.