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Dear Nigel

SUBJECT: Total Response to Ofgem Impact Assessment on Identification and Apportionment of Costs of Unidentified Gas (Mods 0194/0194A, 0228/0228A, 0229)

Total Gas and Power Ltd (TGP) welcomes the opportunity to comment on the findings of Ofgem's Impact Assessment regarding the Apportionment of Cost 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?

In order to give an independent view of the values proposed by the modifications Modification proposals 194, 194a, 228 and 228a, ICoSS commissioned TPA solutions to analyse the underlying assumptions of this proposals. The information used in compiling this report is the same as that provided by xoserve to Ofgem as part of the impact assessment.

Their report is attached with this letter and I would like to draw the reader's attention to two of the questions that were asked. These were:

"Are RbD volumes indicators of significant quantities of "unidentified gas"?", and, "Does RbD apportionment appropriately deal with "unidentified gas"?".

The report concludes "No" to both of these questions and therefore the average charge of £9.33 that each SSP customer made as a result of the RbD mechanism is irrelevant. It also follows that the values highlighted in Modifications 194a and 228a are built on sand as both of these look to the value of RbD as their starting point.

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 UNCC, being composed of industry representatives has historically provided sufficient oversight to protect their customer's interests with regard to the administration of the UNC. In the event that an issue with the proposed AUGE mechanism is identified then the industry is likely to develop a solution; this has been demonstrated with the work undertaken on Modification 0275 (Reduction in DM LDZ Exit Capacity for Supply Points with Significant Changes in Usage). The UNC framework therefore seems adequate for protecting consumer interests. We do note that Modification 0267 is aiming to examine the UNC governance regime and so this should highlight any deficiencies.

In the unlikely event that the AUGE process highlights issues cannot be solved within the UNC, the licence modification route is available to either increase the regulatory oversight, or to alter the theft detection mechanism. Historically such consumer issues that have occurred (such as protection for micro-businesses, etc) have been solved in this manner and can be used in this area as well.

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

As identified elsewhere in the consultation document, Modification 0229 will have additional benefits in that the appointed AUGE will undertake significant analysis on the scale and causes of Unidentified Gas. This will provide the industry and consumers with greater understanding of the problem and so allow suitable remedies to be developed. None of the other Modifications will realise this benefit.

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?

The issue of creating incentives or mechanisms to reduce Unidentified Gas is a separate issue in our mind to what these modifications are looking to achieve; the apportionment of Unidentified Gas to appropriate market sectors. We do agree with Ofgem that at present the costs of Unidentified Gas are socialised amongst all SSP Shippers. There is a perverse incentive placed upon LSP Shippers to not identify the sources of Unidentified Gas as they will bear the full costs of any gas identified; also SSP Shippers stand to gain from any Unidentified Gas they can identify, and can bill for, as RbD is not adjusted retrospectively. Gaining or being penalised from detecting Unidentified Gas also creates a perverse incentive for Shippers to treat all (or no) unexplained gas consumption as Unidentified Gas. In order to allow the most appropriate treatment of Unidentified Gas any framework must be revenue neutral for the Shippers concerned.

None of these modifications will create, or even seek to create this situation. The industry is currently examining the incentive mechanism for Unidentified Gas

through Modification 0274 and it is more appropriate that this modification seek to create incentives using whatever information is available. Only Modification 0229, through the work of the AUGE, will help provide greater understanding of the issues surrounding Unidentified Gas. Only this modification therefore should be seen to be creating an environment that will reduce Unidentified Gas volumes.

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

We agree with Ofgem's view of the distributional impact of the Modification Proposals.

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

There is a natural concern that any reallocation mechanism may incur such costs as to render the exercise counter-productive. It is a risk that all of the Modifications proposed have. It is our belief that the magnitude of the costs proposed for all these modifications will add costs, but they will be less than the total materiality of the energy reallocated. There is currently little benefit to customers from Modifications 0194, 0228 and 0228A as they do not result in any investigation into the causes of Unidentified Gas; they merely reduce one set of customer costs as the expense of another. As Ofgem has recognised, Modification 0229 will result in significant information on Unidentified Gas being compiled and so will help the industry form measures to tackle the causes. Compared to the other modifications, there is therefore much greater benefit accrued by customers from Modification 0229.

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?

Any allocation methodology must be accurate to eliminate as far as possible any cross-subsidy of market sectors. Modifications 0194 and 0228 propose to allocate a percentage of RbD to the LSP market sector. This is inappropriate for several reasons. Firstly, as the size of RbD varies daily, this link will create the counterintuitive effect of the Unidentified Gas error varying with RbD. There is no link between the size of the RbD "pot" and the volumes which should be applied to the individual error categories. It seems incorrect for example that, as RbD volume varies the amount of gas stolen by LSP customers also varies in direct proportion. As RbD can in theory become negative, (that is an energy credit to the SSP sector) negative volumes of Theft would be attributed to the LSP sector on those days.

In addition, RbD being a correction mechanism triggered by periodic reconciliation of LSP meter points, is inherently unpredictable. This means that Shippers will be unable to accurately include this additional volume in either their contracts, or their wholesale procurement strategies. This will lead to greater inefficiency and costs to

consumer as a whole, in particular to those who are supplied by Shippers that concentrate on LSP consumers. In summary both Modifications 0194 and 0228 will damage competition and result in cross-subsidies between market sectors.

These issues are avoided by determining a fixed charge, as proposed by Modifications 0228A and 0229. This allows efficient procurement of gas long-term to cover the determined values of Unidentified Gas resulting in lower costs for customers. Though Modification 0228A follows these mechanisms, the lack of any supporting analysis of the values proposed make it impossible to say that they do not result in a cross-subsidy.

Modification 0229 creates greater certainty that the volumes derived are accurate as they are not varying according to market reconciliation, but as a result of expert derivation of the volumes involved. We do note that during the last Price Control review, the Shrinkage volumes moved to a fixed volume basis as this was felt to give a more accurate reflection of losses.

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

As stated above, we do share Ofgem's concerns that the costs of reallocating Unidentified Gas to the LSP Sector should not be excessive. We feel that the activity undertaken by the AUGE will highlight the scale and natures of the causes of Unidentified Gas to the industry. We would then expect Shippers to propose modifications that would address these causes. In summary Modification 0229 is likely to stimulate development of incentives by Shippers, avoiding the additional costs of an external agency. We do note that at present Shippers have brought forward a number of proposals that attempt to address the causes of Unidentified Gas (namely Modifications 0274 and 0277).

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 overall these modifications will have a marginal impact on sustainable development as their primary focus is the correct allocation of Unidentified Gas, not the reduction of the scale of Unidentified Gas.

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

We agree with Ofgem's assessment that Modification 0229 is likely to have the greatest impact on sustainable development, through the additional work that will be done by the AUGE in ascertaining the scale of Unidentified Gas.

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 anticipate 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?

We agree with Ofgem's assessment that the modifications will, at most, have limited health and safety implications. Only Modification 0229 is likely to have any noticeable impact on customer behaviour as the AUGE investigates the underlying causes of Unidentified Gas, in particular Theft of Gas, so giving the industry greater understanding. It should be noted that the Single Revenue Protection Agency that is proposed by Modification 0274, would be able to benefit from this additional information collated by the AUGE, so increasing its effectiveness.

CHAPTER: Seven

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

The AUGE appointment process, as detailed in the modification document, will be subject to the oversight of the UNCC either directly, or via an appointed sub-committee. Though the UNCC (or the committee) will not be directly subject to authority oversight Shippers do have the option to raise modifications to challenge the process. The Major Policy Review process that is currently proposed ensures that Ofgem will be able to step in, if it felt the process is significantly failing. Taken together, these measures provide sufficient recourse to challenge AUGE activities if it is felt that the UNCC was abusing its position. We do agree with Ofgem that consumer representatives do not currently have a vote within the UNCC, but the self-governance discussions occurring under the auspices of Modification 0276 may result in greater consumer representation and any decision to alter the governance arrangements should wait upon the outcome of this work.

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

As stated above we would do not feel that any additional governance is needed, but feel that the AUGE process should be included in the discussion currently being undertaken in Modification 0276.

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 believe that all have been identified.

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?

We fail to understand the GT's concerns in regard to the contract. The terms of reference for appointing the AUGE clearly states that Shippers will be able to commence legal proceedings for the activities undertaken by the AUGE in compiling the AUGES only if the AUGE activities are found to be fraudulent or clearly erroneous¹. In addition the AUGE must limit its legal proceedings to the recovery of any fees from the Transporter.²

Therefore the Transporters are only liable for the managing the contract they will have with the AUGE, and then only in a very limited sense. We would expect this contract to be standard and drawing on the precedence of appointing such third parties as the RbD auditor and the Meter Error Expert, of which historically there has been no issue. Under the proposed process the GT have complete control over the contract they devise for appointing the chosen AUGE; there is no compulsion on the GT to contract with the appointed AUGE (only to offer the contract to the favoured AUGE). Modification 0229 places the GT in a very strong position to enter into a favourable contract.

There is therefore no need to create additional securities to indemnify the GTs. To do so would damage the AUGE appointment process as the GTs would not be incentivised to draw up the contract with the due care and diligence expected of a commercial entity.

It should be noted that Modification 0229 (unlike the other Modifications) has not had the benefit of legal text being produced. If this had been done, then a form of wording of full legal rigour will have been developed (to the Transporter's satisfaction) that covers these concerns.

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?

Any third party that is appointed as the AUGE will be required to undertake significant analysis of the sources of Unidentified Gas to ascertain its impact on the market, and so determine the level of energy to be re-allocated. They are incentivised (through continuous oversight by the UNCC who may re-tender for the work) to make a robust case for the values derived. As they are not impacted by the values derived they will be objective in their judgement, unlike Shippers. They will

¹ Final Modification 0229 Report Appendix 1, Section 5: Generic Terms of Reference for Appointed AUGE

² *ibid*

also be able to adjust the Unidentified Gas values over time in light of industry developments. None of the other modifications generate these benefits. We therefore agree with Ofgem that Modification 0229 has significant benefits over the other modifications proposed.

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?

We do agree with Ofgem that were Modification 0228 or 0228A to be implemented then the values that have been arbitrarily suggested would require significant and repeated revision to ascertain whether they are appropriate. This post-implementation review would be avoided if Modification 0229 were implemented however.

It is likely that improvements to the AUGÉ appointment process will become evident during its operation, particularly in the first couple of years. We do note however that the timeline proposed in Modification 0229 includes a period to allow the UNCC (or whatever committee oversees the AUGÉ) to examine the tendering process and to suggest improvements. This seems to provide adequate opportunity for the process to be reviewed.

Yours sincerely

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