

Mr Bob Fletcher
Secretary, Modification Panel
Joint Office of Gas Transporters
51 Homer Road
Solihull
B91 3LT

3rd June 2011

Dear Bob

RE: UNC Modification Proposals 0282 and 0282 – “*Introduction of a process to manage Vacant sites*”.

1. British Gas welcomes the development of industry proposals which create a process for the management of vacant premises in the gas market and believes that implementation of an effective solution will facilitate the relevant objectives of the Uniform Network Code (UNC). To that end, we support the implementation of Modification Proposal 0282A but do not support the implementation of Modification Proposal 0282. Our detailed reasoning is given below.
2. There are a large number of vacant sites in the United Kingdom (UK)¹ with gas Shippers in the Small Supply Point (SSP) sector unable to fully manage their commodity costs so that they reduce to zero along with the offtake rates at these sites. The current UNC arrangements provide for SSP Shipper commodity costs to be based on the Annual Quantity (AQ) value, a lagging indicator which estimates future gas usage at a site based on the previous meter readings. Using this method, once a site becomes vacant it can take up to twenty-four months for the AQ to reach zero, exposing that Shipper to charges which do not reflect actual usage at the site in question.
3. This in itself would not be a problem if all SSP Shippers had equal quantities of vacant sites within their portfolio at all times, as the extent to which this inaccuracy in charging would not distort the proportion of charges a Shipper would collect. Not only is such a premise of equality improbable, but we consider that the diverse makeup of individual Shipper portfolios, with varying proportions of domestic and non-domestic SSP sites reacting differently to economic conditions, means that the current arrangements will inevitably

¹ Study by Empty Homes for the 2008 period – www.emptyhomes.com and details outlined on the Parliament website www.uk-parliament.co.uk

disadvantage some Shippers more than others at various points in the economic cycle. We consider that non-domestic or commercial sites in particular are more sensitive to economic conditions and therefore more likely to be vacant during a downturn. Variations in market share between the domestic and non-domestic SSP sector will therefore play out differently for Shippers year to year, distorting competition along the way.

4. The current UNC process allows Shippers to avoid this distortion by isolating the site in question and then withdrawing from it such that the meter is removed and the supply is capped, removing all liabilities the Shipper faces for the site. By definition however, this necessitates a Shipper gaining access to the meter location, which may be internal and thus require a warrant, and disconnecting it. It also means that, assuming the site remains vacant for twelve months, the Network Owner will have executed their obligations under the Gas Safety Management Regulations (GSMR) and turn the service off in the road.
5. The impact on Shippers and customers of this is significant. The average cost of disconnecting and then subsequently reconnecting it some time later is several hundred pounds, and we note that when the customer wants to have the site reconnected it will take at least twenty eight days. This creates problems for all customers but especially domestic customers where the effects of a delay in reconnecting a site, essentially preventing them from occupying the premises in either summer or winter, are particularly severe.
6. We believe that a more pragmatic approach to handling vacant sites is required which ensures that Shippers charges accurately reflect the amount of gas actually consumed on vacant sites, which does not add extra cost in to the process in terms of disconnection and reconnection and minimises inconvenience to customers.
7. Whilst we therefore agree with SPower on the need for a vacants process, we believe some of the key features in Modification Proposal 0282 are deficient and may lead to unintended consequences which reduce the accuracy of settlement costs and lead to distortions in competition. In particular we consider there is a need for greater controls to prevent a Shipper from misusing the vacants process as a mechanism to erroneously avoid commodity charges, that vacant sites should remain in the Reconciliation by Difference (RbD) process, that gas used whilst a site is classified as vacant is eventually allocated to the registered Shipper and that the governance of the proposed process should rest entirely within the UNC and not across a number of Codes. These are all key areas of difference between Modification Proposal 0282 and Modification Proposal 0282A and are expanded on below.

Greater Control

8. The SSP settlements process helps assign £billions of cost in the gas market and any issues or misuse of it can therefore have a material impact on the accuracy of cost allocation and therefore consumer's bills. We estimate that were a Shipper with a 10% NDM market share to avoid just 1% of their costs

through misuse of the settlements process the misallocation of costs would be worth ~£6.5m².

9. It is for this reason that we believe that any vacants process must contain adequate controls to ensure that only genuinely vacant sites remain in the process and that changes in status are identified and updated as soon as possible. Modification Proposal 0282A therefore requires Shippers to warrant the site remains vacant every 215 days by attempting a meter reading and confirming the vacant status of the site remains as before. This means that not only will these vacant sites be carefully inspected by Shippers through physical site visits, but that through the act of providing the outcome of these visits to the Network Owners, either through a confirmation that the site remains vacant or an instruction to remove it from the vacants process, the industry can be sure that no Shipper is misusing the process to reduce their share of SSP settlement charges.
10. By contrast, we note that Modification Proposal 0282 merely obligates Shippers to notify the Network Owner of a change in status if they “*acquire evidence that the Supply Meter Point no longer qualifies as vacant*”³ and does not convey an obligation on that Shipper to proactively look for that evidence. This creates an incentive on Shippers who benefit from reduced commodity charges for vacant sites to reduce their attempts to inspect the meter to the two year minimum for inspections in the fear that they may find the property has since become occupied.
11. This incentive would create a distortion of industry charges in favour of those Shippers choosing to take a more relaxed approach to managing their vacants sites, and thus a favouring of competition towards those parties exhibiting undesirable market behaviour. We also consider that the incentive to visit vacant sites less frequently may also lead to any potential safety issues present on site from being properly identified and resolved as quickly as they may otherwise have been dealt with in either the current situation or under Modification Proposal 0282A. This is expanded on below in paragraphs 20 and 21.

Inclusion with RbD and treatment of gas used at vacant premises

12. The Reconciliation by Difference (RbD) process allocates any unidentified gas not already allocated to Shippers based on SSP market share. As a number of other Modification Proposals in this area have commented, the potential causes of unidentified gas are numerous and include unregistered and shipperless sites, downstream theft, iGT measurement errors, stock change within the gas network, Shrinkage modelling error, Offtake and Supply Point meter errors and unreconciled Large Supply Points (LSPs).

² Assuming approximate SSP aggregate AQ of 328 TWh at an average cost of approximately £20m p/TWh, or £6.5bn total value. 10% share of this cost is therefore approximately £650m, with 1% of that cost valued at approximately £6.5m.

³ Modification Proposal 0282 Business Rules, rule 11.

13. We note that many of these causes can also occur in relation to vacant sites, for example, the site may be on an iGT network which does not have its overall consumption accurately measured. We also note that the leakage and upstream theft assumptions in the Shrinkage model may be incorrect meaning that assumed leakage on the pipes to vacant properties or upstream theft occurring on services leading to vacant properties may also be incorrect. Finally, we do not discount the fact that theft may occur at sites which are classed as vacant, either through squatters or from a new tenant who has taken occupation of the premises since the vacant status was granted but before the Shipper has completed subsequent checks.
14. We therefore believe that it is appropriate for even vacant sites to be included within the RbD calculations; a proposal which forms part of the drafting for Modification Proposal 0282A, but not Modification Proposal 0282. Furthermore we are concerned that during the development of MOD0282, provisions were dropped which would have ensured that any gas found to have been offtaken at a site classified as vacant would have been allocated to the registered Shipper.
15. We accept that, even under Modification Proposal 0282A, which ensures that changes in vacant status will be captured every 215 days *as a minimum*, there may be cases where a new occupier enters the property and starts consuming gas. When this happens we believe it is entirely appropriate for the registered Shipper to be allocated the costs associated with that gas usage as they themselves will hold a deemed contract with the new occupier entitling them to the revenue associated with that gas usage. We believe that to allow that usage to fall in to RbD as Modification Proposal 0282 proposes – especially when the site itself will not count towards a Shipper’s RbD market share – is perverse and likely to distort the accuracy of SSP charges and thus competition itself. It is for this reason that we have included provisions in Modification Proposal 0282A⁴ for such charges to be allocated directly to the registered Shipper.

Governance

16. Whilst we understand SPower’s rationale for choosing to split the governance of Modification Proposal 0282 between the UNC and the Supply Point Administration Agreement (SPAA) we do not believe this is either the most efficient or appropriate way of managing the process and consider that this is likely to lead to dual-governance with Shipper Suppliers potentially being found in breach of both the UNC and the SPAA if they fail to follow the Modification Proposal 0282 business rules.
17. In addition we recognise the views of some non-SPAA Suppliers who have argued that in order to make use of the process considered by Modification Proposal 0282 they will have to ensure that they comply with rules that, at the time of writing, they have no control over. We consider that, in advance of any SPAA reform, this is an issue which could simply be avoided by placing

⁴ Modification Proposal 0282A Business Rules, rule 13.

the business rules solely within the UNC and have thus proposed in Modification Proposal 0282A all business rules should form part of the UNC itself.

18. Furthermore, we consider there is a benefit of transparency associated with keeping all rules associated with any vacants process within the UNC as Parties have a complete view of their rights and obligations in the process in one place, rather than having to look across fragmented Schedules and Documents in a variety of different Industry Codes.

Safety

19. We are aware that some have argued that the introduction of a vacants process will endanger customer safety as it will lead to an increase in the volume of live Supply Points where no safety checks are completed. Whilst we consider that this may be a valid concern with Modification Proposal 0282 where checks can be completed once every two years, we consider that Modification Proposal 0282A ensures that vacant sites will be closely monitored by Suppliers with site visits at least every 215 days.
20. Our conclusion is that the provisions contained within Modification Proposal 0282A are actually an improvement on the existing safety measures in place within the industry as they ensure that a vacant site will remain under a Supplier's control both through meter reading and Revenue Protection activity, as opposed to the current process where either a Supplier may choose to avoid the costs associated with an isolation and withdrawal and reduce meter inspection activity to once in every two year period, or isolate and withdraw and allow that isolated (capped but live) service to remain in place unchecked for another twelve months until the Network Owner completes a GSMR visit.
21. We have set out our view on how these Modification Proposals meets or does not meet each of the relevant objectives below.

Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs

(a) to (c) the securing of effective competition:

(i) between relevant shippers;

(ii) between relevant suppliers; and/or

(iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;

22. As we have stated above, we consider that the introduction of an effective gas vacants process will allow SSP Shippers to improve the accuracy of the commodity charges they are allocated by reducing them to zero where a site is genuinely vacant and therefore consuming nothing. We also consider that as the prevalence of vacant sites will vary depending on customer type, and therefore vary from Shipper portfolio to portfolio, this more accurate allocation of charges will enable Shippers to compete more effectively with each other.

23. We believe that Modification Proposal 0282A best achieves this as it introduces greater control against the risk of Shippers either failing to notify the Network Owner of a change in vacant status or the risk of Shippers declaring a site as vacant and then resorting to bi-annual meter inspections to assess the ongoing vacant status; both of which could result in sites being left in an erroneous vacant site status distorting the accuracy of settlement costs in the process. We therefore argue that Modification Proposal 0282A facilitates this relevant objective, whereas Modification Proposal 0282 does not facilitate it.
24. If you have any queries relating to this representation, please do not hesitate to telephone me on (07789) 570501.

Yours sincerely

David Watson
Regulatory Manager, British Gas