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10 September 2010

Dear Bob

Response to UNC Modification Proposals 0317 and 0317A Interim Allocation of Unidentified Gas

We welcome the acknowledgement by the Proposer Shell Gas Direct that LSP shippers should contribute to the cost of unidentified gas from April 2011 ahead of any published AUGE methodology.

Proposal 0317 includes the report produced by an independent body but sponsored by the Industrial & Commercial only Shippers and Suppliers group (ICoSS). The report provides an assessment of the share to be borne by LSP shippers as being the midpoint within a given range. The Proposer describes this share as being 'fair and logical' and so we assume that ICoSS members believe this to represent the likely outcome of any independent AUGE assessment. The LSP market share figure given in 0317 is £2.75m.

E.ON does not agree with the logic behind the ICoSS report for a number of reasons which we will go on to illustrate.

Proposal 0317A does not attempt to provide an alternative to the 0317 figure of £2.75m but includes a mechanism to reconcile the figure once the AUGE findings are known. This allocation/ reconciliation process is not dissimilar to the long established NDM demand attribution/reconciliation process including the RbD mechanism which must have been developed at some point based on an estimation process which has been refined over time.

Given that the applicable date for the application of LSP unidentified gas is April next year, i.e. in the future, we do not see how this can be described, as it has by some, as retrospective.

It simply follows an established allocation/reconciliation philosophy.

Whenever estimates are used ahead of reconciliation we would expect parties to apply appropriate risk management strategies. It has been acknowledged widely by the industry including I&C shippers and Ofgem that the status quo, whereby the SSP market comprising mainly domestic customers has been subsidising predominantly I&C customers for some considerable time, is unfair. It has also been accepted by I&C shippers that they would at some point need to bear their share. We would expect that any prudent player would have planned for this eventuality and provisioned accordingly. We would also expect that I&C shipper/supplier businesses would include an element in their supply terms and conditions to deal with unforeseen third party costs or manage this risk in some other way.

As a shipper/supplier in the LSP market we would however suggest exercising caution before adopting the ICoSS report findings as a basis for any likely outcome of eventual AUGE findings.

<u>ICoSS report</u>

We would challenge the logic used to derive an accurate assessment of the size of the unidentified gas pot and the LSP share as it omits key elements and where data is provided as part of its findings, the conclusions are based largely on assumptions.

Taking extracts from the report:

ICoSS report page 3

Potential sources of "unidentified" gas

Gas measurement and shrinkage errors

6. In our previous assessment we looked at errors in gas measurement and shrinkage estimation as potential sources of "unidentified" gas and, whilst we believe these areas are worthy of further investigation, no strong evidence of undetected errors was immediately apparent.

7. For the purposes of this exercise we have not therefore considered errors in gas measurement (LDZ inputs, DM consumption and LSP consumption) or errors in shrinkage quantity estimates (other than the"network" theft element – see later) as potential sources of "unidentified" gas.

LDZ Inputs

We do not believe that it is prudent to discount measurement errors. In the case of LDZ inputs there is considerable evidence to show that quantifiable errors exist, supporting data is available on the Joint Office website under Meter Error Reports[1].

DM and NDM meter sizing

Whilst we agree that there may be little firm evidence of DM and NDM supply point measurement errors it would seem logical to consider the likelyhood of these occurring. Supply meters, particularly those installed at larger I&C sites are designed to operate within a defined range and may not be accurate at low flow rates. Such meters would have been originally selected to cater for maximum demand in terms of flow rates. Due to recent economic conditions and a gradual decline in the UK industrial base it would seem likely that many I&C sites could be using gas at flow rates considerably below those for which the meter was selected leading to potential measurement errors. It should be noted that there is no regular replacement programme for larger I&C meters.

We are not suggesting that any particular design of meter is more or less likely to be accurate at low flow rates, nor are we suggesting that suppliers are acting inappropriately when assessing the need for meter downsizing. Appropriate sizing is very difficult to achieve with varying shift in load patterns. Larger meter installations are very expensive, usually costing many thousands of pounds and often only manufactured to order with long lead times. A programme of work to replace such meters may take many months and may see the load requirements return to previous levels in the intervening period. It may not therefore be practical or cost effective to consider replacing meters in all cases, however the associated under measured gas could be ascertained and included within the unidentified gas pot.

DM & NDM measurement adjustments

In the event of meter failure no read data will be available and the consumption data will be estimated. Should the meter need replacing then as described above long lead times to procure the meter which when coupled with scheduled shut down times to facilitate the works can result in periods of estimation of many months. Any underestimate will result in energy being assigned to the unidentified pot.

[1] http://www.gasgovernance.co.uk/MER

Where the fault is related to the meter pulse output or the automated temperature and pressure conversion equipment a calculated temperature and pressure conversion factor (CF) based on set meter pressure, altitude and set temperature is applied. Experience shows that this factor generally results in a lower resultant measured volume when compared to an actual conversion carried out by equipment at site and is particularly noticeable where extremes of temperature and pressure prevail. This can be the case for many larger DM sites which are fed directly from the 7 bar pressure tier.

Unregistered Sites

ICoSS report page 3

Late/ Unregistered/ Orphaned sites and IGT issues

8. In both these areas, it remains unclear to us the extent to which there is only a transient problem, whereby contributions to RbD are reversed at a later stage. We have seen no clear evidence (other than for orphaned sites – see below) that there are significant volumes of "unidentified" gas arising from these processes that are not ultimately, when data becomes available, properly accounted for.

18. Our analysis assumes that it is not appropriate to apportion RbD volumes arising from orphaned sites to the shrinkage account. Our analysis also assumes that there are no volumes associated with DM sites within the xoserve data. If there were, sector proportions for SSP, LSP and DM sectors would theoretically need to be calculated.

19. However, we note that if DM load was included in the apportionment, the occasional instance of a large DM load contributing to orphaned sites volumes would strongly influence the apportionment drivers. We would be extremely reluctant to develop apportionment methodologies for market sectors as a whole, based on single instances such as this.

This section refers to DM sites as only occasionally contributing to orphaned sites. This may be true, however a single instance over a short period of time can represent a considerable amount of energy. Taking the example of a very large (VLDMC) site with AQ at the lower end of the band i.e. 1,465 GWh. One month's energy at the median System Average Price over the last twelve months of 2.116 p/kWh amounts to £ 2,583,909.

Theft

ICoSS report page 8

LSP and SSP sector proportions of "non-network" theft

30. Consistent with industry views, we have assumed there is negligible theft in the DM sector. For LSP and SSP sector proportions, our potential range includes figures derived from analysis of detected theft statistics,

analysis of alleged (and detected) theft statistics, and from AQ and throughput data:

The report focuses on theft. It uses the assumptions made by the transporters to estimate network theft along with know detected theft figures provided by xoserve. It also dismisses DM theft, we are not aware of any consensus that leads to a conclusion that DM theft is negligible

Given that transporters views about network theft are assumptions and not measurements and that know detected theft can only be a minimum amount, we do not see that detailed figures derived from these assumptions can be authenticated.

Our conclusion is that of the two proposals we prefer 0317A as it properly allows for any estimated values to be properly reconciled following the outcome of the AUGE findings. However we do not feel that a figure of £2.75m is appropriate given our misgivings about the ICoSS report and so we are only able to give qualified support to 0317A but do not support 0317.

Yours sincerely

Brian Durber
Retail Regulation (by email)