

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

10th September 2010

Dear Bob

RE: UNC Modification Proposals 0317 & 0317A – “*Interim Allocation of Unidentified Gas Costs*” and UNC Modification Proposal 0327 – “*Alternative to Interim Allocation of Unidentified Gas Costs*”

1. British Gas supports the implementation of either Modification Proposal 0317A or 0327, although we express a preference for 0327. We do not support the implementation of Modification Proposal 0317. Our detailed reasoning is given below.
2. Since 2005 it has been widely accepted that the present allocation of costs is unfair, a fact which the Proposer of Modification Proposal 0317¹ themselves agree with. Despite spending five years attempting to secure reform however, these costs are still being unfairly allocated to the Small Supply Point (SSP) sector today.
3. Modification Proposal 0229 was referred to Ofgem in June 2009, following their extensive consideration of other attempts to resolve this issue, including Modification Proposals 0194, 0194A from December 2008 and 0228 and 0228A from February 2009.
4. After eleven months of deliberation Ofgem directed the implementation of the legal text prepared for Modification Proposal 0229. This legal text clearly requires the reallocation of unidentified gas costs from the Large Supply Point (LSP) sector to SSP sector from 1st April 2011, a view confirmed by our legal advice, provided in Appendix Four of this letter for reference. Modification Proposal 0317 seeks to reverse this however, taking us from that position to one where the full reallocation of costs is deferred until April 2012 in lieu of a

¹ Modification Proposal 0317, page 1.

fixed one off payment to the SSP sector of £2.75m; a sum which vastly understates the actual reallocation of charges due.

5. The Proposer, along with others members of the I&C Shippers and Suppliers Group (ICoSS) trade association argue that £2.75m is an accurate reflection of the present misallocation of costs. If this is true then the subsequent adjustment when the AUGE concludes their work would be zero and consequently have no impact on them. The Proposer seeks to prevent any adjustment however, and in doing so seeks to:
 1. Unwind the decision that Ofgem has spent a considerable amount of time over regarding the implementation date of Modification Proposal 0229. It is difficult to understand why after eleven months of deliberation Ofgem should now change their mind.
 2. Create a further incentive on the I&C Shipper and Supplier community to stall the implementation of Modification Proposal 0229.
 3. Continue the misallocation of unidentified gas costs to domestic customers, despite accepting themselves (as above) that this allocation is incorrect.
6. The evidence provided by the Proposer in support of Modification Proposal 0317 is claimed to be an “*independently produced report*”² yet it is written by ICoSS themselves, a far from independent body. It comes as little surprise to us therefore that the analysis concludes with a position favourable to the LSP Shipper community. More detail on this is provided in Appendix One.
7. There are also serious flaws in the Modification Proposal 0317 methodology which lead to a significant underestimate of the cost to be reallocated. Again, these are set out in more detail within Appendix One of this response, but in particular we want to point out that:
 1. There is a failure to appreciate that the vast majority of unidentified gas in the market has *already been allocated to the SSP in their initial allocation*. In effect, the Proposer is incorrectly arguing that *all* unidentified gas resides within the Reconciliation by Difference (RbD) process – a fundamental misunderstanding which runs right through Modification Proposal 0317. It is not right to calculate a percentage of unidentified gas which the LSP sector is responsible for and then only apply that percentage to the value of RbD. Instead, that percentage should be applied to the aggregate sum of unidentified gas in the market, including the significant amount initially allocated to the SSP sector. This is such a fundamental error that, for this reason alone, that the justification for the £2.75m figure in Modification Proposal 0317 is completely invalid.
 2. The ICoSS report is, by the author’s own admission, “*not underpinned with sound data*”. Furthermore, ICoSS explicitly state that “*more high quality information and data is required before an apportionment methodology (like Modification Proposal 0317) could*

² Modification Proposal 0317, page 2.

*be used in practice*³, however the Proposer does just that and makes conclusions based on the flawed data. The report itself explicitly warns against this specific error by saying that “*We emphasise how strongly the results are influenced by our assumptions, and that our assumptions in many cases, in particular aggregate theft levels and “network” theft proportions, were not underpinned with sound data. The results should be viewed in this light*”⁴. The Proposer chooses to ignore this advice.

8. It has been argued by some that if costs are reconciled retrospectively to 1st April 2011, after the Allocation of Unidentified Gas Expert (AUGE) confirms the level of misallocation, LSP Shippers will be unable to recover their costs from customers who leave their portfolio before the end of the year to May 2012. In response, we consider that

1. In their decision letter on Modification Proposal 0171, Ofgem addressed the specific point about Shippers’ ability to provision for a retrospective correction of costs, saying “*We consider that in such a case a shipper will have, in error, benefited from the increased difference between billed payments received for gas supplied to these customers and payments made by their shipper for their proportion of the aggregate LDZ AQ. Conversely, where a past error means the shipper has in effect overpaid, their revenue would have been reduced. We therefore consider that the Modification Proposal does not carry an undue risk associated with cost recovery from customers but instead it reallocates charges and credits to better reflect shippers’ initial outlay*”⁵. We consider that this principle applies equally in this case, as without Modification Proposal 0317A or 0327 LSP Shippers will receive substantial benefit for the period 1st April 2011 to May 2012.
2. It is far better to have a previous misallocation corrected than allow it to persist in lieu of far smaller, potential, issues such as having to provision appropriately for costs you are likely to incur.
3. Assuming Ofgem make a decision on these Modification Proposals before April 2011, Shippers are fully able to make an assessment of the likely exposure they may face for the period to May 2012 and provision accordingly. The Proposer, for example, may suggest that the LSP community should provision for no more than £4.9m, whereas we take the view they need to provision much more. The level of risk associated with a provisioning exercise is purely determined by how accurate your respective view on reallocation will be, as is standard commercial practice. We also want to make clear that *the SSP sector has had to provision against these misallocated costs for many years, and will continue to have to do so under Modification Proposal 0317.*

9. It has also been argued by some LSP Shippers that the long term contracts they have with customers do not allow sufficient flexibility for prices to take in

³ Modification Proposal 0317, “Quantification and Apportionment of “Unidentified” Gas” Report, page 1.

⁴ Modification Proposal 0317, “Quantification and Apportionment of “Unidentified” Gas” Report, paragraph 56.

⁵ Ofgem [Decision Letter](#) on Modification Proposal 0171, page 4.

to account changes to the legal or regulatory framework. We disagree with this point entirely and point out that it is standard industry practice to provide a term within all LSP site contracts which allow the agreed price to vary mid-contract term following a change to the regulatory arrangements. Indeed, as the largest LSP Shipper by Supply Point, we confirm that this is the case with all our LSP customer contracts.

10. Each of these Modification Proposals agrees that some form of interim allocation of costs should be made between the LSP and SSP sectors before the AUGE makes their conclusions. Modification Proposals 0317A and 0327 however seek to overcome the issues associated with one sector trying to impose a settlement on the other by guaranteeing that once the AUGE has reached their conclusions, any interim reallocation of unidentified gas costs will be revised such that all Shippers can be confident that they will pay or receive only what is right.
11. We also consider that the approach used in Modification Proposal 0327 to determine the correct apportionment of unidentified gas costs provides Shippers with a much more accurate view of on the scale of reallocation which is due as it approaches the problem, not by trying to complete the AUGE's task of quantifying unidentified gas and apportioning it between sectors, but by looking at the average level of genuine reconciliation in the market each year and using that to derive the amount of cost which should be allocated to the LSP sector. As unidentified gas generated by the SSP sector will have already been allocated to that sector during their initial allocation, this is a much more accurate way of assessing the reallocation due.
12. For clarity we have set out our view on how each of these Modification Proposals meets or does not meet each of the relevant objectives below, and then gone on to provide a more detailed assessment of each Modification Proposal within Appendix One.

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;

13. We disagree that Modification Proposal 0317 will lead to a fairer allocation of costs between Shippers in the SSP and LSP sectors. This Modification Proposal seeks to change the principle implemented with the Modification Proposal 0229 legal text that the SSP sector should benefit from the implementation of the Allocation of Unidentified Gas Statement (AUGS) from 1st April 2011 and instead impose an initial allocation of just £2.75m without the ability to correct this should the AUGE subsequently show it to be wrong. This moves the industry from a position where they can expect an accurate

reallocation of costs to one where they will receive an allocation based on flawed analysis and unsound data.

14. As the SSP sector is already entitled to benefit from a backdating of any initial AUGE methodology to 1st April 2011, any move to change that arrangement in favour of an arbitrary allocation of £2.75m will actually reduce the degree to which costs are fairly allocated for the period 1st April 2011 to 31st March 2012, thus distorting competition in favour of those shippers predominantly focussed on the LSP sector. We cannot therefore accept that Modification Proposal 0317 meets this Relevant Objective, and in fact argue that it runs counter to it.
15. For the reasons given in Appendix One, we believe that the proposed reallocation of £2.75m from the LSP to SSP sectors is grossly under-stated and is based on data which is acknowledged as being fundamentally flawed. An allocation of costs on such a basis can only increase the inequity with which unidentified gas costs are treated, thus distorting competition further.
16. Both Modification Proposals 0317A and 0327 also allow for an initial payment from the LSP to SSP sectors, but crucially then allow for that payment to be corrected by the AUGE when they publish their findings in May 2012. Thus we believe that the risk of error within that initial reallocation is removed and therefore that the potentially negative impacts on competition are mitigated, whilst still allowing for interim relief for the SSP sector from the incorrect allocation costs it would pay under the current regime until May 2012. This interim relief will allow SSP and LSP Shippers to compete on a more level playing field. We therefore argue that both Modification Proposal 0317A and Modification Proposal 0327 meet this Relevant Objective.
17. For the reasons detailed in Appendix Three, we believe that the correct reallocation of unidentified gas costs from the LSP to SSP sectors will be £121m per annum, and that given the scale of this reallocation LSP Shippers will be wise to provision appropriately. Only Modification Proposal 0327 ensures this occurs, and thus only Modification Proposal 0327 truly protects Shippers from the full weight of costs they can expect to incur in future years following publication of the AUGS, therefore protecting their ability to compete properly.

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

(a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

18. We do not agree that Modification Proposal 0317 facilitates this Relevant Objective. It is claimed that by introducing a temporary framework which facilitates better decision making on the allocation of unidentified gas between the market sectors, the ability of the industry to efficiently implement the Uniform Network Code will be improved. We consider that this is only true however if the amount of reallocation considered under the temporary framework is an accurate amount.

19. As we argue in Appendix One, the basis for the £2.75m allocation proposed under Modification Proposal 0317 is fundamentally flawed and that as such any allocation will be incorrect. It therefore follows that Modification Proposal 0317 will actually reduce the ability of parties to make sound decisions regarding unidentified gas, thus failing to facilitate this relevant objective.
20. We consider that as Modification Proposal 0317A and Modification Proposal 0327 make it entirely clear that any initial reallocation of costs is a temporary arrangement made in advance of the AUGS, parties will be able to proceed with certainty that a fully accurate reallocation of costs will follow, thus enabling the industry to make decisions about the allocation of unidentified gas with the best information, thus meeting this Relevant Objective.
21. Furthermore, we consider that Modification Proposal 0327 introduces a far more robust methodology for calculating the likely amount of cost which will be reallocated as it recognises the fact that the SSP sector has already met a substantial part of the total unidentified gas costs in its initial allocation. Even without the important concession that the AUGS will correct the Modification Proposal 0327 allocation therefore, we consider this Modification Proposal forces parties to properly provision for the likely costs they may face, thus improving the overall ability of the industry to make better decisions on the treatment of unidentified gas and therefore meeting this Relevant Objective.
22. Our detailed reasoning on each of the Modification Proposals is set out below; Modification Proposal 0317 in Appendix One, Modification Proposal 0317A in Appendix Two, Modification Proposal 0327 in Appendix Three. As mentioned above, our legal advice on the position brought about by Modification Proposal 0229 is contained within Appendix Four.

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

Appendix One – Modification Proposal 0317

General Comments

23. MOD0229 introduced legal text which, after over three years of debate, ensured both that an independent expert would be appointed to establish the correct apportionment of unidentified gas between the SSP and LSP sectors, and that this methodology would be applied with effect from 1st April 2011 regardless of when the methodology was actually first published. This provided the SSP sector with the certainty that there would be a fair reallocation of costs to the LSP sector based on the findings of an independent expert, and that this reallocation would not be delayed any longer than was necessary; minimising the harmful effects caused by continued exposure to unfair charges.
24. Modification Proposal 0317 affirms the MOD0229 legal text by seeking to amend it such that any reallocation of costs for the period from 1st April 2011 until the publication of the first AUGS is not based on the findings of the AUGS but by a fixed charge of £2.75m from the LSP to SSP sectors. Whilst we are pleased that the Proposer implicitly agrees with our interpretation of Modification Proposal 0229, we cannot agree that removing the ability of the independent AUGS to allocate costs for this period in lieu of a one-off payment of £2.75m is a fairer way of allocating the costs associated with unidentified gas.
25. Indeed, we consider that Modification Proposal 0317's proposal that the SSP sector forsake a full reallocation of costs based on the view of an independent expert in return for a one off payment of £2.75m will leave SSP Shippers (and therefore largely domestic customers) continuing to meet the cost of unidentified gas on LSP sites. The net effect of Modification Proposal 0317 will simply be to take the industry back to the days before Modification Proposal 0229 provided relief from inaccurate SSP allocation costs, and impose a charge of approximately £118m⁶ on SSP customers between 1st April 2011 and 31st March 2012.
26. Indeed, the Proposer says themselves that the issue of how to allocate unidentified gas "*needs to be done in an equitable, transparent and impartial manner*", and that this should be done by relying "*on the work of an independent expert*"⁷; an argument accepted by Ofgem when they directed the implementation of Modification Proposal 0229 legal text. Modification Proposal 0317 directly contradicts this aim.
27. The Proposer went even further in their comments at the time, questioning why any Shipper should be concerned about allowing an independent expert

⁶ The difference between £121m, which we believe to be the true scale of reallocation due, and the £2.75m proposed under Modification Proposal 0317.

⁷ Shell Gas Direct [response](#) to MOD0228(A), 6th February 2009.

to determine how unidentified gas should be allocated when it was considered that this allowed for *“the central role for shippers and UNCC in appointing such an expert; the need for the expert to adhere to the set of high-level allocation methodology principles; the annual approval of the AUGS and the right to suggest proposed changes; and the ability to veto any work of expert that produces clearly erroneous results”*⁸. We believe that the industry have every right to be sceptical when the LSP Shipper and Supplier community now says it wants to stop the ability of the industry to rely on this independent expert to determine the allocation of unidentified gas, in lieu of a one off payment based on a flawed methodology.

28. Furthermore, we note that in their Decision Letter on Modification Proposal 0229, Ofgem stated that one of the benefits of the proposal was that *“The introduction of the AUGE (will) enable an appropriate methodology to be developed, using the best evidence available to determine which market sector is likely to have contributed to Unidentified Gas and how these costs should be apportioned.”*⁹ This was in contrast to Modification Proposal 0228 which sought to propose that analysis commissioned by British Gas be used to determine the correct allocation. We are conscious that the Proposer is now seeking to impose their own analysis on the SSP sector, rather than respect the decision Ofgem have made to allow an independent expert to settle the matter.
29. We are also concerned that the report on which Modification Proposal 0317 is based on may not be as independent as the Modification Proposal suggests. Modification Proposal 0317 states that the report contained within it is *“independently produced”*¹⁰, yet the report attached to Modification Proposal 0317 is written on ICoSS headed paper and starts with the sentence *“ICoSS has attempted to quantify and apportion volumes and costs within RbD that might more appropriately be borne by the LSP sector”*, clearly indicating that the report has been written by ICoSS members themselves, members who include the Proposer. Notwithstanding this, we have reviewed the methodology used and have found it to be materially flawed.
30. In particular, the assumptions upon which the conclusions are based are fundamentally unsound. This is referred directly to by ICoSS themselves within Modification Proposal 0317 when they say that the *“results (of their analysis) are influenced by our aggregate theft and “network” theft assumptions, which are not underpinned with sound data. We believe that more high quality information and data is required before an apportionment methodology (like Modification Proposal 0317) could be used in practice”*¹¹.
31. The report goes further than this when setting out its conclusions, saying that *“We emphasise how strongly the results are influenced by our assumptions, and that our assumptions in many cases, in particular aggregate theft levels and “network” theft proportions, were not underpinned with sound data. The*

⁸ Shell Gas Direct [response](#) to MOD0229, 12th June 2009.

⁹ Ofgem Decision Letter on MODs 0194(A), 0228(A) and 0229, May 2010, page 7.

¹⁰ Modification Proposal 0317, page 2.

¹¹ Modification Proposal 0317, “Quantification and Apportionment of “Unidentified” Gas” Report, page 1.

*results should be viewed in this light*¹². We therefore urge all parties to consider their position on Modification Proposal 0317 in light of these comments from ICoSS, and believe in doing so the only rational decision will be to reject the Modification Proposal.

32. Despite the admission that the conclusions of the ICoSS report are not based on “*sound*” data and should not be used to reach any apportionment, the Proposer ignores their own advice and proposes that £2.75m of costs are apportioned to the LSP sector without the ability for this to be subsequently corrected by an AUGE.
33. The author of the ICoSS report continues by acknowledging that there is “*a paucity of reliable information*”¹³ around the issues which go to create unidentified gas, yet does not attempt to quantify the scale of the issue. We would have expected the Proposer to have noted this comment themselves and attempt to quantify the risk that this places on their conclusions, but this has not happened. This is compounded by the fact that Modification Proposal 0317 does not allow for any error in the calculation to be subsequently corrected by the AUGE, once they have reached firm conclusions as in Modification Proposals 0317A and 0327. As a result, we infer that the Proposer believes that the £2.75m figure might not be accurate but that they have no way of establishing by how much.
34. We believe that the most fundamental flaw in Modification Proposal 0317 however is its failure to appreciate that only a small section of the total amount of unidentified gas is within RbD; the majority of it having already been assigned to the SSP sector during initial allocation. Failure to recognise this is such a fundamental flaw in Modification Proposal 0317 that the proposed amount of cost reallocation is materially undermined.
35. Gas consumed in any one day is measured at the entry to each Local Distribution Zone (LDZ) and then allocated to all Non-Daily Metered (NDM) sites based on their share of the market Annual Quantity (AQ). This is known as the Initial Allocation and as this is measured at the entry to the LDZ, it will already include all unidentified gas, other than an element of shrinkage.
36. Consumption on LSP sites¹⁴ is subsequently reconciled to actual meter readings as and when they are received. The difference between the Initial Allocation and the position after submission of the LSP reads is assigned to the RbD process and distributed across SSP based on their share of the market AQ.
37. As unidentified gas generated by SSP sites is already included within the initial allocation to the SSP sector, it is incorrect to say as Modification Proposal 0317 does that all unidentified gas is found within RbD and that it is

¹² Modification Proposal 0317, “Quantification and Apportionment of “Unidentified” Gas” Report, paragraph 56.

¹³ Modification Proposal 0317, “Quantification and Apportionment of “Unidentified” Gas” Report, paragraph 2.

¹⁴ i.e. those sites consuming more than 73,200 kWh p/a.

RbD which needs to be re-allocated between the SSP and LSP sectors. In effect, by reallocating unidentified gas found within RbD, Modification Proposal 0317 attempts to reallocate just a subset of the total amount of unidentified gas in the market from SSP to LSP. The unidentified gas found within RbD will have been generated by the LSP sector, and therefore should be borne entirely by that sector. The real question is over the degree to which RbD also contains genuine consumption drift as well as LSP unidentified gas.

38. The £2.75m figure is totally implausible, and is according to ICoSS, based on data which is fundamentally flawed. We also consider that were the £2.75m figure to be correct, it is unlikely so much time and effort would have been invested by the industry, on both sides of the debate, for the past three years.

Late / Unregistered / Orphaned Sites

39. Some of the issues which ICoSS no doubt refer to, include the fact that the model used does not take in to account any unallocated gas created by the LSP sector which is not from either theft or Orphaned sites¹⁵, i.e. those sites burning gas without being registered to a particular Shipper. This fails to consider the possibility that Unregistered or Late registered sites, or Supply Point metering errors and issues on iGT sites can lead to unallocated gas within the LSP sector.
40. This is partly recognised by ICoSS, for example, when they discuss the exclusion of “*Gas measurement and shrinkage errors*”, concluding that although ICoSS believe these sources as worthy of “*further investigation*” they go on to discount them entirely from their methodology on the grounds that there is no “*strong*” evidence to show that these generate unallocated gas¹⁶. We would have appreciated the opportunity to scrutinise the evidence which ICoSS have seen in this regard so that we could form a view as to the appropriateness of dismissing these potential sources of unidentified gas. For clarity, we believe that all these discounted sources have the potential to generate significant amounts of unidentified gas, in both the SSP and LSP sectors, and that as such must be considered when assessing how to reallocate unidentified gas using the method chosen by the Proposer.
41. We believe this is a tacit acknowledgement that there is the possibility of unidentified gas being created outside of the factors considered in the ICoSS report, but that the Proposer was unable to assess for lack of robust evidence. We recognise that evidence on precisely how unidentified gas used on unregistered sites might be apportioned may be difficult to quantify, but note that this was the one of the very reasons the Proposer argued in favour of Modification Proposal 0229. We are therefore surprised that they now favour a model which favours figures provided by one sector to allocate unidentified gas rather than allow an independent expert to complete the work following detailed analysis. We consider this to be a highly regressive idea.

¹⁵ Modification Proposal 0317, “Quantification and Apportionment of “Unidentified” Gas” Report, page 1.

¹⁶ Modification Proposal 0317, “Quantification and Apportionment of “Unidentified” Gas” Report, page 3 and 4.

42. Notwithstanding the narrow view which ICoSS have taken on the potential causes of unidentified gas, the figures for Late, Unregistered, Orphaned sites and IGT issues have been produced from xoserve analysis which focuses on a small sub-set of the overall problems¹⁷. Also, the assertion that there is “*no clear evidence ... that there are significant volumes of “unidentified” gas arising from these processes that are not ultimately, when data becomes available, properly accounted for*”¹⁸ is not correct, for the reasons set out below.
43. No attempt has been made to quantify volumes of incorrectly allocated gas associated with unregistered sites on IGT networks, a recognised problem which is currently being discussed in the “Connected System Entry Point” (CSEP) reconciliation workshops. Nor has any attempt been made to quantify the volume of incorrectly allocated gas for any site on a network where gas is being consumed and there is no record of a Meter Point Reference Number, or indeed for Shipperless¹⁹ sites which are still using gas. No reason has been given for these exclusions.
44. The report’s failure to consider the possibility of unidentified gas being created by any type of Unregistered Site other than those which are defined as “Orphaned” narrows the scope of the analysis significantly. xoserve define an Orphaned Site as a site where the Meter Point Reference Number (MPRN) creation was requested by one Shipper, but at a later date the site was confirmed by a different shipper. Consequently, the sample used in the report contains just 656 sites, a very small number of cases representing less than 1% of the total unregistered problem within the industry. For example, xoserve data for the end of May 2010²⁰ showed that there were 78,332 Unregistered sites potentially generating unidentified gas in both SSP and LSP sectors, constituted as follows:
- 16,403 sites that are more than 12 months old, not yet registered and orphaned by virtue of a Shipper expressing they have no interest in the MPRN.
 - 658 sites that are more than 12 months old, some Shipper activity has taken place, but the site is not yet registered but not "orphaned".
 - 4,190 "Shipperless sites", previously confirmed and withdrawn but with a meter on site.
 - 5,878 sites where an MPRN has been created but xoserve are unaware of any further Shipper activity taking place.
 - 24,136 "legitimately unregistered" sites, where site is vacant or still being planned.
 - 27,067 sites less than 12 months old, not yet registered, expected to resolve within 12 months.

¹⁷ See paragraph 44, below.

¹⁸ Modification Proposal 0317, “Quantification and Apportionment of “Unidentified” Gas” Report, paragraph 8.

¹⁹ xoserve define a Shipperless sites as one which has been previously registered to a Shipper who has subsequently withdrawn from it.

²⁰ xoserve presentation to the [Industry Shipperless and Unregistered Working Group on 7th July 2010](#).

45. 22,281 of these sites are not confirmed and more than 12 months old (the first two categories, above) and this number is trending upwards²¹, indicating more unregistered sites are being created than being resolved. This indicates that the real volume of unidentified gas created by Unregistered sites is several orders of magnitude larger than the 67,935,310 kWh²² quoted in the report underpinning Modification Proposal 0317. The conclusions drawn therefore about the amount of unidentified gas the LSP sector is responsible for are also by extension wrong.
46. xoserve have also published data²³ which suggests that if you look across the entire portfolio of Unregistered sites, 93% of the AQ share rests within the LSP sector. This indicates to us that Modification Proposal 0317 has largely under-estimated the amount of unidentified gas which unregistered LSP sites generate. This inevitably means that the conclusions Modification Proposal 0317 makes on the amount of cost which should be reallocated to the SSP sector are also largely under-stated. Furthermore, the data which xoserve published was delivered in the same meeting in which they made the presentation on Orphaned sites which the ICoSS report references. This suggests to us that the ICoSS report is highly selective in the evidence it chooses when analysing industry data.
47. We also question the Proposer's assertion that process improvements will reduce the volume of unregistered sites by between 67% and 100%²⁴. Not only is this assumption unsubstantiated by ICoSS, we note that there are also no agreed industry-wide targets to reduce the numbers of Unregistered and Shipperless sites, and no firm plan or proposed solutions to achieve the reduction the industry aspires to. In fact, the evidence from the xoserve Shipperless Workgroup shows that the current problem is both growing and much larger than the 67,935,310 kWh quoted by ICoSS. This demonstrates that the "*Central Case*" used by the Proposer to estimate the LSP share of unidentified gas costs generated by Unregistered sites is inaccurate.
48. Finally in relation to Unregistered sites, we note that there is no recognition of the fact that a substantial amount of unidentified gas is already allocated to SSP sites in the initial allocation process. Thus, when the report concludes that all unidentified gas used by these sites is found within RbD²⁵, and that the methodology must therefore apply the cost allocation in terms of a proportion of the annual RbD bill, it is wrong.

Theft

²¹ xoserve presentation to the [Industry Shipperless and Unregistered Working Group on 7th July 2010](#), slide 4.

²² Modification Proposal 0317, "Quantification and Apportionment of "Unidentified" Gas" Report, paragraph 17.

²³ xoserve [presentation](#) on Unregistered Sites made to UNC Development Group 0194 on 30th June 2008.

²⁴ Modification Proposal 0317, "Quantification and Apportionment of "Unidentified" Gas" Report, paragraph 22.

²⁵ Modification Proposal 0317, "Quantification and Apportionment of "Unidentified" Gas" Report, paragraph 40. The table clearly calculates the costs of unidentified gas from Orphan sites to be apportioned as proportion of RbD rather than a proportion of the total unidentified gas generated.

49. We also have significant concerns about the analysis which underpins Modification Proposal 0317's assumptions on the amount of unidentified gas costs generated by theft on LSP sites. For example, although we acknowledge the limited data available on aggregate theft levels we believe that this is entirely due to the nature of theft and that this is unlikely to change. If conclusions are to be drawn on the scale of theft therefore, a degree of risk should also be calculated around these conclusions being wrong so that respondents to the Proposal can understand the potential margin of error. The Proposer of Modification Proposal 0317 has not done this.
50. We are surprised that at a time when the industry is considering a series of Modification Proposals designed to address the structural failure by many parties to invest in theft detection, an ICoSS report suggests that theft detections are a sound basis upon which to estimate what proportion of theft is attributable to the LSP sector, even if that is multiplied by a variety of factors. Indeed, we note that one of the primary drivers behind Modification Proposal 0229 was that it was only independent detailed analysis which could accurately determine the true level of LSP theft.
51. We contend that xoserve statistics on theft detections are a wholly inappropriate basis to make any conclusions about the true level of theft in the market because the majority of Shippers singularly fail to adequately invest in theft detection activities.
52. This is demonstrated by xoserve's own statistics which show that British Gas is responsible for 83% of all theft detections in the entire UK gas market, with the other 37 Shippers responsible for the remaining 17% of theft detections *combined* between themselves. In other words, investment in theft detection activities is so low that we are *twenty times* more likely to find theft on a site than the next best performing Shipper, despite representing less than half of all Supply Points, and despite only representing 33% of all theft detection leads.²⁶ On this basis, any conclusion about the scale of LSP theft which relies on the number of detections made is incorrect.
53. Indeed, ICoSS themselves say in their report that xoserve detected theft statistics are an inappropriate basis for any calculation of unallocated gas²⁷, and thus attempt to create a number of scenarios by first multiplying the confirmed detections registered with xoserve by a factor of ten, and then by using a multiple of the Network Owner assumptions.
54. We would have liked to understand more about ICoSS' statement that the various cases they have chosen in support of Modification Proposal 0317 are "*somewhat arbitrary*"²⁸ so we can better understand the degree of risk that should be associated with their findings. For example, there appears to be no

²⁶ All statistics taken from xoserve TOG Statistics for the year 2009.

²⁷ Modification Proposal 0317, "Quantification and Apportionment of "Unidentified" Gas" Report, paragraph 26.

²⁸ Modification Proposal 0317, "Quantification and Apportionment of "Unidentified" Gas" Report, paragraph 25.

scientific basis for the multiplication of xoserve detection levels by a factor of 10 to derive the low case, nor is there any apparent rationale for deriving the high case by doubling the Network Owners' assumed level of theft. The central case chosen is set at half of the Network Owners' assumed level of theft, but again, no rationale is provided to support why true theft levels will be at this level. Do ICoSS have evidence, for example, to suggest that the Network Owners have overstated the incidence of theft by a factor of two?

55. We also strongly dispute the statement that the High case is representative of a "*figure approaching the levels generated by Mod.228/228A methodology*"²⁹. The high case of theft used by Modification Proposal 0317 is given as 0.60% of throughput whereas the levels quoted in Modification Proposal 0228 and 0228A were 1.0% of throughput; the difference of 0.4% of throughput equates to some 2.44tWh or approximately £38.13m. This is a material difference. The statement that "*we believe we have erred on the side of higher aggregate theft levels*"³⁰ is also wholly incorrect, since 0.60% of throughput is well below other estimations³¹.
56. The ICoSS report states that theft from the "*network ... was unlikely to be any lower than the 3.1% figure*"³² that Network Owners have assumed, but they fail to substantiate this claim. We are not aware of any Network Owner who does not accept that their assessment on the scale of network theft contains a margin of error, however small, and thus it is surprising for ICoSS not to present evidence to show why 3.1% of theft is the absolute minimum. This omission suggests to us that the high, central and low cases used are entirely "*arbitrary*".
57. The ICoSS report dismisses xoserve detected theft statistics as "*too low to be realistic*"³³ and the combined xoserve allegations and detections theft statistics as "*unsound*"³⁴, but then inexplicably chooses the former as the basis for its central case on how aggregate theft should be allocated between LSP and SSP sectors. The decision to use figures which Modification Proposal 0317 itself describes as unrealistic means the conclusions eventually drawn by the MOD on how theft should be apportioned are incorrect.
58. The ICoSS report arbitrarily discounts all theft levels that would lead to an allocation of theft volumes to LSPs above 7.4%³⁵, despite the fact that LSPs

²⁹ Modification Proposal 0317, "Quantification and Apportionment of "Unidentified" Gas" Report, paragraph 26.

³⁰ Modification Proposal 0317, "Quantification and Apportionment of "Unidentified" Gas" Report, paragraph 25.

³¹ The UKRPA, for example, state on their website that theft represents "well in excess £100m per year". We consider even this to be an under-estimate.

³² Modification Proposal 0317, "Quantification and Apportionment of "Unidentified" Gas" Report, paragraph 28.

³³ Modification Proposal 0317, "Quantification and Apportionment of "Unidentified" Gas" Report, paragraph 28.

³⁴ Modification Proposal 0317, "Quantification and Apportionment of "Unidentified" Gas" Report, paragraph 31.

³⁵ Modification Proposal 0317, "Quantification and Apportionment of "Unidentified" Gas" Report, page 1.

took 26.2% of all throughput in the same period³⁶. It is our view that in the absence of either the independent analysis which the AUGE will eventually deliver, or the absence of evidence to the contrary, it should be assumed that theft is proportional to actual throughput. This suggests that the arbitrary cap applied to LSP theft levels in Modification Proposal 0317 leads to an understatement of the amount of cost which should be reallocated.

59. Finally, and as mentioned above, there is no recognition anywhere in the calculation methodology that SSP sites have an element of theft already included within their initial allocation. The failure to adjust the final proposed apportionments of theft costs to take account of this fatally undermines the £2.75m figure proposed by Modification Proposal 0317.
60. In conclusion, Modification Proposal 0317 applies unreliable xoserve detected statistics and assumptions on the level of theft as the basis for models which they themselves accept as arbitrary, failing to provide supporting evidence for them in the process. Modification Proposal 0317 then goes on to use those same xoserve theft detection statistics which the ICoSS report accept as flawed as the basis for apportioning their assumed level of theft between the LSP and SSP sectors. The resulting output is not then adjusted to reflect the fact that the SSP sector has already borne a significant allocation of theft costs during the initial allocation, effectively arguing that all theft is found within RbD. We find this approach is in stark contrast to the argument made by the Proposer, and accepted by Ofgem, in Modification Proposal 0229 that an independent expert should be appointed to develop a robust methodology, rather than relying on data drawn up by one market sector or another to apportion costs.
61. In our view, all of the errors we identify in the report result in an under-estimation of the value to be reallocated. This is therefore a report commissioned by ICoSS members, drafted by the ICoSS group who represent the interests of the ICoSS community, and it draws erroneous conclusions that favour the ICoSS members at the expense of the SSP sector. We do not view this as being an independent report.

³⁶ As per Modification Proposal 0317 data.

Appendix Two - Modification Proposal 0317A

62. Modification Proposal 0317A takes the same £2.75m of costs which Modification Proposal 0317 says should be reallocated from the SSP to LSP sector, and thus relies on the same analysis which we have shown above to be flawed. Importantly however, Modification Proposal 0317A allows for that initial reallocation of costs to be subsequently corrected by the AUGE once they have published their findings. This removes the risk for the market of errors in the Modification Proposal 0317 methodology, whilst retaining the benefit of allowing the LSP Shipper community to make an initial payment in April 2011 which can be included within customer pricing if they so wish.
63. For clarity, we consider that the initial allocation of £2.75m proposed under Modification Proposals 0317 and 0317A to be wholly inaccurate and to be a huge under-estimate of the amount of cost which should be allocated from the SSP to LSP sectors. We believe however that the fact that the AUGE will be allowed under Modification Proposal 0317A to correct the £2.75m figure will ensure that the correct costs are eventually allocated to the correct sector.
64. This ability for the AUGE to correct the initial allocation of £2.75m once they publish their findings ensures that there will ultimately be no under or over allocation of costs, ensuring that every Shipper makes a fair and equitable contribution towards the cost of unidentified gas and thus improving their ability to compete.
65. It may be argued by some LSP shippers that leaving them liable for a future unspecified amount will leave them unable to accurately provision costs, creating risk. We reject this argument on a number of grounds.
66. Modification Proposal 0171 for example proposed that unbilled energy arising from metering errors should be apportioned against Shippers based on the share of market they had at the time the error occurred rather than the time the error was notified. In response British Gas raised Modification Proposal 0171A which accepted this principle but proposed that the change take effect for issues which related to future meter errors, such that Shippers could appropriately provision for the costs.
67. In their decision letter on Modification Proposals 0171 and 0171A, Ofgem addressed this very point and said "*We consider that in such a case a shipper will have, in error, benefited from the increased difference between billed payments received for gas supplied to these customers and payments made by their shipper for their proportion of the aggregate LDZ AQ. Conversely, where a past error means the shipper has in effect overpaid, their revenue would have been reduced. We therefore consider that the Modification Proposal does not carry an undue risk associated with cost recovery from customers but instead it reallocates charges and credits to better reflect*

*shippers' initial outlay*³⁷. We argue that the same circumstances apply now, and that it is the LSP Shipper community who has had a significant benefit in recent years which must be balanced now with a reallocation of costs.

68. Notwithstanding this, we appreciate that Modification Proposal 0317A will lead to Shippers having to provision for an amount against the sum they believe will be due following the publication of the AUGE's methodology. Given that we believe that Modification Proposal 0317 could result in an under payment to the SSP sector of some £118m, we believe it is far better to have that misallocation corrected than allow it to persist in lieu of far smaller, potential, issues.
69. We also want to make clear that, assuming Ofgem make a decision on these Modification Proposals before April 2011, Shippers will have the ability to make an assessment of the likely exposure they may face for the period April 2011 to May 2012 and provision accordingly. The Proposer, for example, have clear views that the LSP community should provision for £2.75m, and certainly no more than £4.9m, whereas we would take the view they need to provision much more than that. The decision on what to provision is purely a commercial one, and one which Shippers responding to this consultation process will already have a view on.
70. It is relevant to note that the SSP sector has been provisioning against uncertain levels of misallocated costs for many years whilst this issue has been debated.

³⁷ Ofgem [Decision Letter](#) on Modification Proposal 0171, page 4.

Appendix Three - Modification Proposal 0327

71. We raised Modification Proposal 0327 in response to what we believed was a highly inaccurate assessment at the likely costs which should be reallocated between the LSP and SSP sectors contained within Modification Proposal 0317. In particular we were concerned that the Proposer of Modification Proposal 0317 had misunderstood the way in which gas is allocated in the market, and had not appreciated that once reads on LSP sites had been received and the initial allocation corrected, the SSP sector has already been allocated all unidentified gas. This point is explained in more detail in paragraphs 34 to 37 of Appendix One.
72. Modification Proposal 0327 corrects this mistake by acknowledging that after the initial allocation of energy between SSP and LSP sectors is made according to share of market AQ, the LSP allocation is corrected as and when reads are received from LSP sites. The correction amount is known as “Genuine Reconciliation” as it signifies the quantifiable change in LSP usage which arises when the actual usage is compared to the estimate used in the initial allocation.
73. Consequently *all* unidentified gas is now assigned to the SSP sector, and as such RbD contains only that portion of unidentified gas which has been generated by the LSP sector. For this reason, Modification Proposal 0327 correctly states that the true reallocation of costs due from the LSP sector is the total amount of energy found in RbD, less the amount of Genuine Reconciliation.
74. The data used to calculate this is publicly available in the MOD81 reports published by xoserve and thus the calculations used to arrive at the £121m figure are fully transparent and not reliant on arbitrary assumptions.
75. We acknowledge that actual annual consumption can vary from the sum of all non-daily metered AQ, and that the extent of this variance is the margin of error within our calculations. Albeit a small variance, it is important to note that Modification Proposal 0327 states that the initial allocation of £121m will be corrected by the AUGE when they publish their conclusions. This ensures that only the correct amount of cost is ultimately reallocated by the Modification Proposal 0327 process.
76. Finally, we believe it is important that Shippers accurately provision for the costs which we believe they will face. Modification Proposal 0327 acknowledges the fact that until the AUGE completes their analysis, we cannot second guess precisely how unallocated gas will be allocated between the SSP and LSP sectors, and thus all we can provision for at this time is a share of unallocated gas which is linked to share of demand between the two sectors.

Appendix Four – Legal Advice Received on the Interpretation of the Legal Text Provided for Modification Proposal 0229

77. The legal text states that the *"AUG Year" means the twelve month period commencing 1 April 2011 and the twelve month period commencing on each subsequent 1 April; and in relation to an AUG Year a reference to the preceding year is to the twelve month period ending 31 March before the start of the AUG Year.*³⁸ This means that the first AUG Year starts on 1st April 2011.
78. The legal text says that for each and every AUG year, *"a methodology ... shall be established for ... estimating for each Unidentified Gas Source ... the aggregate quantity of Unidentified Gas over the AUG Year and ... the amount which is attributable to events, circumstances, acts and/or omissions (as referred to in paragraph 9.1.1(b)) which relate to Larger DM SPCs and to Larger NDM SPCs respectively"*³⁹. This means that a methodology will be produced which covers the period starting 1st April 2011.
79. The legal text continues to say that for each and every AUG Year *"a table ... shall be established which sets out ... for each Unidentified Gas Source ... an aggregate quantity of Unidentified Gas; and ... for each SPC Class, a quantity of gas which shall be ... for Larger DM SPCs and Larger NDM SPCs respectively, the amount of the quantity under paragraph (i) which is attributable (as provided in paragraph 9.4.1(b)(ii)) to such SPC Class (and) for Smaller SPCs, an amount equal in magnitude and opposite to the sum of the quantities (above)"*⁴⁰. This means that the methodology produced for the period from 1st April 2011 will detail the reallocation of costs between the SSP and LSP sectors.
80. On the use of each AUG Year's methodology, the legal text says that, following consultation, *"the Committee shall decide upon, adopt and publish the AUG Methodology"*⁴¹. This means that the Committee will be asked to agree the methodology which is produced for the period starting 1st April 2011.
81. On the actual reallocation, the legal text sets out a calculation to be used to calculate the actual fiscal reallocation from the table created by the AUG *"for each AUG Year (and) for each User"*⁴².
82. Finally the legal text concludes with a statement that the amount considered above *"shall be payable, by way of adjustment in respect of the aggregate User Aggregate Reconciliation Clearing Values ... and shall be invoiced (at the same time or as soon as practicable after the Invoice in respect of the*

³⁸ Modification Proposal 0229 Legal Text, Clause 10.1.1 (i)

³⁹ Modification Proposal 0229 Legal Text, Clause 10.4.1 (b)

⁴⁰ Modification Proposal 0229 Legal Text, Clause 10.4.2 (a) and (b)

⁴¹ Modification Proposal 0229 Legal Text, Clause 10.4.3 (e)

⁴² Modification Proposal 0229 Legal Text, Clause 10.5.1, 10.5.2

Aggregate NDM Reconciliation) and payable in accordance with Section S⁴³.
This means that the reallocation for the period starting 1st April 2011 will be credited or debited to Shippers as soon as possible.

⁴³ Modification Proposal 0229 Legal Text, Clause 10.5.3