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Dear Tim,

Re: Corona Energy consultation response to Modifications 0317/0317A & 0327

Corona Energy (CE) welcomes the opportunity to respond on proposed UNC Modifications 0317, 0317A and 0327. CE is an independent gas supplier to the Industrial and Commercial sector and is the major gas supplier to the public sector. For the avoidance of doubt CE supports the implementation of Modification 0317 and does not support the implementation of Modifications 0317A & 0327.

Modifications 0317/0317A & 0327 all concern the treatment of unidentified energy under the UNC. There are various potential sources of unidentified energy in the LSP sector. However, it is expected that the major contributory source is theft.

CE would therefore like to use this opportunity to express its support for the industries NRPS proposal, the implementation of smart/advanced metering technology and other such proposals that will help to reduce the levels of theft and therefore unidentified energy, bringing significant benefits to consumers.

As each of the modifications listed above appear to be raised as alternative solutions to each other, it seems appropriate to assess the merits of the modifications together. All of the modifications attempt to implement some form of interim charging arrangement between April 2011 (the appointment of the AUGÉ) and April 2012 (when corrective charges are to be levied on Shippers). In addition Modifications 0317A and 0327 attempt to impose some form of retrospective charging.

Interim Payments (April 2011 – April 2012)

Modification 0229 implements a process to appoint an independent third party expert (the AUGÉ) to identify the contribution that the LSP sector should make towards unidentified energy in the gas market. The AUGÉ will be appointed by April 2011



and final charges are to be levied on Shippers in accordance with their NDM LSP market share from April 2012.

Modification 0229 therefore corrects an issue that has been present since the rollout of Domestic Competition and the implementation of RbD in 1998. In its Modification 0229 decision letter¹ Ofgem considers that “*UNC229 offers an expedient route to establish an appropriate solution*”. We agree with Ofgem that the process implemented by Modification 0229 provides for a robust and transparent solution that is being implemented as fast as is practical. These comments notwithstanding, we also agree with Ofgem that “*an interim measure could have benefits in reducing the inaccurate allocation of Unidentified Gas.*”

CE believes that any interim payment should attempt, as far as possible, to follow the precepts identified by Ofgem in the decision letter for Modification 0229, namely that any reallocation proposed should use “*an explicit and traceable methodology.*” The report provided by ICoSS and prepared by an independent third party, which is referenced by Ofgem in their Modification 0229 decision letter, provides such a process.

Corona Energy has confidence in the assessment in this report and so believes that the values proposed in Modification 0317 (and copied in Modification 0317A) provide an appropriate interim payment until the AUGE has completed its analysis. It should be noted that the ICoSS group helped develop Modification 0317, despite the fact that they will not benefit financially from its implementation, and in fact will incur greater costs.

In contrast we have no confidence in the values proposed in Modification 0327. It could be argued that this modification purely serves to create a political expectation that significant sums must be paid by I&C consumers to domestic suppliers rather than to solve the unidentified energy problem.

CE also notes that the 0299 modification assumes that consumers and suppliers are provided sufficient notice, in line with transportation rate changes, to budget for any changes in charges. CE assumes that Ofgem will consider this in the speed and timing of any decision on these proposals.

Do AQ movements reflect movements in unallocated energy?

Modification 0327 assumes that any reconciliation undertaken during the RbD process must be accounted for in the AQ review. It is not clear why as there is no

¹ <http://www.gasgovernance.co.uk/sites/default/files/UNC229D.pdf>



informed rationale to assume that the difference between LSP AQs in 2008 to 2009 is the same as the difference between SSP estimation (using AQs) and actual consumption or that this relates to unallocated energy.

The difference between LSP AQs between one year and the next does not represent unaccounted for gas in SSP consumption (and hence unidentified Gas). It partly represents the change in the overall sector's consumption for the year and partly it represents the AQ the customer has chosen for the next year (DM LSP's can nominate any AQ they believe will reflect their actual usage).

NB. Please note many other factors would also impact the level of "genuine" reconciliation amounts due to the SSP sector and these factors have been described in detail in the previous responses provided by CE and ICoSS on this subject.

Modification 0327 makes the bold assumption that after the AQ review every site's future consumption for the year is accurately determined. This is not the case. In many cases a site's AQ will be rolled over from the previous year due to a lack of meter reads, calculation problems or due to the cap that exists in the SSP sector. During the last AQ review, around 5.5m SSPs or around a quarter of all SSP sites did not have their AQ recalculated.

Additionally in the LSP sector the reconciliation process and the use of the meter read ensures actual evidence of a sites demand is used for charging the customer. Of course for SSP sites the AQ cannot be corrected until the next review. Unfortunately this creates an incentive to err on the side of caution when reviewing SSP AQs or when choosing which reads to submit to the Gas Transporter.

CE has no evidence of shippers 'cherry-picking' AQ adjustments or reads. It is clear however that commercial benefits could be gained by large SSP shippers being able to minimise their share of the energy in RbD by appealing all overstated AQs and ignoring understated AQs or submitting reads that will reduce the AQ but not providing reads that would increase the AQ.

This behaviour would not only result in that shipper receiving a smaller share of RbD (assuming all SSP shippers weren't doing the same) but would also result in the NDM LSP sector being over allocated until their sites were reconciled.

Interestingly TPA identified in their analysis of the Modification 0228 & 0228A² that historically NDM LSP sites have been over allocated, and this will be reflected by the movement of this overstated consumption back to the SSP sector via RbD.

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<http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Ias/Documents1/TPA%20response%20to%20Identification%20and%20Apportionment%20of%20Costs%20of%20Unidentified%20Gas.pdf>



In comparison the LSP sector's does not suffer from the same AQ recalculation performance issues as read performance and frequency is much higher and recalculation caps do not exist. Additionally as LSP shippers are aware that sites will be reconciled there is an incentive to make the AQ as accurate as possible.

None of these significant flaws are addressed in the Modification 0327 calculations.

Is theft uniform?

By its very nature it is not possible to identify where unidentified energy has been used. However, it is possible to look at the evidence available for the possible sources of unidentified energy such as confirmed theft and use this to consider the likely levels.

The independent report commissioned by the ICoSS group uses this evidence based rationale. CE recognises that this report is not, and cannot be, completely accurate. However CE is confident that this report is as accurate as it is possible at this time to achieve. This report forms part of the argument put forward by Shell Gas Direct for the proposal of Modification 0317.

Modification 0327 on the other hand makes a broad (unstated) assumption that unallocated energy is uniformly spread based on volume. All the evidence provided to the various UNC workgroups including that provided by British Gas in the 194 workgroup shows that this is incorrect.

Confirmed theft levels consistently demonstrate that LSP theft is significantly less than SSP theft (even if volumes are taken into account).

Could it be broadly correct?

Given the significant flaws in the methodology proposed it seems highly unlikely that the figures are even vaguely accurate. This is the fourth set of figures proposed by British Gas during the discussion of this issue. Each set of figures has been confirmed as their realistic assessment of the LSP contribution until such time as the next set is published.

CE has always accepted that the LSP sector should be making a contribution towards unidentified energy but has never had any confidence in the figures put forward by British Gas.

Even using the Modification 0327 assumptions the figures do not appear to add up.



Ofgem in its 2006 review of RbD³ noted that around £270m in charges had been reconciled between 1998 and 2005, which equates a total value to RbD of £40m a year.

Even if you were to ignore the plethora of issues and inaccuracies that create energy flows in RbD and assumed that it were all LSP unallocated energy then (even allowing for inflation over time of gas prices), £121m seems far in excess of the possible scale of LSP unidentified energy. This modification would therefore replace the cross-subsidy of the LSP sector by the SSP with a cross-subsidy of the SSP sector by the LSP sector.

Retrospective Charging

Modifications 0317A and 0327 both propose, in addition to an interim payment, that any charges determined by the AUGGE should be back-dated to the date it is appointed, 1 April 2011. As we noted above, this problem has clearly existed since 1998 when domestic suppliers agreed to avoid costs of line by line reconciliation and accept the RbD regime.

There appears to be no logic why any such proposed retrospective charges should be back-dated to April 2011, or indeed to any other date. CE also note that domestic suppliers are not proposing a corresponding reconciliation of the past benefits of RbD.

It is our view that any reallocation should be undertaken from the time that the costs are assessed. This will ensure that LSP consumers can be fairly billed for their fair share of Unidentified Gas and increases the chances that SSP (Domestic and I&C) consumers may benefit from a corresponding reduction in their prices.

Payments a year after the costs were incurred do not achieve this aim.

As consumers switch Shipper, market shares would change from when the Unidentified Gas costs were incurred (in 2011), to when they are charged (2012). It is also not realistically feasible for LSP Shippers to re-bill every consumer.

The idea that I&C Shippers recover costs or even provide refunds to consumers they no longer supply or have gone out of business would mean that an individual LSP consumer would pay more or less than is fair according to its Shipper's performance and that SSP Suppliers would instead receive a windfall profit, rather than passing their reduced costs to their consumers.

³ http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/13487-RbD_FinalV1.1.pdf



Any ongoing reconciliation process would also be difficult and more costly to administer as it will require the Transporters and Shippers to reconcile initial payments made from April 2011 against the actual charges determined by the AUGE. In some cases this will mean that the Transporters will be unable to recover the costs (because the Shipper will have ceased trading) and so will need to determine a process for handling these exceptions.

Secondly, Modification 0229 requires UNCC approval of the final AUGE statement. The current regime, with no retrospection, incentivises the UNCC to approve the statement on the basis of the information provided, on the understanding that the charges derived from the AUGE statement cannot be challenged once approved.

Retrospection on the other hand provides the option to defer consideration of any contentious issues until the following year. Indeed it could incentivise parties to challenge and block the AUGE statement until such time as they get the 'result' they wish as they would know such charges would be retrospectively applied.

Retrospection significantly weakens the principle of User Commitment with regard to costs incurred in Supplying the consumer, creating uncertainty in the process and reduces the incentive on the UNCC to resolve any issues with the AUGE statement in good time.

Finally implementing any form of retrospective charging into the UNC creates a precedent that has significant ramifications. This creates additional risk and uncertainty into the market, which Shippers can only guard against by building additional margin into their supply contracts. As I&C Shippers will have to include these costs in their contracts, it will mean that prices will rise in the market generally, with these additional costs borne by the consumer.

Summary

Any interim payment that is proposed must be based on a robust business case. This rules out Modification 0327 which, rather than being evidence based, appears to be a naked attempt to set an expectation of a level of contribution which will provide a commercial benefit to domestic, SSP suppliers.

Modifications 0317 and 0317A are identical except that Modification 0317A proposes retrospection. Any form of retrospection is inherently unfair, will disadvantage consumers and damage the market. Therefore Modification 0317 is the only modification will provide a reasonable mechanism to provide an interim payment and so is the only modification Corona Energy support.



If Ofgem would like to discuss any of the points raised in this response in more detail please contact Richard Street via the details below.

Regards,

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Appendix I

Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Both Modifications 0317 & 0317A (which copies Modification 0317 in this regard) propose an interim payment based on robust and independent third party analysis. Modification 0317 will further the relevant objectives, as it is the only modification that proposes an interim payment based on robust analysis without proposing a retrospective charge that is an inherently unfair recovery mechanism. We also agree with the proposer that Modification 0317 will introduce a temporary framework that facilitates better-informed decision taking with regard to the allocation between market sectors of Unidentified Gas.

Though Modification 0317A copies the interim payment proposed in Modification 0317, it also introduces a retrospective charge into the Unidentified Gas process, which will unfairly penalise or benefit Shippers depending on whether their market share has increased or decreased respectively since when the costs were first incurred.

The risk and uncertainty caused in the market would certainly impact on supplier competition and would increase prices for consumers. It would also create a complex process for the Transporters (through their agent, xoserve) and Shippers to administer as it requires reconciliation of charges initially levied, as well as the creation of a process handling non-payment from defunct Shippers. Modification 0317A therefore does not meet the relevant objectives.

Modifications 0327 will not further the relevant objectives as it proposes arbitrary values for the interim cost allocation, with no relevant analysis and based on faulty assumptions. This modification will create a cross-subsidy of the SSP sector from the LSP sector. Modifications 0327 also creates a temporary framework, which will be difficult for the Transporters (through their agent, xoserve) and Shippers to administer as it requires reconciliation of charges initially levied, as well as the creation of a process handling non-payment from defunct Shippers. These additional costs and complexities mean that this modification does not further the relevant objectives.

The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk:

a) Administrative and operational implications

We would expect that the additional costs created by Modification 0317 would be modest as the costs are fixed and will not require reconciliation.



Modifications 0317A and 0327 both introduce a retrospective charge that will be levied a year after the initial interim payments are made. Recovering such costs retrospectively from consumers will create significant costs.

b) Development and capital cost and operating cost implications

No operating or development cost implications are presented by these modifications.

c) Consequence for the level of contractual risk

Modification 0317 does not present any increase in contractual risk as the costs are fixed and will not require reconciliation.

Modifications 0317A and 0327 both introduce a retrospective charge that will be levied a year after the initial interim payments are made. In many cases Shippers will find it difficult to recover these reconciliation amounts from customers they were supplying at the time the costs will be incurred, even if their contracts cater for such eventualities. These modifications therefore significantly increase the level of contractual risk for Users and in some cases may result in I&C suppliers withdrawing from the market.

The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

Modification 0327 does not provide any meaningful analysis to justify its charges and so will result in a cross-subsidy between consumers. In addition the scale of the charges proposed will significantly increase the costs to consumers.

Both Modifications 0317A & 0327, by introducing a retrospective charge, will mean that LSP consumers will be charged additional costs a year after they have been incurred, and possibly by a Shipper they no longer contract with. In addition Shippers will build additional costs into their charges to cover any unrecoverable debt. Finally a retrospective charge is unlikely to be passed on in full to SSP consumers, owing to the time lag in cost reduction.

The values proposed in Modifications 0317 & 0317A both will result in a fairer allocation of costs between the SSP and LSP sector on the basis of robust analysis. This should mean that costs for LSP consumers will increase and those for SSP consumers decrease.

As Modifications 0317A & 0327 are likely to result in I&C suppliers leaving the market, reduced competition in the I&C market will, in the medium term, result in higher prices to the consumers.



Analysis of any advantages or disadvantages of implementation of the Modification Proposal

a) Advantages

Modifications 0317 & Modification 0317A

We agree with the proposer that the modification provides the following advantages:

- reduces the current cross-subsidy between the LSP and SSP sectors in a clear and simple interim mechanism, allowing costs to be recovered from the LSP sector until such time as the AUGE produces a statement in line with 229.
- provides for an earlier allocation of costs to help reduce the current degree of cross-subsidy between the SSP and LSP sectors immediately.

Modification 0327

None Identified

b) Disadvantages

Modification 0317

None Identified

Modifications 0317A

- This modification introduces a retrospective charge and is inherently unfair. It will disadvantage consumers and damage the market.

Modification 0327

- This modification introduces a retrospective charge and is inherently unfair. It will disadvantage consumers and damage the market.
- This modification proposes an interim payment has not been produced as a result of any meaningful analysis and is way in excess of the likely value of Unidentified Gas.
- This modification may create an unreasonable expectation that unidentified energy costs are of this magnitude