Representation

Draft Modification Report

0388 - Fixed parameters for determining Shipper contribution to Unidentified Gas

Consultation close out date: 30 September 2011

Respond to: enquiries@gasgovernance.co.uk

Organisation: **E.ON UK**

Representative: Brian Durber

Date of Representation: 30 September 2011

Do you support or oppose implementation?

Not in Support

Please summarise (in one paragraph) the key reason(s) for your support/opposition.

Currently Unaccounted for Gas is charged to the SSP sector via the RbD mechanism with the exception of an interim payment of £2.75m made by the LSP to the SSP sector to recognise the delays that have been experienced introducing the AUGE process. The actual amount of UG contained within the monthly RbD reconciliations is of course unknown, but the AUGE will determine the volumes and hence energy which will form the LSP contribution. The financial exposure arising out of the RbD process includes the price volatility of System Average Price as it is this value that is applied to RbD reconciled energy including UG. The AUGE process provides for a contribution towards UG in energy not cash terms. This contribution along with the SSP contribution is turned into cash by applying SAP in other words LSP and SSP contributions are treated in the same way. This forms the baseline solution.

SAP is an established value and is used throughout the GB gas industry. Its variability is recognised and it would seem inconceivable that any player in the industry would not adopt appropriate measures to manage this variability risk.

Should this Modification be implemented it would mean that the SSP sector would bear the SAP price risk for the total amount of UG, both the SSP and LSP contributions. The point of having a AUGE process is to remove the cross subsidy of the LSP sector by the SSP sector by determining an appropriate LSP contribution to UG energy cost. This Modification would have the effect of re-establishing part of this subsidy.

In terms of fixed volumes, whatever the merits or de-merits we cannot see how UG LSP can be fixed. The AUGE will determine the levels of UG and to which activities they are attributable. These may be constant or they may be associated with activities or usage patterns that vary throughout the year. This is for the AUGE to determine and not for any shipper or sector to pre-judge.

Ofgem have indicated that it would be particularly helpful if the following questions could be addressed in responses:

Ofgem understand that the main issue to be solved is the reduction of costs associated with the SAP mechanism. This involves replacing SAP with a fixed price. They are concerned that this may discriminate between LSPs and SSPs, as LSP uncertainty is reduced at the expense of greater uncertainty for SSPs.

Ofgem ask the following questions to better understand the context and scale of the issue, and how the solution will affect parties.

Understanding the processes

1. Would it be helpful to show, through a diagram, how the current and proposed pricing flows are passed through the industry.

Understanding the scale of the problem

2. The proposal sets out that the existing pass-through mechanism mainly affects approximately 75% of LSP NDM customers. What proportion of all gas goes to these parties?

We do not understand why the Proposer has made a particular case for customers on transportation pass-through contracts. UG is essentially energy and any associated transportation commodity is very small. Transportation commodity is by definition variable and payable on kWh used. Transportation charge rates are not part of this Modification and so would not be required to be varied. In any event we believe that the 75% figure is much lower and excluding the SME LSP sector is more in the region of 15% at customer level.

Understanding the strength of the proposed solution

3. Do you agree LSPs are less able to manage the risk of fluctuating prices and to what extent?

We do not see why LSP shippers would be less able to manage fluctuating price risk as they already do so for other settlement activity.

4. What is the level of saving made by LSPs under this modification proposal - for example of avoiding administration costs?

As an LSP and SSP shipper we do not identify any administration costs that would be avoided. As mentioned above pass-through is irrelevant as it applies to transportation charge rates.

5. Would the risk borne by SSPs under this modification proposal increase?

The SSP risk would increase as SSP shippers would be providing SAP price risk management on behalf of LSP shippers.

6. How does the modification proposal affect the allocation of unidentified gas between parties?

The allocation is to be determined by the AUGE, this Modification will pre-judge that determination.

7. What are the arguments for a shipper not taking on this risk?

Risks are an inherent component of the industry and should be borne on an equitable basis.

8. For a range of different gas price scenarios, how are parties affected? For example, is a long--run increase in gas prices taken into consideration?

This would seem to be a question for the Proposer. However any price increase should affect all sectors equitably.

9. If one sector (SSPs or LSPs) is always going to have to bear the risk set out by this modification proposal, which sector is better able to manage that level of risk efficiently and effectively? At present, how does each sector deal with risk?

Risk management is an integral part of the business of any shipper regardless of sector. Shippers buy and trade large volumes of gas in the wholesale market. We would not expect, nor should expect any player to avoid the risks and benefits of participating in the GB gas market, be they small domestic SSP shippers or large producer affiliate LSP shippers.

Implementation of the proposed solution

10. What are the implementation costs associated with this modification proposal in the following two cases: a) decision is reached before 1 November 2011; b) decision is reached after 1 November 2011?

11. If this modification results in losses or gains for LSPs, in comparison to the baseline solution (P299), should they be recovered through the subsequent AUGE process?

The baseline solution corrects a previous inequitable situation where one part of the market (SSP) subsidised another (LSP). All shippers are required to be prudent operators and to put in place appropriate tools to manage risk.

12. Would a further modification be needed to make the adjustment envisaged by the previous point (question 11)?

Are there any new or additional issues that you believe should be recorded in the Modification Report?

Relevant Objectives:

How would implementation of this modification impact the relevant objectives?

Impacts and Costs:

What analysis, development and ongoing costs would you face if this modification were implemented?

Implementation:

What lead-time would you wish to see prior to this modification being implemented, and why?

Legal Text:

Are you satisfied that the legal text will deliver the intent of the modification?

Is there anything further you wish to be taken into account?

Please provide any additional comments, supporting analysis, or other information that that you believe should be taken into account or you wish to emphasise.