Joint Office of Gas Transporters

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:	**ScottishPower Energy Management Ltd**
Representative:	David McCrone
Date of Representation:	30 September 2011

Do you support or oppose implementation?

Not in Support

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

We are unconvinced that the scale of the issue described within the proposal is material and believe that it represents a risk that Shippers would be reasonably expected to manage. We expand on this in our answers below.

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.

We believe that xoserve would be better placed to provide this information to the Authority.

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 believe that each LSP Supplier would be better placed to provide this information to the Authority for their portfolio.

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 believe that LSPs Shippers are any less able to manage the risk of fluctuating prices than any other market participant. Indeed all Shippers face the implications of managing SAP on a daily basis on their portfolio, in respect of balancing.

UNC modification 317, approved by Ofgem on 18 November 2010, quoted a report commissioned by the ICOSS Group, which was said to be independent. This report concluded that the LSP DM and LSP NDM contributions to unidentified gas for the AUG Year 2011 were £0 and £2.75m respectively. In addition the introduction of MOD317 will see the LSP NDM contribution valued at £2.75m in at least the first year of the AUGE process. However we would highlight that the AQ 2010 Review report quoted that there were approximately 450,000 LSP sites across the market, which suggests that these are the sites that would be subject to unidentified gas allocation under the AUGE process. Without taking volume into account, and assuming a uniform exposure across all LSPs, this would equate to a £6.11 contribution per LSP customer.

Although we have never agreed with these figures (£0 and £2.75m), we believe that it highlights the scale of the "risk" that the LSP Shippers believe will be placed on them and their customers (if you believe LSP Shipper's and ICOSS' own assertions that their contribution is only in the region of £2.75m).

We do not believe that such risk is unmanageable either for the customers or the large Shipper entities in this area of the market. In particular this is the case, when considering that NDM (typically domestic) consumers and their Shippers have been picking up unidentified gas risk to date at roughly £10 per customer per annum.

Both LSP and SSP Shippers manage SAP risk in the daily management of their portfolio and the values quoted here do not, we believe, constitute a material additional risk that justifies the changes proposed in this modification. In particular as changes to give certainty to LSP Shippers would place a further additional risk on SSP Shippers and their customers.

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

We believe that LSP Shippers would be best placed to provide this information. However it should be noted that as any risk is being transferred to the SSP market, any savings made by LSP Shippers may be counteracted by additional costs being incurred by SSP Shippers and their customers. These costs, if indeed found to be material, may then need to be passed directly on to the SSP market.

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

Yes, by the nature of the proposal the risk currently deemed to be within the LSP market, around SAP and unidentified volumes, will be transferred to the SSP market. Any increased risk would need to be accounted for and any additional costs passed onto Suppliers, and ultimately, SSP customers.

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

We do not expect any impact on the allocation of unidentified gas.

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

The LSP and SSP markets currently manage the risk around SAP fluctuation and volumes used by consumers on a daily basis, related to their own customer segment. We therefore cannot see any valid justification why one market should be allowed to avoid this risk to another's detriment. In particular we cannot see why this would be the case for unidentified gas, when Ofgem have agreed the principle that the LSP market is accountable for a share of this. We believe that this share should be as accurate a reflection of the overall risk as possible.

With the exception of administrative costs, the modification proposal does not fully quantify the scale of the problem allegedly experienced by the LSP market in either financial or volume. As per our answer to question 3 above, we remain unconvinced that the issue is material and that a shipper should not be reasonably expected to manage such a risk.

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?

We would expect LSP Shippers to come up with valid justifications and demonstrate how price sensitivities would factor into the process and explain why they cannot manage this risk, together with the other SAP and volume variation risks that they manage.

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?

Any risk that the SSP or LSP market experiences should be commensurate with the assessed contribution of that sector to unidentified gas. Ofgem have already agreed the principle that LSP supplies contribute to unidentified gas and that LSP Shippers should therefore accept a share of it. We therefore believe that LSP Shippers should accept this share and manage it as they would any other risk associated with costs and volumes. Within the gas market, we would expect parties to have a dedicated risk management team which aims to ensure that prices offered to customers do not fluctuate (in the SSP market this being tariffs) and protects the business from unforeseen risk.

If you believe the LSP only Shipper assertion, through ICOSS and previous representation, that their contribution to unidentified gas is of the order of £2.75m, and this equates to roughly £6 per customer, we believe that the LSPs are more than adequately placed to manage the risk of unidentified gas unless the LSP only Shippers no longer hold with the view that their contribution is of the order of £2.75m.

If this modification proposal goes ahead, then the minimisation of "risk" to the LSP Shippers and customers will be at the expense of SSP (mainly domestic) customers. We do not believe it is equitable, in a time of rising energy prices and fuel poverty, to expect SSP customers to take on more risk and more share of unidentified gas than that of LSP supply points (typically large business users).

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?

We do not believe that there would be a material difference in implementation costs depending upon when any change was implemented. LSP Shippers are best placed to confirm whether they would be affected by a later implementation date.

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?

We do not support this proposal and do not believe that the AUGE process should be used to recover any gains or losses incurred as a result.

It is not appropriate that the market should be reliant upon another process to correct any unintended consequences that may arise from this proposal.

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

Yes a further modification would be required. However as per our answer to Q11 we do not believe this would be justified.

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

None identified.

Relevant Objectives:

How would implementation of this modification impact the relevant objectives?

d) 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.

We believe that this proposal would detrimental to SSP Shippers and their customers and increase uncertainty of risk in relation to unidentified gas in this market segment. This would reduce confidence in this market sector and potentially impact the attractiveness of this market to new entrants.

Impacts and Costs:

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

We do not expect to incur any material implementation impacts or costs from this modification. Any costs that were incurred as a result of managing an increased risk in pricing would need to absorbed by SSP Shippers or passed on to the SSP customers.

In the longer term, this proposal would result in an ongoing cross subsidy from the LSP to SSP market to the detriment of SSP customers. The proposer has stated that there will be occasions where the price paid by LSP shippers is above the SAP price at that time and the SSP market may gain as a result. The proposal does not state however how often they would expect this to occur or whether they believe it would be of an equivalent magnitude.

Implementation:

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

We are satisfied with the implementation date suggested in the modification proposal.

Legal Text:

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

We are satisfied that the legal text meets 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.

We would like to reiterate the point made in Q3. We do not believe that the modification has shown that the issue being experienced by the LSP shippers is material and cannot be expected to be accounted for as part of their normal risk management policy. Using the £2.75m figure purported by the ICOSS Shippers (which includes the proposer) to be the contribution of LSP supply points to unidentified gas, this translates to a value of approximately £6.11 per LSP customer. Given the scale of the businesses operating in this sector and the volumes used by these customers we do not think it unreasonable for LSP shippers to be expected to manage this “risk”.

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