

Representation

Draft Modification Report

0442 and 0442A:

Amendment to the implementation date of the Allocation of Unidentified Gas Statement (AUGS) for the 2013/14 AUG year

Consultation close out date: 22 February 2013

Respond to: enquiries@gasgovernance.co.uk

Organisation: British Gas

Representative: Graham Wood

Date of Representation: 22 February 2013

Do you support or oppose implementation?

0442 - Support

0442A – Support

British Gas supports both modification proposals with a preference for 0442.

If either 0442 or 0442A were to be implemented, which would be your preference?

Prefer 0442

0442 provides the earliest possible opportunity to introduce more equitable distribution of unidentified gas charges between market sectors.

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

0442

The purpose of the introduction of the Allocation of Unidentified Gas (AUG) process was to address the unfair allocation process present within the Reconciliation by Difference (RbD) arrangements, removing the inequitable, default position of smearing Unidentified Gas just to shippers operating in the Smaller Supply Point market. This proposal seeks to implement an AUG Methodology which is acknowledged by many parties (including the AUGS) as being knowingly more robust and providing a statistically more accurate outcome for all gas consumers. Specifically, use of this updated methodology would provide a fairer and more representative split of Unidentified Gas costs between Smaller Supply Point (SSP) and Larger Supply Point (LSP) sectors, at the earliest possible opportunity. It would also

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help to unwind an unfair cross subsidy running into tens of millions of pounds, which has been demonstrated to have existed for many years.

0442A

The same comments apply to 0442A as articulated above for 0442. We are mindful that whilst 0442A delivers the same result, the timeframe for its implementation would be extended. It is evident that the earlier that the new AUG Methodology can be implemented the earlier the existing market sector subsidy can be remedied and the greater the benefit to SSP consumers whom are predominantly domestic.

Implementation of either modification proposal would allocate costs more accurately to the relevant SSP and LSP market sectors. Non-implementation would see this existing, unfair allocation remain, predominantly to the detriment of domestic consumers.

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

Not applicable as to our knowledge no specific questions have been posed by the panel.

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

At the UNC Committee (UNCC) meeting on 20 December 2012, the AUGE advised that *'the estimated volume based on the new analysis is around 11 to 12TWh – the LSP share is 2 to 3TWh and, using an average SAP of 2p per kWh, about £70m might be projected.'*¹

For clarity it should be noted that at the UNCC meeting on 6 February 2013, the AUGE advised that based upon its latest analysis, they expect that the estimated volume of Unidentified Gas to be at the lower end of its original estimate.

This estimate still represents a significant financial cross subsidy across the SSP and LSP market sectors. Whilst this is a specific financial impact to SSP consumers, the introduction of a fairer allocation of costs at the earliest opportunity, via a statistically more accurate methodology, is the primary purpose of this modification proposal.

¹ <http://www.gasgovernance.co.uk/sites/default/files/Minutes%20UNCC%2099%20v1.pdf>

Relevant Objectives:

How would implementation of either of these modifications impact the relevant objectives?

The AUG process was introduced into the Uniform Network Code via the approval of Modification Proposal 0229. In essence, the purpose of Mod 0229 was to introduce a mechanism by which Unidentified Gas costs could be impartially assessed and allocated to the correct market sector. Both modification 0442 and 0442A work entirely with the grain of Mod 0229, in that they seek to achieve entirely the same objectives, but at the earliest reasonable opportunity rather than unnecessarily delaying the introduction of the most equitable and up to date numbers.

Within The Authority's decision letter on Modification Proposal 0229², it concluded that the implementation of 0229 '*will better facilitate the achievement of the relevant objectives of the UNC*' and '*Directing that the modification be made is consistent to the Authority's principal objective and statutory duties*³.'

We believe that whilst both 0442 and 0442A will better facilitate the achievement of the relevant objectives, as detailed below, we also believe that more importantly approving either modification proposal would be consistent with the Authority's principal and statutory duties, particularly protecting '*the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems.*'

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 consider that the aims and objectives of modification proposals 0442 and 0442A promote effective and efficient competition between relevant shippers and suppliers, and allow for an ongoing equitable distribution of Unidentified Gas charges between market sectors.

Implementation of either 0442 or 0442A will prevent all consumers that are connected to Smaller Supply Points (approximately 21.4m supply points – 20.9m of which are domestic consumers) from being exposed to another full year of inaccurately apportioned Unidentified Gas costs.

Should either 0442 or 0442A not be approved and the 'rolled over' figures from the 2012/13 AUG Year remain in place until 1 April 2014, then a significant cross subsidy, across the SSP and LSP sectors will knowingly continue to be in place. This

² <http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/UNC229D.pdf>

³ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

would be to the detriment of securing effective competition within the market and result in SSP consumers (whom are predominantly domestic consumers, including a significant proportion which are classified as fuel poor) picking up significant charges which should be allocated elsewhere.

We note that within its latest Annual Report⁴ the Department of Energy & Climate Change stated: "*In 2010, the number of fuel poor households in the UK was estimated at around 4.75 million, representing approximately 19 per cent of all UK households.*"

Given the significant pressures on household incomes and energy prices, the removal of a financial cross subsidy of this magnitude has to be the correct outcome for consumers and particularly the fuel poor.

The Authority's decision letter on modification proposal 0229 stated that: '*We consider that UNC229 will improve transparency and accuracy in the allocation of RbD gas to the contributing sector.*'

Non-implementation of 0442 or 0442A would have an adverse impact on the effectiveness and efficiency of competition between parties, by not facilitating an ongoing equitable distribution of Unidentified Gas charges between market sectors and would therefore not improve transparency and accuracy in the allocation of RbD gas to the contributing sector.

Authority's Principal and Statutory Duties

The Authority's principal objective is to '*protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems.*'⁵

The statistically more accurate consumption based AUG Methodology provides evidence that there has been a significant cross subsidy of Unidentified Gas charges between market sectors for many years. It is therefore in the interests of both existing and future consumers that this inequitable position is remedied at the earliest possible opportunity.

Whilst it is general industry practice not to retrospectively address previous cross-subsides, it is essential that the industry ensures that the current inequitable arrangements are not allowed to continue and that the interests of consumers, particularly domestic consumers are appropriately protected.

The initial RbD bias AUG Methodology produced by the AUGE in 2011, for the 2012/13 AUG Year, allocated approximately 1 TWh of Unidentified Gas, out of a total of approximately 6 TWh, to the LSP sector, which in financial terms amounts to £26m out of a total of £160m.

⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/66016/5270-annual-report-fuel-poverty-stats-2012.pdf

⁵ <http://www.ofgem.gov.uk/About%20us/Authority/Pages/TheAuthority.aspx>

This compared to the year 2011/12, which immediately preceded the implementation of the AUGÉ, when modification proposal 0317 allocated just £2.75m of Unidentified Gas costs to the LSP sector.

Prior to this, from the inception of the Uniform Network Code and the implementation of RbD, the SSP sector has by default been erroneously exposed to all costs associated with Unidentified Gas, which over the numerous years since the introduction of RbD, has meant that SSP consumers have been exposed to hundreds of millions of pounds of undue cost.

It is evident that the financial values associated with the allocation of Unidentified Gas costs are of such significant proportion that, in our opinion, to not urgently address the issue would be to the detriment of existing and future consumers, and therefore not consistent with The Authority's principal objective.

Stability of Code Arrangements and Independence of the AUGÉ

During the development phase of the Modification 442 and 442A, discussions have touched upon the need to preserve arrangements which are currently set out in the UNC. We note such arguments have tended to be made by shippers/suppliers who we believe are likely to have the most to gain from protecting the current cross subsidies. Since its inception, the UNC has been designed with rigorous governance processes to ensure that only modifications which are considered to better facilitate the relevant objectives are made, and it goes without saying that this is the test which will be applied in this case. There can be no presumption in favour of the *status quo*, simply because those happen to be the arrangements which prevail, and with which some shippers are extremely comfortable.

Most importantly, no arrangements established by the UNC have ever been, or should ever be, ring-fenced from change. All arrangements established under the UNC are open to modification providing, on balance, the relevant objectives are better facilitated. NTS entry arrangements, for example, have been subject to tens of modifications since their initial implementation into code, all of which have sought to refine them. Evolution of UNC arrangements is therefore entirely appropriate in the light of new information, evidence and experience and change of this nature is a necessary feature of the GB gas shipping and supply business which all UNC signatories have signed up to and are expected to structure their business around.

Neither 442 nor 442A in any way undermines the authority or independence of the AUGÉ. The *raison d'être* of the AUGÉ, in summary, is to implement the most robust available AUG methodology and figures in the most timely manner. Both 442 and 442A therefore strengthen the AUGÉ's hand in achieving these objectives, rather than requiring the AUGÉ artificially to withhold a much better solution for a whole year, for the sake of missing a previously communicated deadline by just a few days.

The AUGÉ's decision to roll over the previous year's methodology and numbers, despite having a far more accurate and statistically robust solution to hand, was made on the basis of having to select a way forward

from a range of options constrained by the arrangements established by Mod 0229 and the associated Guidelines.

The most notable constraint faced by the AUGE was the need to implement updates only from 1 April in any given year. It was not within the AUGE's ability to implement new arrangements, for example, from 1 June.

In summary therefore, these modification proposals are necessary in order to correct a weakness, which with experience, is now known to exist within Mod 0229 and the associated Guidelines and are a legitimate use of the UNC modification process.

Impacts and Costs:

What analysis, development and ongoing costs would you face if either of these modifications were implemented?

We do not expect to face any analysis, development or ongoing costs if either of these modifications were to be implemented, as any requirements were introduced at the time that 0229 was implemented.

Ability of suppliers to pass through costs

The number of Larger Supply Points registered, totals approximately 296k supply points⁶. As a major supplier within this market sector, with the largest market share of the total LSP population, British Gas does not share the same concerns as some other code parties on this issue.

We can therefore speak with some authority when we say that suppliers generally retain the right to 're-open' contracts so that they can take account of new regulatory or industry charges such as those associated with the allocation of Unidentified Gas.

Furthermore, we would point out that as all LSP suppliers in the market will have proportionally similar charges levied at them, competition between relevant shippers and suppliers would not be distorted.

Efforts to reform the current SSP/LSP cross subsidies have been underway for many years now. The establishment of the AUGE under Mod 0229 was a major breakthrough in this process. It has been evident to all shippers/suppliers in the more than two and a half years since its implementation, that the AUG process would necessarily lead to an unwinding of the SSP/LSP cross subsidy. However, given the independent nature of the AUGE, no-one had perfect foresight as to how quickly or to by what magnitude this unwinding would take place.

In light of this, as a reasonable and prudent operator, British Gas ensured that it did not enter into supply contracts which might potentially leave it financially exposed, or unable to pass on either additional costs (or indeed customer benefits) as a result

⁶ As per Mod81 figures published by Xoserve in November 2012

of the AUG process. All shippers/suppliers have had plenty of notice and numerous contract renewal cycles in order to structure supply contracts which mitigate their exposure to AUG adjustments. It is therefore completely unacceptable to contemplate delaying the deployment of the best available methodology and data as assessed by the independent AUG on the basis of claims that some supply contracts will not allow the pass through of additional costs.

If such contracts do indeed exist, we consider that they would have been offered imprudently by the relevant gas supplier, and that this is no reason for delay. Indeed, rejecting 442/A on these grounds incentivises further such contracting which could again be used as grounds to frustrate appropriate inter-sector cost allocation.

Conversely, SSP shippers may well have factored the unwinding of the cross subsidy into their business plans, and may now have to contemplate revising customer supply prices upwards in order to compensate.

Implementation:

What lead-time would you wish to see prior to either of these modifications being implemented, and why?

Both modification proposals 0442 and 0442A propose a minimum two month lead time, between the date that the final AUG Table is published and the date from which the published final AUG Table will be implemented and become effective.

This lead time aligns with previous iterations of the AUG process where for the 2013/14 AUG Year a final AUG Table was published on 1 February 2013, for implementation on 1 April 2014 and for the 2012/13 AUG Year where clarification of the final AUG Table to be used was published on 13 March 2012.

A two month lead time provides suppliers with sufficient time to implement the values associated with a new AUG Table and provides consistency with section 9.3(b) of the AUG Guidelines which establishes a two month lead time, requiring publication of the final AUG Table by 1 February in readiness for the commencement of the next AUG Year on 1 April.

As a major supplier in the LSP market sector, we can confirm that we do not have any issues or concerns associated with a two month lead time. Indeed the concept and subsequent existence of the AUG process has been around now for a number of years, enabling all LSP suppliers sufficient opportunity to structure their contractual arrangements with their customers to address issues which may require contracts to be 're-opened'. In our opinion, any LSP supplier would have been careless in the extreme not to have addressed this issue.

Legal Text:

Are you satisfied that the legal text will deliver the intent of either of these modifications?

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After careful and detailed consideration with the SGN lawyers, who have been responsible on this occasion for developing legal text, we are satisfied that the legal text for both 0442 and 0442A will deliver the intent of these modification proposals.

The solutions proposed by both 0442 and 0442A are straightforward in their aims in that they simply seek to bring forward the implementation of a knowingly more robust and statistically more accurate AUG Methodology, once that methodology has been published and approved.

For clarity, neither of the proposals seek the approval of any AUG Methodology by The Authority, the proposal simply seeks to address the implementation of an AUG recommended and UNCC approved AUG Methodology and subsequent AUG Table, under timeframes which are currently outside of current code arrangements.

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.

Consumption Based AUG Methodology

Upon review of the latest draft version of the consumption based AUG Methodology, it is evident to us that the consumption based AUG Methodology represents a major step forward towards the achievement of a more ongoing equitable distribution of Unidentified Gas charges between market sectors.

British Gas note that the AUG has recommended that the consumption based method of estimating Unidentified Gas is utilised moving forward. In doing so the AUG makes reference to the fact that this method of calculating Unidentified Gas is a more simple and intuitive concept.

We further note that the AUG acknowledges that the previous Reconciliation by Difference (RbD) method only calculated Larger Supply Point assigned Unidentified Gas. The AUG has stated that the RbD method is therefore not suitable moving forward, since the AUG has managed to ascertain that there is in fact considerable Smaller Supply Point assigned Unidentified Gas. The RbD method is reliant on long-term data trends that have not manifested.

The AUG has also confirmed that the consumption based methodology is statistically more accurate when directly compared with the RbD bias methodology. The consumption based methodology utilises a larger data sample, which statistically increases accuracy.

In addition, the sector theft allocation contained within the 2011 AUG Methodology for the 2013/14 AUG Year has since been proven

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to be highly inaccurate, which has a significant overall effect. The consumption based methodology addresses this issue.

We therefore fully support the recommendation of the AUGE that the RbD method replaces the consumption based method and be utilised moving forward and we will be providing a positive response to the ongoing consultation.

Whilst we are concerned and disappointed at the failure of the AUGE to complete its work on the consumption based methodology during 2012, in readiness for implementation on 1 April 2013, and given that the AUGE themselves state that the RbD method is no longer suitable for its purpose, we believe that a knowingly more accurate methodology should be implemented at the earliest opportunity.

It is evident to British Gas that the 2012 AUG Statement, which included the RbD bias AUG Methodology, has been proven to be no longer fit for purpose and when utilised to calculate the 'rolled over' figure for the 2013/14 AUG Year, yields an inaccurate output. This clearly does not provide equitable distribution of Unidentified Gas charges between market sectors.

The effect of knowingly taking this course of action perpetuates the long standing cross subsidy from the predominantly domestic SSP sector to the mostly commercial LSP sector. This would appear perverse as it is the specific issue that the AUG process was implemented to tackle.

AUG Process

The AUGE has provided progress updates to industry parties during the year and within their letter dated 23 November 2012⁷, they issued a '*proposed timeline in order to publish a set of final figures by 1st February 2013*'.

This communication provided suppliers with a clear impression that the process was on track for completion in a timely manner and in accordance with the AUG Guidelines under 9.3(b), enabling a subsequent 1 April 2013 implementation.

On 11 December 2012⁸ however, the AUGE issued a further communication advising that '*Three unexpected operational issues impacted the production of the AUGS...*' in line with their previously advised date. To date we have been unable to obtain any information relating to the 'three operational issues' encountered by the AUGE, therefore we are unable to conclude the reasons for this critical delay.

The AUGS was subsequently issued ten days later than originally expected, on 17 December 2012. However, rather than the consultation period starting immediately

⁷ http://www.gasgovernance.co.uk/sites/default/files/2012%20AUGS%202013_14%20Progress%20Update%2021112012.pdf

⁸ http://www.gasgovernance.co.uk/sites/default/files/2012%20AUGS%202013_14%20UNCC%20Letter%201122012.pdf

upon publication, it did not commence until 2 January 2013, some 16 days later, with the period of consultation running for 60 days rather than the stated 42 days.

We are concerned that an initial ten day delay in the production of 2012 AUGS during December, has escalated into a much longer delay, which has subsequently prevented completion of work on the 2012 AUGS in readiness for implementation on 1 April 2013.

It is wholly inappropriate for this small initial delay to ultimately manifest into a twelve month delay in the implementation of a knowingly more accurate AUG Methodology, and for SSP consumers to bear the financial impact of this.

Transparency and Trust

Given the current challenging economic climate, the significant pressures on household incomes and the impact upon consumers of recent energy prices, British Gas believes it prudent that any opportunity to more equitably distribute Unidentified Gas charges between market sectors should be realised at the earliest opportunity.

The high profile focus on energy prices by the media, consumers and government highlights the importance on maintaining industry integrity and the importance of positively promoting an environment of trust with customers.