

Representation

Draft Modification Report

0456 (Urgent): - Revision to the treatment of Allocation of Unidentified Gas for the 2013/14 AUG Year

Consultation close out date: 11 June 2013

Respond to: enquiries@gasgovernance.co.uk

Organisation: British Gas Trading

Representative: Graham Wood

Date of Representation: 11 June 2013

Do you support or oppose implementation?

Support

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

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 solely to Shippers operating in the Smaller Supply Point market.

This proposal seeks to implement an AUG Methodology which has been proven to be statistically more accurate and negates previous concerns regarding the incumbent methodology, providing a more accurate outcome for all gas consumers.

Specifically, implementation of this updated AUG Methodology in line with the timetable established within modification 0456 would deliver this fairer and more representative split of Unidentified Gas volumes between Smaller Supply Point (SSP) and Larger Supply Point (LSP) sectors, a full six months earlier than the current default timescales. It would also help to address an existing, unfair cross subsidy running into tens of millions of pounds, which has been demonstrated to have existed for many years.

A more equitable allocation of Unidentified Gas volumes will ensure that competition within the shipping and supply markets are not distorted. Implementation of 0456 will be particularly beneficial to smaller domestic suppliers in the current challenging economic conditions.

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

No, we do not believe that there are any new or additional issues to be recorded, other than the points raised within this response.

Relevant Objectives:

How would implementation of this modification impact the relevant objectives?

British Gas is of the view that this modification proposal meets the following Relevant Objective:

- 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.

British Gas considers that the aims and objectives of this proposal promote effective and efficient competition between parties, particularly competition between relevant Shippers and relevant Suppliers.

The proposal seeks to improve transparency and accuracy in the allocation of Unidentified Gas (UG) to the contributing market sector, enabling a more equitable and accurate distribution of UG volumes at the earliest possible opportunity, a full six months earlier than the current default timescales

Should this proposal not be approved, a known, significant cross subsidy will continue to prevail across the SSP and LSP sectors, for the last six months of the 2013/14 AUG Year, exposing predominantly domestic SSP consumers to a further six months of inaccurately apportioned UG volumes.

In addition to having a continued, significant commercial impact upon relevant shippers, suppliers and consumers, failing to address this issue will also have an adverse impact upon competition in shipping and supply.

British Gas are mindful that the issue that this proposal seeks to address has a particular detrimental impact upon smaller SSP suppliers, whose exposure to any inaccurate allocation of UG gas volumes will continue to have significant commercial consequences.

The recently raised modification proposal 0451 is a clear example of how small supplier exposure to inaccurate RbD over allocations can be unsustainable and potentially damaging.

Impacts and Costs:

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

We do not expect to face any analysis, development or ongoing costs if this proposal were to be implemented, as any requirements were introduced at the time that Mod 0229 was implemented.

Implementation:

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

As the proposer of the modification we support the implementation date of 1 July 2013. This date will enable the AUGE sufficient time to undertake the activities required, as detailed within the modification proposal, to enable an AUG Table to be published on 1 August 2013.

The publication of the AUG Table on 1 August 2013, for its effective implementation on 1 October 2013, will provide Shippers and Suppliers with adequate time to address implementation issues. Indeed, should a positive decision be provided by Ofgem, in accordance with the suggested urgent timetable published¹, Shippers and Suppliers will have an additional one month's notice (from 1 July 2013) to prepare for implementation.

The lead time (of at least two months) aligns with previous iterations of the AUG process. For the 2013/14 AUG Year a final AUG Table was published on 1 February 2013, for implementation on 1 April 2013 and for the 2012/13 AUG Year clarification of the final AUG Table to be used was published on 13 March 2012 for a 1 April 2012 implementation.

It is evident that a two month lead time provides Shippers and Suppliers with sufficient time to implement the values associated with a new AUG Table and provides consistency with section 9.3(b) of the AUGE 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.

Therefore the implementation proposed within 0456 should not present any implementation difficulties for parties. With a broad portfolio across both the SSP and LSP sectors, British Gas can confirm that we would have no issues whatsoever with the implementation of this proposal.

British Gas supplies approximately 1 in 4 of all LSP sites, and it would seem reasonable to assume that other parties who actively supply consumers within the LSP sector, should also therefore be able to undertake the same implementation actions.

¹ [http://www.gasgovernance.co.uk/sites/default/files/UNC456_UD%20\(2\).pdf](http://www.gasgovernance.co.uk/sites/default/files/UNC456_UD%20(2).pdf)

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.

Within Ofgem's decision letter on Modification Proposal 0442, a number of points were raised which this proposal seeks to address.

Accuracy & Certainty

The latest version of the consumption based methodology published by the AUGE on 1 May 2013, which this proposal seeks to implement, is the product of over eighteen months worth of development work, analysis and consultation. The supporting rationale is therefore well understood by industry parties and has been the subject of multiple consultation periods.

For clarity, whilst the most recently published version has been marked as a 'first draft' of the 2014/15 AUG Statement, it is actually a third iteration of the extensively consulted upon consumption based methodology developed during 2012.

This version of the methodology addresses all of the issues raised within the two previous consultation processes, independently undertaken by the AUGE. It can subsequently be concluded that its implementation would result in a more accurate and equitable allocation of costs, than the incumbent methodology.

The small delay in the delivery of the last year's process prevented this third iteration of the consumption based methodology from being ready for implementation on 1 April 2013. Given the significance of the changes made from the incumbent methodology, specifically in terms of its improved accuracy, we believe that it is wholly inappropriate that the results of this revised approach be delayed for a whole year, because of a small process delay.

The ongoing 2014/15 AUG Year process will continue in accordance with UNC rules and deliver a further revised methodology and associated AUG Table for implementation on 1 April 2014. We anticipate that this methodology will not be significantly different from the methodology 0456 seeks to implement on 1 October 2013.

It can therefore be argued that should 0456 be implemented, Shippers will actually have an earlier than normal view of what the likely changes will be forthcoming from 1 April 2014. This will enable all Shippers and Suppliers to undertake better and more informed forecasting of costs for any contracts being prepared which span across the 2014/15 AUG Year period.

This will assist in reducing any uncertainty associated with future UG volumes in the short to mid-term; benefitting competition in the market and ultimately consumers.

Distributional Effects

The number of Larger Supply Points registered, totals approximately 296k supply points.² The volume of LSP customers that would be affected by the impacts of 0456 are dwarfed by the significantly larger volumes (many millions) of SSP customers that are adversely impacted by the current arrangements.

Contracts provided to LSP customers are both fixed and flexible in their nature. Typically in our experience, a large proportion of contracts (by gas volume) provided to larger I&C gas customers are flexible in nature, which enables the pass through of costs to be easily undertaken.

Given the evolving nature of the energy industry and ongoing changes to a variety of cost elements, Suppliers offer fixed price I&C gas contracts at their own commercial risk. The degree of risk is associated with the volatility of elements such as commodity costs and transportation charges amongst others. These risks are fully understood by all Suppliers before they enter into such contracts.

The length of fixed price contracts offered can vary in length, typically from 1 year to 3 years. Under normal circumstances a revised AUG Methodology and AUG Table is published every 12 months, therefore any fixed priced contract which runs for any length of time over a 12 month period, must already include some assumptions, made by Supplier, as to how future AUG Methodologies may impact the fixed price offered. Suppliers offering fixed contracts are fully aware of this issue when they enter into such contractual arrangements.

Due to commercial sensitivity, British Gas will be providing a more detailed view of our specific contractual arrangements to Ofgem, within a Confidential Annex.

As a major supplier in the LSP market sector, we can confirm that we do not have any issues or concerns associated with the implementation of this proposal and the linkage to tariffs and existing contractual arrangements with customers. 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 appropriate, contractual arrangements with their customers, should they so wish, to address issues which may require contracts to be 're-opened' or address future changes to AUG Methodologies.

With regard to how the impacts of Mod 0456, if approved, would be reflected in SSP tariffs, again due to commercial sensitivity we have provided detail on this aspect within the Confidential Annex issued to Ofgem.

Consumption-Based AUG Methodology

² As per Mod81 figures published by Xoserve in November 2012

British Gas note that during the development of the consumption-based AUG Methodology by the AUGE, the AUGE has consistently recommended that this method of estimating UG is utilised going forward. Further that this method is a more simple and intuitive concept.

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

The AUGE 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 therefore statistically increases accuracy.

In addition, the sector theft allocation contained within the RbD bias AUG Methodology utilised for the 2012/13 AUG Year (and subsequently rolled over for the 2013/14 AUG Year) has since been proven by the AUGE to be highly inaccurate, which has a significant overall effect. The consumption-based methodology addresses this significant issue.

Whilst we were 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 an 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.

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.

Under normal circumstances the effect of Mod 0456 would have been implemented from 1 April 2013, which would have removed the current inequitable arrangements and negated the requirement for this modification proposal to be raised.

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.

Knowingly choosing to not address this known issue would not appear to be in-keeping with the important concept of transparency and trust.

Stability of Code Arrangements and Independence of the AUGÉ

During the development of modification proposals 0442 and 0442A, discussions touched upon the need to preserve arrangements which are currently set out in the UNC. We note such arguments tended to be made by shippers/suppliers who we believe are likely to have the most to gain from protecting the current cross subsidies associated with the incumbent arrangements.

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 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.

Modification 0456 does not in any way undermine the authority or independence of the AUGÉ. Indeed it seeks to implement the output of over 18 months worth of work by 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.

Modification 0456 therefore strengthens 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 AUGÉ was the need to implement updates only from 1 April in any given year. It was not within the AUGÉ's ability to implement new arrangements, for example, from a slightly delayed date (i.e. 1 June) to take into consideration the small delay encountered.

In summary therefore, this modification proposal is 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.