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Your Reference: UNC Modification Proposals 0277 and 0346.

Re: UNC Modification Proposal 0277: 'Creation of Incentives for the Detection of Theft of Gas (Supplier Energy Theft Scheme)'
and
UNC Modification Proposal 0346: 'An Alternative to the Supplier Energy Theft Scheme Based on Throughput'

Dear Bob,

Thank for your invitation seeking representations with respect to the above Modification Proposals.

National Grid Gas Distribution (NGD) acknowledges that although not formal alternative Proposals as described in Section 6.4 of the UNC Modification Rules, these two Proposals nevertheless represent alternative approaches and as such we are providing responses to both the respective Draft Modification Reports within this representation. NGD would like to offer support for implementation of either Proposal and believes for the reasons outlined below that implementation of Proposal 0277 would have the greater beneficial impact on the facilitation of the relevant objectives.

NGD recognises that the costs of undetected theft of gas are likely to ultimately borne by those consumers at Supply Points legitimately registered within the Transporters' Supply Point Register. Whilst the implementation of UNC Modification 0229¹ may apportion such costs more equitably across all markets, these costs are nevertheless incurred for gas which has not been consumed by the party that is paying for it. We also recognise the potential safety risks created by gas illegally taken. For example, where such theft involves interference with the network or the Supply Meter Installation.

In an open letter² to all Gas Suppliers dated 20 October 2010, based on the issues highlighted above Ofgem stated a clear aspiration that "*robust arrangements are in place to detect and investigate suspected theft of gas*". In the same correspondence Ofgem expressed concern in respect of the overall proportion of theft allegations notified to Suppliers by xoserve to which no response has been provided by Suppliers. Ofgem also highlighted concerns in respect of the differential 'performance' levels between Suppliers, both in terms of the proportion of allegations to which no response is provided and also the proportion of theft allegations determined as 'valid' as a consequence of investigation. In summary Ofgem stated "*We are writing to you to request your commitment to address robustly suspected theft cases that are notified to you within an appropriate timescale*".

¹ This Modification enables energy charges allocated via the 'Reconciliation by Difference' (RbD) mechanism to be apportioned between Smaller Supply Points and Larger Supply Points based upon the determination of an independent industry expert ('Allocation of Unidentified Gas Expert' (AUGE)).

² http://www.ofgem.gov.uk/Markets/RetMkts/Compl/Theft/Documents1/Suspected%20gas%20theft_Final_.pdf

With differential Supplier performance a key concern of Ofgem it is relevant to note that xoserve statistics³ demonstrate that between January and November 2010 one Shipper⁴ reported 83% of valid theft cases and 87% of the associated volume of gas illegally taken. Further, in respect of the valid theft cases referred to Shippers in the same period, 11 of the 29 shippers (38%) have not reported any valid cases with a further 9 of the 29 Shippers (31%) reporting between 1 and 6 cases.

Accordingly, NGD agrees with the proposer of both Proposals that it is appropriate to introduce an incentive on Shippers⁵ to detect a level of theft proportionate to its market share. We note that development of an incentive scheme was a recommendation of UNC Review Group 0245.

In our opinion, implementation of either Proposal would better facilitate the relevant objective of the securing of effective competition between relevant shippers and relevant suppliers (Standard Special Condition A11(1)(d)) by reducing the costs of gas illegally taken which, under the prevailing arrangements, are smeared to all Shippers and are thus likely to be recovered from other consumers. Such costs are likely to be reduced on the basis that instances of theft may be detected (and actions taken to curtail the volume of gas taken in such circumstances) earlier than under prevailing arrangements. This should result in a more appropriate allocation of costs and therefore better facilitate competition.

The difference between the two Modification Proposals is to how the level of theft detection and Shipper market share is determined. Proposal 0277 advocates that theft detection is based on the number of *valid offences* identified and Shipper market share upon the number of *Supply Points* to which a Shipper is the Registered User. However, Proposal 0346 advocates theft detection based on the *volume of gas* associated with the valid offences identified and Shipper market share upon the *aggregate Annual Quantity* for the Supply Points to which a Shipper is the Registered User.

Both approaches utilise the same principle that a Shipper's level of theft detection should be proportional to its market share however reliance upon report theft volumes as required by Proposal 0346 may inappropriately incentivise an overestimation of volumes of gas illegally taken. Utilisation of a measure based upon absolute number of cases detected would not appear to be subject to such risk and for this reason we believe that Proposal 0277 would provide a preferable solution.

In respect of both Proposals, we note that it is proposed that the development costs and the costs of the ongoing administration of the scheme by xoserve would be recovered via the User Pays mechanism with 100% of such charges attributable to Shippers.

Please contact me on 01926 653541 (chris.warner@uk.ngrid.com) should you require any further information.

Yours sincerely,

Chris Warner
Network Code Manager, Distribution.

³ Shippers are obliged to communicate information in respect of instances of gas illegally taken (of which it becomes aware) to the Transporter pursuant to Condition 17.4 of the Supplier's Licence.

⁴ Whilst supplier performance is the concern, industry reporting provided by xoserve (as the agent of the Large Transporters) is provided at a Shipper level, Shippers being the counterparty in the UNC contractual arrangements with the Large Transporters.

⁵ This mechanism would operate in respect of gas shippers (being party to the UNC) however, we would envisage that such risk would be reflected in Shipper arrangements with respective gas suppliers.