

Mr Bob Fletcher  
Secretary, Modification Panel  
Joint Office of Gas Transporters  
51 Homer Road  
Solihull  
B91 3LT

11<sup>th</sup> January 2011

Dear Bob

**RE: UNC Proposal 0292 – “Proposed change to the AQ Review Amendment Tolerance for SSP sites”**

1. British Gas does not support the implementation of Proposal 0292 and believes that its implementation will both distort competition and unduly discriminate between Shippers in their ability to use the Annual Quantity (AQ) Review process.
2. We are also concerned that the Proposal seeks to remove the controls introduced by Modification Proposal 624 to prevent abuse in the AQ Review process and in doing so, Shippers who use the process honestly will be exposed to a large increase in gas allocation costs, distorting competition in the process. We calculate that were a Shipper who held 10% market share of the aggregate Small Supply Point (SSP) AQ to abuse the AQ Review process so that they moved just 1% of their costs from their portfolio to the rest of the Small Supply Point (SSP) Shipper population, the cost to the industry would be approximately £6.5m<sup>1</sup>.
3. The fact that this is happening at a time when serious allegations regarding the activities of three Shippers in the 2010 AQ Review process, possibly affecting £13m of costs, is a serious concern for us. We believe that considering this, and the value associated with potential abuse of the process, this proposal would potentially undermine confidence in the effective operation of the market.
4. We also believe that as the daily capacity limits are to be calculated from a Shippers' market share of Supply Points, a piece of information which bears no relation to the volume of AQ amendments they submit, those Shippers who currently submit more than their market share suggests will be

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<sup>1</sup> Assuming approximate SSP aggregate AQ of 328 TWh at an average cost of approximately £20m p/TWh, or £6.5bn total value. 10% share of this cost is therefore approximately £6.5bn, with 1% of that cost valued at approximately £6.5m.

disadvantaged. For example, the number of amendments a Shipper will submit each year depends more on the degree to which that Shipper has been able to prepare for the AQ Review by collecting read data throughout the previous twelve months. Those Shippers who invest more time and money in collecting meter readings from customer's properties will have more ability to manage their AQs and consequently submit more amendments, and vice versa. The last MOD81 report (attached as Appendix Two) shows that eleven different Shippers submitted more AQ amendments than their market share suggests, and may therefore be prevented from submitting all the AQ amendments they need to under this Proposal.

5. Furthermore, we consider that the inability of large Shippers such as ourselves to submit AQ amendments early in the AQ Review window due to the sheer number of files and records to be processed, mean that this Proposal will allow some Shippers to use the process more than others. Small Shippers for example, will be able to use their daily capacity almost immediately, spreading the submission of their AQ amendments throughout the window to maximise use. Large Shippers such as ourselves face up to three weeks of initial file loading, processing and analysing before they are able to start submitting AQ amendments, and will effectively see their daily capacity limit reduce by over 27%<sup>2</sup> under this Proposal. We cannot accept this discrimination in application of the AQ Review process, and believe that it will inevitably distort competition in the Small Supply Point (SSP) sector in favour of those Shippers with smaller systems.
6. We are also concerned at the lack of development this Proposal has seen ahead of this consultation. Whilst we understand the Proposer's motives, this Proposal is being consulted on without Shippers being able to fully assess the impacts on their business. In particular, we are very disappointed that the industry only had details on "*how amendments should be submitted and will be processed (and) how amendments submitted in excess of the volume cap will be processed*"<sup>3</sup> on 7<sup>th</sup> January 2011 when the document was agreed. Such details are fundamental to Parties' use of the AQ Review process and therefore to their view on the impacts this Proposal has.
7. Crucially we are only now able to understand what steps we should take to change our systems to make use of any new process, were the Proposal to be implemented. Given the Proposer suggests that the process come in to effect in the 2011 AQ Review, this is a material issue for us. Were this Proposal to be implemented in spite of these developmental issues we believe a dangerous precedent would be set on the amount of detail which a Proposal requires before it may progress to consultation.
8. The current AQ process incentivises the investment in meter reading processes, as capturing and submitting regular meter readings will allow you to closely manage the AQs in your portfolio both before and during the AQ

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<sup>2</sup> The AQ Review window lasts for eleven weeks, therefore any Shipper unable to utilise their daily capacity in the first three weeks will see the total system capacity they are entitled to reduce by over 27%.

<sup>3</sup> Modification Proposal 0292, page 4.

Review window, whereas those Shippers who do not invest in collecting regular meter readings will have less accurate provisional AQs and therefore need to rely more on the AQ Review process. We believe that by moving towards a process where many more AQs can be appealed, Shippers will be incentivised to cut back on the expensive business of obtaining regular meter readings, and simply rely instead on the annual AQ Review to manage their costs. Not only will this lead to less accurate customer bills, but we also believe will lead negative impacts in a number of other industry process which rely on meter read accuracy such as the customer transfers process. We believe that these negative customer impacts need careful consideration, as does the fact that such a move would penalise those Shippers who have already invested significant amounts of money making the current process work.

9. We also believe this Proposal fails to meet a number of UNC Relevant Objectives. More detail on these are attached in Appendix One, but specifically

***Standard Special Condition A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates; and Standard Special Condition A11.1 (b): so far as is consistent with subparagraph (a), the coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;***

10. The increase in gaming, or the artificial adjustment of AQ values for the benefit of an industry participant, which we believe will flow from this proposal will result in less accurate AQ information being held in the industry about SSP and thus negatively impact the Network Owners ability to accurately see where demand is throughout the country.

***Standard Special Condition A11.1 (c): so far as is consistent with subparagraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;***

11. We also consider that the push to implement this Proposal for the 2011 AQ Review will leave some Shippers able to make the necessary system changes to use the process and other Shippers unable to. This will undoubtedly distort competition in favour of those Shippers who have either already made a decision to start system development in expectation of an Ofgem decision to implement the Proposal, or have sufficiently small systems to be able to accommodate a change of this magnitude within less than five months. The materiality of this is not be under-estimated in our view; were some Shippers able to use the new rules in 2011 whilst others were prevented from doing so, millions of pounds worth of cost would be erroneously re-allocated across the market. It is our belief that this may give rise to a situation where, certainly within 2011, the Network Owners are obligated to provide services which discriminate between Shippers in a way which contravenes their obligations in Licence..

12. We also consider that as Shippers already have taken the investment decisions needed in order to maximise their ability to use the 2011 AQ Review process, that this Proposal is retrospective in its effect, if not intent. Those Shippers who have already invested money in processes designed to collect read data, filter it such that it meets the current requirements and submit it such that it meets the current xoserve validation will be penalised by an early implementation of this Proposal. Were this Proposal to apply to the 2012 AQ Review forward, then this impact would be mitigated by Shipper's ability to change how they invest their capital.

***Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs (a) to (c) the 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;***

13. We believe that Proposal 0292 will lead to less accurate AQs through an increased risk of abuse of the system and a weakening of the controls which allow scrutiny of Shipper performance. This reversal of the controls introduced by Modification Proposal 624 has the potential to distort competition significantly in favour of Shippers who misuse the process, and those who send their AQ decreases earlier in the day, and then submit their AQ increases later on when there is a higher probability they will be rejected.
14. We also believe that both larger Shippers and those Shippers who submit more AQ amendments than their market share of Supply Points suggests will not be as able to use this process as much as other Shippers, distorting competition in the process.
15. Finally, and as referred to above, we also consider that Shippers will have a varying ability to make use of the process considered by Proposal 0292 in the 2011 AQ Review, with the effect that competition will be distorted in favour of those Shippers who are to make system changes at short notice. We note that an alternative scenario exists whereby the Network Owners may will face a much higher volume of AQ amendments, and therefore cost, as disadvantaged Shippers seek to mitigate potential losses by turning off all validation of AQs before they are issued.
16. Each of these points is expanded on below in Appendix One. If you have any queries relating to this representation however, please do not hesitate to telephone me on (07789) 570501.

Yours sincerely

David Watson  
Regulatory Manager, British Gas

## Appendix One – Proposal 0292

### Increased risk of gaming

17. In the absence of a daily reconciliation regime for the Small Supply Point (SSP) sector, the effective management of industry Annual Quantity (AQ) values is of vital importance to British Gas and its business model. In particular it is important to us to know how we can appeal our AQ values during the AQ Review, how those appeals will be treated and how the industry safeguards us against the misuse of the appeals process by other Shippers, thus erroneously increasing our share of gas allocation costs and placing us at a competitive disadvantage.
18. The importance of this last issue should not be under-estimated in our view. In 2003, Modification Proposal 624 was raised to introduce key safeguards in response to concerns that one Shipper was using the AQ Appeal window to focus on decreasing their AQ values rather than take an even-handed approach, achieving this by “shaving” their AQs; that is to say putting through a large volume of minor amendments with the overall effect being a material reduction in their aggregate AQ. The effect was to reduce their exposure to gas allocation costs with the consequential impact that their competitors share of gas allocation costs increased, distorting competition.
19. Modification Proposal 624 introduced two controls on the process to protect Shippers from abuse in future. It introduced an obligation in to the Uniform Network Code (UNC) which prevented Shippers from taking a selective approach when submitting AQ amendments, and it introduced a requirement that AQ amendments should only be processed if they resulted in a greater than 20% change in the overall AQ value. Whilst the obligation set out a clear expectation that Shippers should not abuse the AQ Review process, the 20% threshold provided a practical solution to Shippers “shaving” their AQs as had been seen previously.
20. British Gas considers that the reduction of the AQ amendment threshold to 5% effectively removes the protection that Modification Proposal 624 provided against Shippers abuse of the system and therefore allows the future possibility of abuse of the process, potentially exposing the Shippers who adhere to the rules, and their customers, to material costs.
21. We are aware that some may argue that as the existing obligation on Shippers to take an even handed approach remains in force, this risk will not materialise. We entirely reject this argument however and want to make clear that without effective processes in place to assess Parties’ level of compliance, obligations on their own are unenforceable.
22. We are aware that the MOD081 Report provides some visibility of each Shipper’s actions during the previous AQ Review period, but the value of this report is in assessing the variance of each Shipper’s performance from both their performance in previous AQ Review periods as well as the performance

of other Shippers in the same AQ Review period. The fact that this Proposal will allow a large increase in the volume of AQ amendments to be submitted means that comparison with previous year's AQ Review performance will not be possible until at least 2014, effectively removing the controls that exist in the process.

23. We accept this may only be an issue for the next three and half years, but despite raising this during the development of the Proposal, no interim control has been included in the Proposal to mitigate the impact this has. We are very disappointed that this aspect of the process has been explicitly ignored and have grave fears that both allowing a large volume of minor AQ amendments without the ability to assess whether they have been submitted in accordance with the UNC obligations will result in misuse of the process, with material effects on competition.
24. Finally, we believe that Shippers may be able to achieve a better, and erroneous, result from the AQ Review process by submitting all their AQ reductions early each day, safe in the knowledge that by submitting all their AQ increases later on, they bear a greater chance of breaching the daily limit and thus being rejected. Each Shipper would be fully compliant with their UNC obligations to be even handed when submitting AQ amendments, but they would have gained a material benefit in the process at the expense of other Shippers.
25. We consider this to be a particularly pertinent point at this moment given that we have raised significant concerns with the way in which three Shippers have managed the 2010 AQ Review process. Specifically, we believe we have evidence that these Shippers have used the AQ Review process to submit a disproportionate number of AQ decreases than AQ increases. These concerns have been raised with xoserve and an investigation is currently underway to assess whether there has been any breach of UNC provisions. We also note that this behaviour was identified by comparing their 2010 performance on the MOD081 report with previous years, something which would not be possible if this Proposal is approved.

#### Modification Proposal 0292 discriminates in its application between Shippers

26. We believe that whilst the intention of the Proposal is that it will apply equally to all Shippers, the effect of it is quite different. In particular, the daily capacity limit proposed for each Shipper is calculated based on their market share of Supply Points, without recognition of the fact that the number of AQ amendments which a Shipper submits in each AQ Review period bears no relation to their actual market share of Supply Points. Indeed, the last MOD081 report submitted by xoserve showed that eleven Shippers submitted more AQ amendments than their market share suggested they would have. Under this Proposal, each of these Shippers will potentially be prevented from submitting all the AQ amendments which they would like to make.
27. This issue is exacerbated by the fact that larger Shippers such as ourselves have a physical constraint on when they can start to submit AQ amendments,

with a longer lead time needed for larger Shippers. For example, British Gas receives almost 9.5m provisional AQ values for at the start of the AQ Review window. The sheer size of this file could require up to 3 weeks to receive, process and analyse. Thus a larger Shipper like us may face a significant delay compared to smaller Shippers, before they can start submitting AQ amendments, and the introduction of a daily capacity limit will prevent those Shippers from catching up. As this restriction does not apply to smaller Shippers, we consider that this will distort competition in the SSP sector.

28. . Again, this will mean that some Shippers are able to use the new process immediately whereas others will be forced to wait until 2012, moving millions of pounds worth of gas allocation costs erroneously around the SSP market, distorting competition in the process.
29. We welcome the moves by xoserve to mitigate this impact by looking at ways to bring forward the date on which the initial file of provisional AQ amendments is submitted, but note that any change in this area will again come too late to allow Shippers such as us to re-configure their systems to accept the new earlier file. We have placed on the record our need for a minimum six month lead time in order to make the necessary changes to use this process, effectively barring us from using any new process this year, whilst our competitors, potentially with smaller systems to change and therefore less lead time required, will be fully able to make use of the process. This potentially exposes us to a significant, and erroneous, increase in gas allocation costs. As an absolute minimum, we call on Ofgem to delay the implementation of this Proposal until 2012 so that all Shippers may compete on a level playing field.
30. The alternative is that any Shipper unable to implement the system changes in time will simply remove all controls and validation from their system, submit AQ amendments for their entire portfolio and let xoserve filter the valid from the invalid. We believe this will add a significant extra cost to the Network Owners and impact their ability to make AQ amendments in the required time in the UNC, but that this may not be avoided given the value at risk for potentially disadvantaged Shippers.

#### Inability to assess full impacts of Modification Proposal 0292

31. Whilst we understand the desire of the Proposer to ensure that this Proposal progress so that it may be implemented in time for the 2011 AQ Review, we wish to make clear our displeasure with the way in which the UNC Modification Process has been abused in order to achieve this. We contend that were this to have been any other Proposal other than Modification Proposal 0292 that the Proposal would have been sent back for further development.
32. In particular, we note that whilst the original intent of the Proposer was to provide for a fully developed solution, in the interests of saving time they have now opted to send this Proposal out for consultation without publishing full details on how the process will operate. Although a Guidance Document was

agreed two working days before the end of this consultation phase, the lack of ability for parties to review the impacts of *“how amendments should be submitted and will be processed, including how amendments submitted in excess of the volume cap will be processed”* means that we do not feel entirely able to

- a) form a view on the potential costs associated with implementing and using this Proposal,
  - b) understand the level of contractual risk that this Proposal may contain for us,
  - c) understand how Shippers who submit more than their market share allows for may make use of spare capacity in the system; a particularly important point for us considering the limitations outlined above on our ability to make use of the process considered.
33. Were this Proposal to be implemented by Ofgem in spite of these developmental issues, we believe that this would set a clear, and our view dangerous, precedent on the standard future Proposals must meet in before they can be implemented. Given the findings of the Code Governance Review on how industry Proposals should be developed, we would consider this to be a retrograde step.

#### Rewards the wrong parties

34. The current regime is clear at the moment and most parties have invested money in making that process work, for example by increasing the frequency with which the attempt to collect meter readings from sites so as to better manage their Annual Quantity (AQ) throughout the year.
35. By changing the regime now, those who have invested little in meter read collection will be able to achieve the same benefits without having to invest in activities such as the collection of meter readings, to the detriment of the consumer. These modifications will therefore have the effect of rewarding those Shippers who have displayed undesirable behaviours at the expense of those who have displayed positive behaviours. There is no rationale behind the distortion of competition in this way, and we consider it to be highly inequitable.

#### Costs and Benefits

36. Whilst we do not have sufficient detail to comment on the full cost implications of this Proposal, we are able to say that we will need to make significant changes to our systems so that they reflect the changes xoserve plan to make to their systems. Without this, we would not be able to guarantee that the amendment requests we submitted complied with UNC provisions. Due to the lack of development in the Proposal at time it was sent for consultation, we are not able to provide full details of these costs.
37. We can however say with some certainty that the aspect of the proposal which allows xoserve to stop undertaking the Referral Process will increase

the Full Time Employee (FTE) costs associated with managing the AQ Review Process. Currently, on receipt of an AQ amendment, xoserve will validate that request against its agreed criteria. At this stage it is possible for an AQ amendment to be accepted, rejected or referred for further analysis. Evidence submitted to xoserve during the development of this Proposal showed that during last year Referral Process 6,097 AQ amendments were accepted. Under this Proposal these AQ amendments would be automatically be rejected and sent back to the Shipper for action, incurring a Shipper processing cost as it happens.

38. We believe that the extra cost associated with re-processing AQ amendments which would ordinarily have been accepted to be unnecessary and without benefit to the industry. We also consider that allowing acceptable AQ amendments to be rejected in this way is highly inefficient and will lead to a degradation of AQ accuracy in the market.
39. Against these costs is the knowledge that given the materiality of the changes proposed that all SSP Shippers will, insofar as they can, make full use of the new process. Assuming that all SSP Shippers have an equal proportion of AQ amendments between 5% and 20% to make, the net result of the process will be no reallocation of cost and zero net benefit to customers. We would have expected as a minimum for some evidence to be presented to demonstrate that some SSP Shippers were more exposed to AQ amendments of between 5% and 20% than others.
40. Without this, the overall benefits cases do not exist for this Proposal, and Ofgem risk setting a precedent for the level of benefits evidence that future Proposals will require before they are implemented.
41. We note that were Shippers to focus on reading the meters of their customers, they would be better able to capture movements in the AQs on their portfolio and thus get the benefit they aspire to receive. This Proposal simply seeks to compensate for some Shipper's lack of investment in receiving meter readings, reinforcing poor behaviour which has a negative impact on customers.
42. Finally, we believe that the allocation of the costs for this Proposal by market share of Supply Points is unfair. As we have highlighted above in paragraph 4, the MOD081 report demonstrates that the volume of AQ amendments submitted, and therefore likely benefit to be derived from Proposal 0292, is not related to market share of Supply Point. This will expose some Shippers to unfair costs whilst allowing others to avoid more costs than potentially they should be.
43. British Gas believe that for the reasons above, Proposal 0292 fails to meet a number of UNC Relevant Objectives, specifically

***Standard Special Condition A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates; and***

**Standard Special Condition A11.1 (b): so far as is consistent with subparagraph (a), the coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;**

44. For the reasons given above, this proposal will result in less accurate information being held in the industry about Small Supply Point (SSP) demand as a result of increased “gaming” of AQ values by Shippers, thereby negatively impacting the Network Owners ability to accurately see where demand is throughout the country. This will create some upward pressure on the costs of operating the pipe-line system, and therefore act contrary to this relevant objective.

**Standard Special Condition A11.1 (c): so far as is consistent with subparagraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;**

45. As above, we believe that the push to implement this Proposal for the 2011 AQ Review will leave the Network Owners offering a process which some Shippers are able to use and other Shippers unable to use. We believe that this may place the Network Owners in breach of their obligations to provide services to Shippers on a non-discriminatory basis.

**Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs (a) to (c) the 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;**

46. As we have outlined above, British Gas believe that Proposal 0292 will lead to less accurate AQs through an increased risk of abuse of the system and a weakening of the controls which allow scrutiny of Shipper performance. This reversal of the controls introduced by Modification Proposal 624 had the potential to distort competition significantly in favour of Shippers who either misuse the process, or simply schedule their AQ decreases earlier than they schedule their AQ increases.
47. For the reasons given above, we also consider that in the rush to implement this Proposal for the 2011 AQ Review, Shippers will be left with varying ability to make use of the process the Proposal considers with the effect that either competition will be distorted in favour of those Shippers with smaller systems or that the Network Owners will face a much higher volume of AQ amendments as disadvantaged Shippers seek to mitigate potential losses.