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10 September 2010

Dear Bob

**EDF Energy Response to UNC Modification Proposals 0317 & 0317A: "Interim Allocation of Unidentified Gas Costs".**

EDF Energy welcomes the opportunity to respond to this UNC Modification Proposal and its alternate. We support implementation of Modification Proposal 0317 and 0317A, although we prefer implementation of 0317A. For clarity we prefer implementation of 0327 as this represents a more accurate reflection of Unaccounted for Gas Costs that should be apportioned to the LSP sector.

Whilst both proposals address the cross subsidy which exists between the domestic and I&C sector we have the following high level comments:

- The figures and methodology contained within 0317 has been developed by a party who might have a commercial interest in its outcome. Therefore, we would question the 0317 methodology and assumptions and its appropriateness in the allocation of energy (even if only for a 12 month period).
- The TPA analysis was conducted on behalf of ICOSS with a clear remit for what was to be delivered. We believe that there are numerous issues with the TPA analysis.
- As a result of these deficiencies a better solution would be to implement 0317A. This goes some way to addressing the level of the cross subsidy in the short term, but allows this to be corrected once the methodology has been developed by the appointed expert.
- The report used in 0317 recommends that it is not used for an apportionment methodology.<sup>1</sup>

The current arrangements under the UNC result in domestic customers funding all of the Unaccounted for Gas (UAG) costs. This is clearly inequitable, representing a cross subsidy from the SSP to LSP market. We note that were this cross subsidy to be paid through the treasury then this would be subject to scrutiny as state aid by the European Commission to ensure that there were no anti-competitive effects. Therefore any proposal which seeks to address, or reduce this cross subsidy will represent an improvement to the current situation and so should be implemented.

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<sup>1</sup> Paragraph 58.

However, we have concerns with proposal 0317 and believe that 0317A represents a better solution than 0317. In particular it is twice stated in the report that:

“We emphasise how strongly the results are influenced by our aggregate theft and “network” theft assumptions, which are not underpinned with sound data. We believe that more high quality information and data is required before an apportionment methodology of this type could be used in practice.”

We note that 0317 is essentially an alternative to 0228A, although the value of the monies to be re-apportioned is lower. As such, the extent to which parties perceive 0317 to facilitate the relevant objectives would also be driven by the extent to which they believed 0228A facilitated the relevant objectives. Any discrepancy between support for the two proposals is likely to be driven by the different impacts that the two proposals have and so commercial interests. We note that the report produced by TPA for ICOSS was sponsored by ICOSS, and so there are questions regarding the independence of this report and the commercial drivers behind this. In addition the TPA report provided for the Ofgem Impact Assessment (IA) did not contain any of the figures that 0317 relies upon. These figures are derived from a report by ICOSS, which has a commercial interest in ensuring that the costs apportioned to the I&C sector are kept as low as possible – regardless of whether they are accurate or not. We therefore disagree that 0317 represents a better solution than 0228.

We believe 0317A represents a better solution than 0317 as it addresses the immediate need to ensure that the cross subsidy is reduced and so re-apportions costs to the LSP market; however it also benefits from the fact that ultimately it will rely on an independent assessment of this energy to ensure that an appropriate re-apportionment takes place. We agree with the proposer of 0317A that the values represented in 0317 represent a significant under valuation of the costs that should be apportioned to the LSP sector, but recognise that the true value of these costs will not be visible until the expert has completed their methodology. 0317A therefore addresses these issues by ensuring that cost allocation from 1 April 2011 is accurate.

In relation to the particular sections of the modification report EDF Energy would make the following specific comments:

**3. Extent to which implementation of the proposed modification would better facilitate the relevant objectives:**  
**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;**

We believe both proposals facilitate this relevant objective by reducing the cross subsidy that currently occurs from the domestic to I&C market. However, 0317A meets this relevant objective

better than 0317 as it ensures that costs are accurately targeted. Whilst 0317 will reduce the cross subsidy, 0317A will remove it entirely.

We note that whilst there is uncertainty with 0317A regarding the final volumes to be apportioned this can be addressed in one of two ways. Shippers can build what they expect the costs of UAG into their tariffs from 1 April 2011 or they can develop their tariffs based on the costs within 0317A and adjust these at a later date to account for the higher figures identified by the AUGÉ. However, ultimately over a 12 month period there will be no difference in the costs recovered from consumers and the costs Shippers are exposed to. The only difference will be between how Shippers seek to recover their costs.

**Standard Special Condition A11.1 (f): so far as is consistent with subparagraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;**

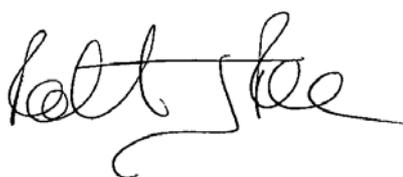
We believe that proposal 0317A facilitates this objective to a greater extent than 0317 as it ensures a more accurate allocation of energy than 0317A.

**9. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party**

We agree with the proposer of 0317A that until reconciliation with the AUGÉ statement occurs there will be a significant mis-allocation of costs between the SSP and LSP markets with the implementation of 0317.

I hope you find these comments useful, however please contact Stefan Leedham ([Stefan.leedham@edfenergy.com](mailto:Stefan.leedham@edfenergy.com), 020 3126 2312) if you wish to discuss this response further.

Yours sincerely

A handwritten signature in black ink, appearing to read "Rob Rome".

Rob Rome  
Head of Transmission and Trading Arrangements  
Corporate Policy and Regulation

## Appendix 1 Analysis of ICOSS Report for 0317 and TPA Solutions Report

### ICOSS Report

**Gas Measurement and Shrinkage Errors:** The ICOSS report has “not considered” errors in gas measurement or shrinkage errors in their analysis, however no evidence or analysis has been provided as to why these sources should not be included and a portion attributed to the LSP sector (paragraphs 6 & 7). This assumes that all LSP meters are accurate, presumably on the grounds that they are read more frequently. However there is clear evidence from the Meter Error Reports published on the Joint Office website<sup>2</sup> that errors do occur even at the largest meters that are read and telemetered on a daily basis. By failing to recognise, or take into account that errors do occur the ICOSS methodology ensures that any meter errors at LSP sites are funded by the SSP sector which is inappropriate. By failing to take into account shrinkage errors the ICOSS report assumes that the shrinkage methodology developed by the Transporters is 100% accurate in forecasting compressor usage, leakage and own use gas. The Transporters recognise that this is not appropriate with the requirement to conduct shrinkage reconciliation at the end of the year to account for errors in their methodology. The cost of shrinkage is recovered from all consumers through transportation charges, and one inconsistency in the UNC is that any errors are only recovered from the SSP market. There are strong reasons as to why some of these costs should be apportioned to the LSP sector.

**Late/Unregistered/Orphaned sites and iGT Issues:** The ICOSS report has also not accounted for any gas costs associated with late/unregistered sites and iGT issues as they argue that these are transitory in nature and any costs funded by RbD are corrected at a later date (paragraphs 8-11). There is no evidence to support this. We agree that the process should work so that a late or unregistered LSP site is corrected when it is eventually registered. However, the evidence and commentary provided by xoserve to the 0194 Development Workgroup indicated that this is not always the case with registration occurring two or three Shippers down the line and the original consumption not being corrected. Failure to allocate any of these costs that are associated with these LSP sites would maintain a cross subsidy from the SSP market, and create a perverse incentive to not register LSP sites. Also by excluding iGT issues from the apportionment to the LSP sector the assumption is that these issues are limited only to the SSP sector and not shared by the LSP sector. There is clear evidence that this is the case and a suite of modification proposals have been raised to address these iGT issues. It is therefore inconsistent that these costs should only be attributed to the SSP sector when they are common to all iGT connections which include both SSP and LSP sites.

**Orphaned Sites:** Whilst the ICOSS report recognises that LSP orphaned sites do contribute to unaccounted for gas, they have assumed that process improvements will be developed to address this issue and so have developed 3 scenarios (paragraph 22). However no evidence has been provided to demonstrate where the process improvements have occurred, or how they would be enacted. There is no work ongoing in this area and so it is imprudent to reduce statistics without

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<sup>2</sup> Available at: <http://www.gasgovernance.co.uk/MER>

any evidence being provided at this time. Therefore for orphaned sites the LSP sector should be apportioned the volume of energy that xoserve's statistics have identified and the ICOSS report has utilised in its high case only.

**Aggregate Theft:** In developing their figures for theft of gas statistics the ICOSS report has not taken into account the fact that of the LSP theft allegations that were closed (84.25% of allegations), 32.5% of these were closed because the Shipper had not taken any action after 80 days. This does not compare well to the SSP statistics where only 21.32% of allegations were closed because the Shipper had not taken any action. It would therefore be wrong to assume that no theft occurred for these sites. Further of the 15.74% of valid LSP theft allegations 18.84% of these had no energy provided. We therefore agree with ICOSS that these figures are far too low; however, to increase these 10 fold is arbitrary. Further no explanation has been provided as to why the network operator assumptions for aggregate theft have not been included in any of ICOSS' modelling. Overall we believe that ICOSS' modelling of aggregate theft bears little resemblance to the statistics or any other "impartial assumptions", with no evidence provided for this divergence other than they "felt" they provided the correct answer. Whilst this may be appropriate for a George Lucas film, we are not convinced that this is appropriate for developing a methodology for the apportionment of gas to the LSP and SSP sectors.

**"Non-Network" and "Network" Theft Proportions:** When developing their figures for apportioning theft to the network and non-network classifications the ICOSS report has relied on "feelings". However these are contradictory to their previous feelings when developing aggregate theft levels. In particular they have chosen to use the network operators' view to develop their high case, although this same view was not used in developing their aggregate theft scenarios. This approach is inconsistent and unsubstantiated.

**LSP and SSP Sector Proportions of "Non-Network" Theft:** The methodologies used to attribute gas are developed based on the analysis and assumptions developed by ICOSS in the previous sections. Combined this results in a low case apportionment based on half of the reported theft levels, and a central case based on the reported theft levels which fails to take into account the volumes of allegations that are closed in the LSP sector through inaction which is a greater proportion than in the SSP sector. The high case includes network theft apportionment. As the assumptions used to derive these scenarios are arbitrary, inconsistent and unsubstantiated, then the scenarios also suffer from the same issue as the inputs are sub-optimal. Further the ICOSS report supports this view with the production of statistics indicating that reported theft volumes decrease with load band and site visit frequency (paragraph 33). Was this assumption to hold then theft as a percentage of throughput for the 73,200 - 293,000 kWh per annum load band would be less than for the SSP market. However the ICOSS figures indicate that this is not the case and in fact this is repeated when comparing the 732,000 - 58,600,000 kWh load band to the 293,000 - 732,000 kWh load bands. As previously noted we have concerns with the reported theft statistics as they stand, as have ICOSS and so their use to support a hypothesis is questionable and also appears to undermine their own hypothesis.

**Conclusions:** Overall the ICSS report and scenarios are underpinned by inconsistent, unsubstantiated and questionable figures. The primary driver of costs – namely theft – has been derived at from feelings, with Transporter assumptions used for some scenarios but not others. The result is a very low allocation of costs to the LSP sector for Unidentified Gas even in the highest scenario. As such therefore the use of this report to allocate costs on anything than an interim basis for correction at a later date would maintain the cross subsidy from the SSP to the LSP market. As such 0317A addresses this.

### **TPA Analysis**

**AQs and Algorithm Performance:** Core to TPA's analysis is the assumption that RbD is on the whole caused by errors in the AQs for the LSP sector and so the algorithm process which drives this process. To support this assumption they analysed the AQs for each sector compared to their view of Seasonal Normal Demand and "demonstrated" that the AQs for the LSP sector were less accurate than the SSP sector. This is a surprising result given that the LSP sector has the optionality of submitting more frequent meter readings and so should benefit from a more accurate AQ. In particular the LSP sector can chose to submit a meter reading once every 7 days, compared to the SSP sector which is constrained to 1 every 54 days. Given the better data granularity that is available for the LSP sector we would have expected more accurate AQs. The TPA analysis also used the inaccuracy of DM AQs to support the argument that all AQs were accurate (Paragraph 3.31). However the AQs and SOQs in the DM sector have a very different purpose and role than in the NDM sector. For the DM sector AQs (and SOQs) are important for booking capacity on the network and so avoiding ratchet charges. They are therefore not representative of the annual demand for a site, but the peak capacity that they are "reserving" on the network. In contrast the AQs for the NDM sector are used for initial energy allocation as well as capacity reservation. There are no ratchets to avoid and so their importance is not to secure peak capacity, but to ensure accurate energy allocation over a 12 month period. Any comparison between DM and NDM AQs is therefore inappropriate due to the different functions that they serve in the different sectors.

**DMP Data Analysis:** To further support the assumption that the AQs and algorithm processes are inaccurate TPA compared the DMP data with the allocated energy data and showed that they were closely matched. However the analysis has not identified at what stage the comparison has taken place – after initial allocation (i.e. prior to RbD) or after final allocation? If this analysis has taken place after initial allocation, then there remains a significant flaw in that RbD does not close until 4-5 years after the initial allocation<sup>3</sup>. As such therefore any analysis of allocation prior to this close out will fail to take into account the continuing effects of RbD and so overstate the accuracy of energy allocation. Further from the figures provided to Review Group 0126 by xoserve it is clear that the bulk of RbD occurs within the first 18 months of allocation<sup>4</sup>. This would explain why the percentage error is greater in later years as the full effect of RbD has been felt and actually underpins the

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<sup>3</sup> As implemented through modification proposal 0152V.

<sup>4</sup> Available from xoserve's slides at: <http://www.gasgovernance.co.uk/0126/140307>

assumptions contained within 0228 that original allocation is accurate and so RbD represents unaccounted for gas.

**Theft:** The analysis conducted by TPA only takes into account the detected theft rates that are reported to xoserve with associated volumes. This does not take into account the large number of LSP allegations that are closed due to inaction and the instances of valid theft where no volumes are provided. It would therefore be inappropriate to use these figures to demonstrate that the 0228 & 0228A methodology are inaccurate. In addition the TPA analysis proposes that the quantity of gas allocated to the networks should be uplifted (paragraph 3.62). The levels funded by the networks are a price control issue and so any changes to this should be discussed as part of this. In the meantime any discrepancy between the theft levels that the networks fund and that which actually occurs will fall into the UAG pot. As network theft is funded by both SSP and LSP Shippers it is inappropriate for any errors only to be funded by the SSP market.

**Shrinkage:** The TPA analysis has argued that any shrinkage errors should be attributed only to the SSP market and not the LSP sector (paragraph 3.105). However the cost of shrinkage gas is recovered through transportation charges which are targeted at both SSP and LSP Shippers. Currently, any error in this volume of shrinkage is covered in the UAG pot and funded by the SSP market. Mod 228/228A sought to address this issue and ensure that the costs of UAG were recovered from the same Shippers who funded shrinkage. The TPA analysis does not recognise this and so is not applicable.

**Measurement Errors:** TPA's analysis suggests that it is unlikely that you would have LSP metering errors in a particular direction (paragraph 3.112). However this goes against the evidence provided by the Transporters in their Meter Error Report, where the majority of errors result in an under recording and so a debit to RbD Shippers. Given that these large meters are subject to more rigorous analysis than an annual read LSP meter, then operational precedence would suggest that it is reasonable to expect a tendency to under record energy at these meters, and so a cross subsidy from the SSP to LSP market.

**Conclusions:** Whilst TPA's analysis has identified work areas that may benefit from further analysis there are no firm conclusions on the volumes of UAG, other than to suggest that those who do not submit meter readings for reconciliation (SSP Shippers) should bear more of a risk than those who do. We note that the ability for SSP Shippers to submit meter readings for reconciliation is constrained not by their desire, but by xoserve's systems and so this forced allocation of risk would appear inappropriate. The analysis does not address some issues raised during the 0194 development workgroup and discredits the work of 0228 & 0228A rather than provide an answer. There are also inconsistencies contained throughout the report which contradict assertions and assumptions. We believe this reveals the fact that this report was written to deliver a specification determined by ICOSS who have a commercial interest.