

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

6th January 2012

Dear Bob

RE: UNC Modification 0378 – “Greater Transparency over AQ Appeal Performance”.

1. British Gas supports the implementation of Modification Proposal 0378 and believes it is an important step towards securing an effective gas settlement assurance regime. This is vital for securing effective competition both now and in the future.
2. The accuracy of the Annual Quantity (AQ) value is crucial in the non-daily metered (NDM) market as it is the primary variable in the cost allocation mechanisms, and a material determinant of the capacity charges which Shippers are invoiced for.
3. The risk arising from misuse of this process is material: £billions of cost is allocated through the AQ process each year and we calculate that were a Shipper with a 10% NDM market share to avoid just 1% of their costs through misuse of the AQ Review process, the misallocation of costs would be worth ~£6.5m¹.
4. AQ values can be updated by Shippers in three key ways; by submitting meter readings throughout the year such that Xoserve update the AQ, by using the AQ Review (small supply points, SSP) or AQ appeals processes (large supply points, LSP) to challenge incorrect values. We welcome initiatives such as Modification Proposals 0379, 0379A and 0387 which seek to mitigate risk associated with of potential misuse of the first two processes, but believe it is essential that assurance frameworks are also developed to manage the AQ appeals process.

¹ 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 £650m, with 1% of that cost valued at approximately £6.5m.

5. Currently, and despite the material scale of costs assigned, there is no scrutiny of Shipper behaviour in the AQ appeal process and it is merely assumed that Shippers are compliant. We consider that this is an unacceptable risk to the accuracy of cost allocation in the gas market and liable to lead to significant distortions in Shippers' ability to compete if left unresolved.
6. The initial step in providing assurance needs to be to provide information about Shippers' use of the process in much the same way as information is provided about Shippers' use of the AQ review process through the "MOD81" reports. This will create a degree of transparency which will then allow the industry to identify any behaviour which warrants further investigation.
7. We also believe that in providing transparency in this mechanism, Suppliers will be dissuaded from misusing the AQ appeals process, and undesirable behaviours such as selectively submitting reads may be prevented. This in turn will improve the accuracy of AQ values and therefore the accuracy with which costs are allocated. Extending the existing MOD81 reports so they include data on Shipper behaviour during the AQ appeal process is the easiest and most cost effective way of achieving this transparency.
8. We are aware some have argued that such data may lead to incorrect conclusions being made about Shipper behaviour, but given transparency in itself merely allows the right questions to be asked rather than impose summary judgements, we reject this criticism entirely. Instead, we consider that facilitating the ability of the industry to ask questions when required, providing a self-governance mechanism, is an important benefit. This Proposal will actually enable different parts of the market to highlight the legitimate reasons that lead to differentiated performance where they exist, and cast a light on Shippers where they misuse the industry process for commercial gain.
9. We are also aware that some have argued that this Proposal does not address the potential misuse of the process in the SSP market, which can either arise when Shippers fail to collect sufficient meter readings throughout the year or manipulate their AQ review returns during the annual process. We accept this argument, but have always been clear that it is not the intention of this proposal to address these issues. Instead we have raised MOD0387 and MOD0379 for such purposes, and have also welcomed SPower's MOD0379A which seeks to build on these themes further. Our view is that this proposal forms an essential part of a wider assurance framework which is now being built by Shippers.
10. Failure to implement this Proposal will mean that the industry continues to remain blind to the activities of LSP Shippers in the AQ appeal process, and therefore unable to assess whether performance is compliant with the provisions of Code and unable to assess where further reform may be required.

11. Our assessment of how these Proposals meet or do not meet the Relevant Objectives of Code are set out below.

(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.

12. By improving the control and assurance framework around the AQ appeal process the industry will have more confidence that the process is working effectively. In addition, Shippers will be dissuaded from any potential misuse of the process and the industry will be better able to identify and resolve any misuse. This will ensure that cost allocation in the gas market will be as accurate as possible thus facilitating effective competition between Shippers.

f) Promotion of efficiency in the implementation and administration of the Code

13. This Proposal will provide greater transparency over the degree to which Shippers are compliant with the existing Code obligations not to misuse the AQ appeal process, thus facilitating efficiency in the implementation and administration of the Code.
14. Finally, we accept the arguments of those who say that information in isolation is not sufficient for the industry to police itself and that this needs to be part of a wider assurance framework. This is not an argument against transparency per se however, and we commit to working towards ensuring that the reports considered by this proposal, and the proposals referred to above, become part of a wider assurance framework for the management of AQ values.
15. If you have any queries relating to this representation, please do not hesitate to telephone me on (07789) 570501.

Yours sincerely

David Watson
Head of Market Design & New Markets, British Gas