Representation

Draft Modification Report

0388 - Fixed parameters for determining Shipper contribution to Unidentified Gas

Consultation close out date: 30 September 2011

Respond to: enquiries@gasgovernance.co.uk

Organisation: **npower ltd**

Representative: John Stewart

Date of Representation: 30 September 2011

Do you support or oppose implementation?

~~Support/Qualified Support/Neutral/~~Not in Support/Comments* *delete as appropriate*

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

This proposed modification does not remove risk; it shifts it onto the SSP sector. There is no business or economic justification for the modification. Moreover, the suggested implementation date is too early for an orderly implementation of the proposal.

Ofgem have indicated that it would be particularly helpful if the following questions could be addressed in responses:

Ofgem understand that the main issue to be solved is the reduction of costs associated with the SAP mechanism. This involves replacing SAP with a fixed price. They are concerned that this may discriminate between LSPs and SSPs, as LSP uncertainty is reduced at the expense of greater uncertainty for SSPs.

Ofgem ask the following questions to better understand the context and scale of the issue, and how the solution will affect parties.

Understanding the processes

1. Would it be helpful to show, through a diagram, how the current and proposed pricing flows are passed through the industry.

Xoserve should be best placed to provide this

Understanding the scale of the problem

2. The proposal sets out that the existing pass-through mechanism mainly affects approximately 75% of LSP NDM customers. What proportion of all gas goes to these parties?

Xoserve should be best placed to provide this

Understanding the strength of the proposed solution

3. Do you agree LSPs are less able to manage the risk of fluctuating prices and to what extent?

No, on the contrary customers in this sector have a better appreciation of risks and the products available to assist them in managing risk. Shippers operating in this market have a good understanding of the risks and are able to mitigate them

4. What is the level of saving made by LSPs under this modification proposal - for example of avoiding administration costs?

Whilst some shippers may avoid some administration costs the transfer of risk will result in additional costs associated with the risks that will outweigh the claimed savings

5. Would the risk borne by SSPs under this modification proposal increase?

Yes.

6. How does the modification proposal affect the allocation of unidentified gas between parties?

The proposal is to fix the volume of gas in the sector for a year. It will distort the volume of gas supplied between and within each sector during that year. Variances in volume between the sector estimates and the actual volume supplied will be borne by the SSP sector. Furthermore, intra-shipper allocation in the LSP sector will also be misaligned as the total volume supplied to the sector will be an estimate.

7. What are the arguments for a shipper not taking on this risk?

Shippers already take on risks, which they manage them in a variety of ways. This proposal shifts risk to SSP shippers that have fewer opportunities to pass that risk onto customers in a timely manner than in the LSP sector. If implemented it is likely to increase the risk premia and hence prices applied to customers in this sector. The argument is not that shippers should not take on the risk, but that the risks are already apportioned appropriately. The main argument put forward by the proposer for shifting the risk is that it is difficult to price its volume; this is not the case, prices will rise and fall and the price of the unallocated volume can be treated as other volumes. Shippers already have systems to deal with price volatility.

8. For a range of different gas price scenarios, how are parties affected? For example, is a long--run increase in gas prices taken into consideration?

The proposal, if implemented could result in large changes in prices from one period to another. This would be another source of price risk, which in times when volatile prices applied could result in large variations in shippers' costs.

9. If one sector (SSPs or LSPs) is always going to have to bear the risk set out by this modification proposal, which sector is better able to manage that level of risk efficiently and effectively? At present, how does each sector deal with risk?

The present AUGE arrangements enable a reasonable apportionment of risks. There is no compelling case to alter them at this time.

Implementation of the proposed solution

10. What are the implementation costs associated with this modification proposal in the following two cases: a) decision is reached before 1 November 2011; b) decision is reached after 1 November 2011?

There is insufficient time to implement this modification in time. It would result in changes to shippers systems that, given the short time, would increase costs and delay to other projects.

11. If this modification results in losses or gains for LSPs, in comparison to the baseline solution (P299), should they be recovered through the subsequent AUGE process?

Yes, otherwise shippers could seek to recover the costs by increasing risk premia.

12. Would a further modification be needed to make the adjustment envisaged by the previous point (question 11)?

Yes, the proposal does not allow for carry forward of unallocated volumes caused by fixing the sector volume yearly. This is a further source of distortion in the allocation process.

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

Relevant Objectives:

How would implementation of this modification impact the relevant objectives?

It does not meet any of the relevant objectives

Impacts and Costs:

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

Moderate costs, but a high demand on resources to meet the implementation timetable

Implementation:

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

At least six months; our developers have a full programme of industry change to manage at the moment.

Legal Text:
Are you satisfied that the legal text will deliver the intent of the modification?

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.

No